

18 March 2020

Ad hoc teleconference of the ECB's Bond Market Contact Group – 6 March 2020

Summary of the discussion

Members reported that liquidity conditions in US high-yield credit markets were very challenging. Market-makers had effectively ceased their bidding for such assets, which left investors unable to move out of these positions. Liquidity in European credit markets was poor, but not yet as problematic as in the United States, possibly because of the presence of the corporate sector purchase programme.

In addition, there was evidence of dislocations in the US Treasury bond markets, particularly in longer tenors, as investors looked for safe assets. A BMCG member reported that trade in the 30-year US Treasury futures market was halted on occasion today – something which had never happened before.

Market participants were increasingly pricing in the negative impact of the international coronavirus outbreak on small and medium-sized enterprises. According to some members, the Federal Reserve System's emergency rate cut had possibly heightened market uncertainty and contributed to market volatility, while others saw the cut as a welcome development.

Market liquidity in the euro area sovereign bond market had deteriorated as developments in the United States had spilled over to Europe. While it was still functional in larger jurisdictions, liquidity was poor in smaller jurisdictions. Some members believed that investors shifting from credit markets into government bond markets, in a flight-to-safety move, were still supporting peripheral European sovereign bonds for now. Nevertheless, a concerning development was that spreads across all other euro area jurisdictions were widening vis-à-vis Germany.

Members were of the view that financial market participants' technical contingency measures for the international coronavirus outbreak were likely to lead to a substantial deterioration in market liquidity. They agreed that while risk buffers are not necessarily reduced when traders are working remotely, traders do tend to be more cautious in this situation.

There had been significant focus on the LIBOR-OIS spread, which had widened sharply. This suggested to some members that funding concerns could be emerging. If that proved to be the case, central banks should stand ready to provide liquidity to the financial system.

However, some members were sceptical that a rate cut would be the right measure at this time and suggested that it might even be counterproductive. Similarly, most members were of the view that a mere increase in quantitative easing was unlikely to support credit market liquidity. Members suggested that this was a credit crisis and not (yet) a funding crisis. Members agreed that a fiscal response would be most effective, but also that it was unlikely to materialise in the short term in the euro area. Therefore, they believed that central bank action was needed to prevent a downward spiral in financial market conditions.