EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB Bond Market Contact Group

18 June 2025
Summary of the discussion

1) Review of recent bond market developments

Georgios Tsapouris (GIC) reviewed the most recent developments in bond markets. He noted that the subdued outlook for euro area inflation has yields supressed compared to other jurisdictions. The continued heavy net bond issuance across the globe was highlighted, with corresponding increases in term premia. High net ownership of foreign bonds and equities by euro area investors was noted as an additional source of support, should these holdings be partially repatriated in the months to come

The breakdown of long-standing correlations between the US dollar and dollar-denominated assets was noted. In particular the recent lack of dollar appreciation to provide a hedge to US Treasury losses was seen as having far-reaching implications for portfolio construction and allocation decisions.

The contrast between the resilience of euro area bond markets and the volatility experienced in other large bond markets (US, Japan, UK), especially at the very long-end, was highlighted. The drivers of this volatility were a combination of fundamental factors, in particular fiscal concerns and less benign inflation outlooks than in the euro area, and technical factors related to the lower structural investor demand for longer-dated bonds, once the life insurance and pension fund sectors have completed their asset-liability matching. A few members noted the role of Debt Management Offices (DMOs) in adapting to changes in investor demand across different maturities.

A majority of members were of the view that positioning for steeper yield curves had become a very crowded trade globally, but that this was less justified in the euro area, despite mixed views on the impact of the Dutch pension reform. On the one hand, several members noted that the higher German fiscal spending, despite a strong immediate market reaction, did not have a lasting impact on term premium, as this spending was starting from a low level of debt and would have positive spill-over effects on growth across the euro area. On the other hand, some members opined that the Dutch pension reform, with an impact concentrated in 2026-27, could cause the long-end to move higher.

2) Attractiveness of European bond markets in times of shifting global allocations

Christian Kopf (Union Investment) and **Loubna Moudanib (Vanguard)** presented on how investor sentiment and preference for euro government and corporate bonds have evolved over recent months.

There was unanimity amongst members that foreign investor interest in euro area bond markets had increased. However, portfolio reallocations are likely to be gradual and follow a multi-year process, particularly for institutional investors and reserve managers, and data do not show any evidence of material reallocations thus far. Some members noted however that “push” factors (features driving investment away from justifications) abroad were currently more powerful than “pull” factors (features enticing inward investment to that specific region) from the euro area.

Members discussed the capacity of euro area bond markets to absorb the potential future inflows. While members noted the size mismatch between the US and euro area bond market, it was felt that even a small portion of investor flows moving from the US to Europe could be quite impactful. Some members added that an increase in international investor demand would be coming at an opportune time as net government bond issuance was at record levels, with the planned uptick in German bond issuance form 2026 onwards providing an additional supply of safe assets.

There were split views amongst members on whether the current heterogeneity of euro area government bond markets helped or hindered inflows from abroad. Some members were of the view that a hypothetical set-up with a common safe asset providing a large, deep and liquid alternative would be more attractive to investors than the status quo. Others pointed to some inherent benefits of the current landscape – for example a range of sovereign issuers to choose from depending on the risk tolerance and yield requirements of the investor.

Members highlighted the opportunity for euro area corporates to also benefit from inflows. The strength of corporate balance sheets compared to some governments was highlighted. The recent high volumes of US corporates issuing euro debt via EU subsidiaries (so-called “Reverse Yankee” issuance) was mentioned as evidence of appetite amongst investors for euro-denominated private sector debt.

3) Implications of digital assets (e.g. DLT and blockchain bonds) for bond markets

Bryan Pascoe (International Capital Market Association) updated members on digital bond issuance in Europe and explored potential benefits, current challenges, and future prospects.

Digital bond issuance remains very small and in a semi-experimental stage. Key challenges include a fragmented landscape of DLT solutions, the current inability to settle in central bank money, and the critical need for interoperability and a common standard. Members underscored the importance of the latter to foster scalability. Some noted an uneven playing field between digital and traditional bonds in the current regulatory framework, hurdles created by national securities laws and an often-lengthy product approval processes on the side of investors. From an issuer’s perspective, any advantage needed to be counter-weighed against currently higher issuance costs. Similarly, investors had to consider investment costs and benefits.

However, notwithstanding above challenges, most members saw potential in the application of DLT technology in the bond space, with adoption in the primary market (mostly on a buy-and-hold basis) seen as easier to engineer than creating an active secondary market. Nevertheless members noted that an active secondary market is a necessary condition to reduce the current premium over traditional assets. Advantages include operational risk mitigation through automation and a more efficient handling of corporate actions through the use of smart contracts.