

ECB Bond Market Contact Group

Summary reflecting the discussion on 3 June 2026

1) Market functioning since the outbreak of war in the Middle East

Amélie Darrort (J.P. Morgan) reviewed bond market developments since March. The conflict has driven yields higher and turned central bank outlooks globally more hawkish as markets revised their inflation outlook and the possible policy response. Although the initial high sensitivity of front-end OIS rates to oil prices had weakened somewhat, euro area rates continued to still be sensitive to headline-risk and energy markets (including natural gas) more broadly. At the same time, most of the initial widening in sovereign bond spreads to Bunds had essentially retraced, reflecting the external nature of the drivers.

Markets have continued to function well despite the structurally higher uncertainty and headline risk, with only some deterioration of liquidity in smaller bond markets. Members saw important stabilising factors in more balanced positioning after the market adjustment early in the war, a robust dealer network that has helped to absorb the unwinding of positions by hedge funds, and strong real money demand at current yield levels. One member suggested that markets may have begun to develop a gradual tolerance to the recurring headline risk which helped moderate rates volatility more recently. Primary market supply has continued to be well absorbed. However, members noted some adaptation by issuers, with syndication windows being selected more carefully to navigate around headlines. Overall, investors were seen to remain cautious around directional and carry positions.

Credit markets were said to have proven particularly resilient, supported by a robust earnings momentum, strong investor demand, and more favourable conditions compared to the mix of factors faced in 2022.

Key risks were seen in scenarios perceived to be underpriced by the market, including a prolonged conflict and a softening of growth data. Members noted that much of the relative market composure remained predicated on the assumption of a time-limited conflict with limited lasting economic impact. A prolonged conflict without a stable solution was expected to lead to further significant repricing in markets. Some members mentioned that while the market had remained very attentive to inflationary risks from energy prices, rate sensitivity to growth data had declined. Any meaningful deterioration in PMIs or employment conditions was seen to represent a significant downside risk not sufficiently priced by markets.

2) Inflation-linked markets in the energy shock

Olivier Herregods (HSBC) provided an update on conditions in euro area markets for inflation protection (both swaps and bonds). Disruptions in the Strait of Hormuz and the resulting oil price dynamics continued to be the key driver of short-term headline inflation expectations. Since the start of the conflict, front-end inflation had repriced more than longer dated forwards.

The broad stability in longer dated forwards, such as the EUR 5y5y inflation swap rate, was attributed to a mix of central bank credibility and market structure. Members noted that the lower sensitivity to oil prices in longer dated forwards reflected market confidence that the ECB would keep inflation within target over the medium term. However, activity in that part of the market was also seen to be dominated by liability driven investor flows that were described to be less sensitive to macro fundamentals and have recently declined (in part due to the Dutch pension fund reform lowering long-end hedging demand). Meanwhile, the majority of speculative positioning, arbitrage and tactical strategies, was said to take place in front-end forwards below 3 years.

Attention in inflation-option markets was seen to increasingly focus on the right tail of the probability distribution, i.e. on inflation outcomes higher than the central forecasts. While these risks have only recently begun to reprice, members expected a more prolonged and persistent crisis in the Middle East to drive both inflation expectations and tail risk premia higher.

Market liquidity and market functioning have normalised at the end of March after a disruptive period in the initial stages of the war. The first two weeks in March were characterised by rapid unwinding of short inflation positions, mainly from leveraged investors, which led to a strong widening of bid-offer spreads, one-sided market activity, and difficulties to hedge inflation in size. By the end of March, the market had returned closer to normality. Overall, demand for inflation-linked products, both swaps and bonds, remained healthy. Traded inflation linked swap volumes in risk-equivalent terms were much higher today than in 2022 and while demand for inflation-linked bonds had not increased at the same pace, liquidity in some markets (particularly Italian bonds) was said to have improved notably.

3) Tokenisation in Finance

Angelica Ghiselli (ECB) presented findings from a recent Eurosystem ad-hoc questionnaire on the trends and adoption of tokenisation in finance, to which members of the BMCG had previously responded. The survey results indicated that adoption was slowly but genuinely underway with momentum accelerating. Yet, despite ongoing optimism, demand for tokenised assets remained moderate. Regulatory constraints, technological and market readiness, thin market liquidity, along with the need for a suitable settlement asset were seen as the main barriers to wider adoption.

Members commended ECB efforts for creating institutional legitimacy. The added eligibility of DLT-based securities as monetary policy collateral was welcomed and Pontes and Appia in particular were seen as pivotal to drive broader awareness and adoption in the euro area. However, members noted that elements of the wider industry (issuers, investors, intermediaries) also needed to come together. Among the recommendations put forward were more focus on specific use

cases (intraday repo, commercial paper) which would create valuable bridges between markets, raising awareness about efficiency and financial benefits at management level, and continued efforts to make internal systems ready – while broader standardisation efforts would support scalability.

Higher secondary market liquidity was seen as a key requirement to accelerate future investor demand. Members noted that it was too early for a liquidity premium for tokenised assets to emerge. While most liquidity was created on-chain during issuance on a digital platform, many investors held assets to maturity, and the still limited secondary market trading predominantly took place on traditional infrastructure. This presented a certain dilemma, with investors waiting for the availability of critical infrastructure and a certain level of market activity before engaging, while issuers waited for a critical mass of investor activity. Members agreed that a transition could not happen overnight and noted that an increase in tokenised market activity would likely follow a gradual path as long as the majority of outstanding bonds remained non-digital. Overall, members expected the Pontes go-live to be helpful in supporting an eventual transition from legacy to new systems.