

17 October 2017

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 4 October 2017
10:00 to 12:30, Sonnemannstrasse 20

SUMMARY

Participants

- Representatives of Aegon Asset Management, Allianz SE, Amundi, Assicurazioni Generali, Aviva, AXA, BlackRock, Nordea Asset Management, PGGM, Singapore GIC, State Street Global Advisors and Union Investment
- Members of the Governing Council of the ECB (or their alternates)
- ECB officials from the Directorates General Market Operations, Communications and Secretariat as well as the ECB's Chief Compliance and Governance Officer

Outcome of the survey of participating investors

Regarding the impact of the ECB's asset purchase programme on asset prices, investors had diverging views about the relative importance of stock and flow effects. While these two effects were seen as having the strongest impact on asset prices, only a few investors argued that the main factor was the duration of the stock of securities held by the Eurosystem. One Governing Council member pointed out that in the United States, the duration of the Federal Reserve System's asset purchases was initially important, but seemed to become less so over time.

Concerning the transmission channels of the public sector purchase programme (PSPP), most investors were of the opinion that the reduction in funding costs of the economy was the most important element. One investor added that it was difficult to disentangle the different transmission channels as they influenced and reinforced each other, thereby releasing their full accommodative power. One Governing Council member stressed that the ECB shared this assessment.

Investors explained that the current low-volatility environment was likely to reflect multiple factors, such as central banks' accommodative monetary policy stance and the increased importance of passive investments. Another investor added that in the current low-yield environment, investors could achieve additional returns by selling volatility via increasingly popular derivative instruments. In the equity market, low volatility might be fundamentally justified by low macroeconomic volatility

backed by strong corporate earnings. One Governing Council member added that markets have been trapped in a low volatility equilibrium, which was also due to speculative short-selling of volatility, and that markets' capacity to reduce the impact of large reallocation across asset classes in a structured way was untested in the new regulatory environment.

Concerning the main drivers of volatility in the medium term, investors considered the uncertainty around monetary policy as well as geopolitical risks to be the most prominent factors. The potential deterioration of market liquidity also remained a source of concern, but less so than in the past.

In terms of the asset classes that could be potential future drivers of volatility, several participants mentioned government bonds, while a few respondents mentioned equities and exchange rates.

With regard to their asset allocation strategies, investors continued to view equities across the globe to be more attractive than bonds. One investor observed that the asset allocations of insurance companies and pension funds were determined to a significant extent by regulatory constraints.

Global investment trends

One investor reviewed the prevailing global investment trends, which reflected a slow recovery of economic activity, continued structural headwinds, high equity valuations, low yields and compressed asset risk premia.

It was mentioned that the weak global recovery was consistent with subdued productivity growth. Participating investors identified a number of secular factors as structural headwinds for productivity growth. Old-age dependency ratios had been increasing, indebtedness remained high, globalisation was perceived to be slowing down and inequality had increased across and within countries. One of the participants envisaged that productivity would increase as technological innovation, which was already appearing on the consumer side, would eventually flow into corporate processes.

One of the investors showed that central banks' accommodative monetary policies had supported growth but had created limited inflation pressure. This investor argued that since the global financial crisis, asset price inflation had been considerably higher than consumer price and wage inflation. Asset price inflation was reflected in globally high equity valuations, though geographical differences were significant. Euro area equity valuations were still seen by several investors to be more attractive than those in the United States.

Investors discussed a number of investment management options to respond to low expected returns and low volatility. The most prominent and most widely applied options were increasing risk and sourcing new return streams. Risk could be increased by focusing more on illiquid asset classes. Regarding infrastructure investments, participating investors mentioned the limited supply of investment opportunities at yield levels that would allow them to reach their internal targets. They saw opportunities in blended finance and stressed the need for political risks to be managed. One Governing Council member warned that since the global financial crisis, a generation of decision-makers had acquired the mindset that liquidity is infinite (e.g. some investors saw infrastructure investments as substitutes for bonds), which could be a future risk factor.

One Governing Council member noted that volatility was important, but at the same time the least controllable part of an asset price and warned that policy induced spikes in volatility should be avoided.

The impact of technological innovation on the asset management and insurance industry

A Governing Council member stressed that the topic of technological change and the associated risks, such as cyber-risks, were relevant for central banks for several reasons. For example, central banks themselves were market infrastructure operators and issuers of trusted currencies.

One investor presented an assessment of the impact of technological innovation on the asset management and insurance industry. He observed that the financial sector, especially the insurance industry, had been lagging behind other industries in applying digital technology. In the value chain of insurance companies, digital innovation had been concentrated in the distribution segment, while other areas (claims, marketing, product development and pricing) had benefited significantly less from technological innovation.

One participant cautioned that if data regarding insured entities became too granular, then risk-pooling could become impossible. Another participant responded that data granularity would improve the pricing of risk, but would not mean the principle of risk-pooling would be abolished. Another participant noted that data privacy regulations could constrain innovation that relies on granular data.

In the asset management industry, declining revenues incentivised market participants to increase efficiency. The emergence of passive asset management was seen by participants as an important example of how technology could shape asset managers' business models.