

Ad hoc teleconference of the ECB's Bond Market Contact Group – 24 February 2022

Summary of the discussion

Members reported that there was an orderly reaction in the euro area sovereign bond market to overnight events in Ukraine. A reduction in market liquidity was evident in some segments, especially at the start of the trading session that morning, but market conditions improved during the day and were resilient overall. Trading volumes of euro area government bonds were estimated at around half their usual level, with some investors predictably preferring to stay on the sidelines given the high level of uncertainty. Trading sizes decreased slightly and bid-ask spreads widened somewhat, but market intermediation continued to function well. The predictable “flight-to-quality” move was well absorbed amid a relatively broad-based demand for euro area government bonds. Members also highlighted that intra-euro area yield spreads were resilient despite the risk-off sentiment. Some attributed this resilience to the fact that the yield increase that followed the Governing Council meeting earlier in the month had prompted both real money account managers and central bank reserve managers to increase their purchases of the bonds of peripheral jurisdictions.

Credit markets were under increasing pressure as investors looked to reduce their risk exposure, but overall price moves and investor outflows remain contained. However, some members cautioned that price moves may not remain so orderly if there was to be a substantial rise in outflows from credit investment funds. Protective measures, such as the gating of funds, had not been required thus far. Members stressed the contrast with March 2020 and the strains affecting investment funds at that time.

The increase in energy prices prompted higher demand for inflation protection. The increase in demand for inflation-linked products, for hedging purposes but also outright positioning, was highlighted. This led to a sharp increase in market-based measures of inflation expectations for shorter maturities, and an inversion of the inflation-linked breakeven curve.

Members cautioned that geopolitical events are still unfolding and it is too early to draw any definitive conclusions about market developments. The full implications of the Russian invasion of Ukraine, together with various sanctions that may be imposed, are still unclear. The situation remains fluid and, as more information becomes available, markets may react abruptly.

Finally, members also pointed out that the increased uncertainty will have implications for ECB monetary policy. In its upcoming policy meetings, the ECB will need to consider the recent geopolitical developments. While the crisis will probably lead to higher inflation in the short term, growth could also be affected, potentially leading to a stagflation scenario. Some members were of the view that the geopolitical developments make it less likely that the ECB will announce a strong reduction in monetary policy support in the near future.