

25 November 2015

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 18 November 2015
10 a.m. to 12.30 p.m. CET, Sonnemannstrasse 20

SUMMARY

Participants

- Members of the Governing Council of the ECB (or their alternates)
- ECB officials from the Directorates General Market Operations, Communications and Legal Services
- Representatives of Aegon, Allianz, Amundi, AXA, State Street Global Advisors and PGGM

Global investment trends

Participating investors thought that the ECB's asset purchases were having a significant impact on financial markets. However, in their view, the full impact on the real economy was yet to materialise, as some effects could emerge with a lag. Moreover, investors' behaviour was affecting the impact of the ECB's asset purchases: while non-residents had been net-sellers of euro area government bonds, residents bearing long-term liabilities had become buyers of those bonds in search of longer-duration assets. In addition, the impact of low interest rates on the euro area economy seemed to be weaker than in the United States, possibly owing to the lack of a harmonised regulatory environment in the EU and less investment-oriented regulation.

Some participating investors warned that asset prices could become decoupled from fundamentals and contribute to systemic risk as a result of non-standard monetary policy measures and of regulatory incentives. Hedging against volatility had become challenging because the correlation between different asset classes had increased and second-round effects from the slowdown in emerging markets were difficult to anticipate. Moreover, the shift from defined benefit pension schemes to defined contribution plans could be expected to continue as the prevailing low rates created challenges for defined benefit schemes.

Participating investors considered that real estate investment continued to offer attractive yields, but that the euro area real estate market could become overheated as a result of low government bond

yields. They also pointed out that alternative forms of investment (energy, infrastructure, etc.) would be suitable for long-term institutional investors. There was significant potential to unlock investment – and thus growth – in the euro area, but several issues needed to be addressed in a number of euro area countries, such as the enforceability of contracts, the protection of minority investors' rights and the resolution of insolvency.

Outcome of the survey of participating investors

Participating investors were of differing views regarding the transmission channels for the ECB's asset purchase programmes, the causes of financial market volatility and the key risk factors. The majority were of the view that the strongest transmission channel for the ECB's public sector purchase programme was the decline in funding costs in the real economy, while others considered that exchange rate effects were also important. As regards the ECB's other asset purchase programmes, investors agreed that reduced secondary market liquidity and tightening spreads could potentially crowd out traditional investors in the covered bond and asset-backed securities markets.

Participating investors cautioned that reduced liquidity was further amplifying the volatility caused by factors such as uncertainty about central banks' monetary policies. The potential for an unexpectedly sharp slowdown in China and geopolitical risks were also mentioned as important sources of uncertainty.

The majority of the participating investors were of the view that policy divergence between the Federal Reserve System and the ECB was a key factor as regards currency exposure and asset allocation decisions.

Participating investors agreed that regulatory developments and banks' deleveraging in Europe had the strongest impact on the non-bank financial intermediation.

The role of liquidity risk in investment management

Participating investors agreed that insurance companies and pension funds were well placed to invest in illiquid assets, given their long-term liabilities. Nevertheless, as illiquidity amplifies price movements and contributes to higher levels of volatility in asset prices, reduced market liquidity was considered to be an important indirect factor in their investment management.

Participating investors pointed out that institutional investors were natural shock absorbers in financial markets, meaning that they could tolerate volatility if they were compensated for it. However, the prevailing regulatory framework and the low interest rates were impairing this shock-absorbing capability. Additionally, banks' diminishing market-making activity in a number of asset classes could make institutional investors' asset-liability management increasingly challenging.

There was a consensus among participating investors that the low interest rate environment in developed economies could last for a considerable period of time. This was supported by structural

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factors such as demographics and the presence of the credibility needed by central banks to prevent high inflation. Institutional investors needed to adapt to this environment, but faced a number of challenges, including regulatory challenges.