EUROPEAN CENTRAL BANK

EUROSYSTEM

DIRECTORATE GENERAL MARKET OPERATIONS

2 December 2020

INSTITUTIONAL INVESTOR DIALOGUE

25 November 2020, 14:00 to 16:00 CET, held online

Participants

- Representatives of Abu Dhabi Investment Authority, Aegon Asset Management, Allianz, Amundi, APG Asset Management, Assicurazioni Generali, ATP, Aviva Investors, AXA, BlackRock, DWS, GIC, Nordea Asset Management, Norges Bank Investment Management, PGGM, State Street Global Advisors, Swiss Re, Union Investment and Zurich Insurance Group
- 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

Summary

Outcome of the survey of participating investors

Based on the survey results, most participating investors were of the view that the ECB's asset purchase programmes remained the most critical element of the ECB's future monetary policy actions from the perspective of the investor community, followed by the outcome of the ECB's strategy review and the forward guidance on policy rates.

Regarding the main risks that could lead to higher volatility in financial markets, most participating investors pointed to developments related to the coronavirus (COVID-19) pandemic. This was followed by the risk of a deterioration of market liquidity in various asset classes and uncertainty about the future monetary policy outlook and reaction function of major central banks.

If financial market volatility were to increase again, investors expected that equities, credit and emerging market assets would be most affected. Compared with the previous two surveys (May 2019 and October 2019) there had been a continued decline in the perceived riskiness of emerging market assets.

As regards the EUR/USD exchange rate, most investors indicated that monetary policy decisions and expectations were most likely to be the drivers over the next 12 months, followed by fiscal policy and macroeconomic fundamentals.

Approximately half of the participating investors stated that they were not planning any changes to their currency allocations. Of those planning some changes, most were considering increasing their allocations to non-G3 currencies.

Regarding asset allocation between equities and bonds, most participating investors did not expect any changes. For developed markets (Europe, North America and Japan) those who were planning changes indicated a shift of assets into equities while none of the respondents was planning to increase the allocation to bonds. For emerging markets, survey respondents considered an increase in the bond allocation to be more attractive, which was most probably due to the relatively high yield levels in comparison to developed markets.

Most participating investors indicated that there had been a further shift into alternative asset classes since bond yields had declined even further into negative territory. Real estate and infrastructure assets continued to be the most attractive options, while the expected relative attractiveness of private debt and private equity had declined somewhat compared with the prior two surveys. Most respondents highlighted continued strong demand for shifting to other asset classes in response to even lower negative rates.

Many respondents indicated that they considered the impact of the COVID-19 pandemic on their investment activities to be only temporary. Some had slightly reduced their risk exposures, while others had identified new investment opportunities or even increased their risk exposures. Several respondents viewed the broad availability of a COVID-19 vaccine as the key condition to be met before increasing their risk exposures further. All respondents were planning to increase their allocation to investments complying with environmental, social and governance (ESG) criteria further, but to varying degrees.

The survey also included a question on the likely impact of the bonds issued by the EU under the Support to mitigate Unemployment Risks in an Emergency (SURE) programme and the upcoming Recovery and Resilience Facility. Many respondents expected that this would attract more global bond investors in search of liquid assets to the EU and that the EU as an issuer would become a supranational benchmark for Europe.

During the discussion participants mentioned several risks going forward: the increasing liquidity provided by central banks could lead to a risk of stretched valuations in some asset classes; fiscal support could be withdrawn too quickly and/or policy errors could be made in general; and the high indebtedness could lead to debt sustainability issues, especially once interest rates started increasing. It was also widely recognised that the US-China relationship remained a geopolitical challenge, even though the tensions might be reduced under the new US President and administration. Finally, increased populism could put emerging markets under pressure, as some of these countries might also be negatively affected by de-globalisation and climate change.

Global investment trends with a special focus on sustainable and responsible investment

One investor provided an overview of prevailing global sustainable investment trends.

In general, participants agreed that sustainable and responsible investment is a major trend among institutional investors, supported by increased demand from clients. With the international spread of COVID-19 at the beginning of 2020, some had expected that this could imply a pause in that trend. However, in the EU, specifically including ESG considerations in the European Green Deal and the new EU Recovery and Resilience Facility had acted as an important signal of support for ESG investment in general. A few participants had already been including ESG factors in their investment strategy for many years and reported that strategies including ESG considerations had so far outperformed the non-ESG investment strategies in 2020, also acting as risk-mitigating factors. One participant reported that the best returns were not generated by investing specifically in already best-in-class companies, but in companies or projects that were currently implementing a credible transition towards a more sustainable and responsible business model.

However, the participants also agreed that there was still a need for more policy action in this market segment. Many mentioned the importance of establishing a common taxonomy as well as increasing the availability and transparency of data. The need for governments to incentivise companies/projects to move towards sustainable and responsible business models was also cited. One investor was of the view that the current situation presents an opportunity to direct additional fiscal support to greening the economies and, for example, supporting more efficient transportation. Another investor mentioned that several institutions in the industry are joining forces for various initiatives, given the substantial effort required to make progress in this area.

Regarding general investment trends, the participants acknowledged that the current environment of low-for-long interest rates had led all types of institutional investors to step up their risk exposures. They had mainly done so by increasing the share of equities, but had also prioritised alternative assets, which had resulted in an increase in illiquidity risk. In this respect, several participants cited two main challenges. First, investment in private assets required specific skills and sufficient lead time to build up internal knowledge, which was particularly challenging for smaller investors. Second, the current availability of private assets seemed to be too limited to accommodate increasing investor demand and inflows, which had already led to a compression of returns.

Finally, some participants mentioned a few other investment themes, namely the increasing use of index-based products due to lower costs, including as part of active investment strategies; the increasing use of digitalisation and algorithms in investment decisions; and the challenges posed by the de-globalisation trend for institutional investors with global presence.

Investment themes in times of and after COVID-19

One investor provided an overview of this topic. He stressed that investors needed to achieve an appropriate balance between resilience and profitability, especially in times of market stress, as exemplified by the COVID-19 pandemic period. He mentioned that for his institution, diversification had brought advantages, and that benefits had also been associated with having an internal credit research department instead of relying exclusively on external credit ratings.

This investor also mentioned that counter-cyclical actions were possible in 2020 as liquidity remained relatively supportive, facilitated by well-functioning repo markets. This made it possible to seize new opportunities amid sharp yield increases for some fixed income assets, providing attractive entry points.

The ECB strategy review was mentioned by several investors as coming at a very opportune time to take account of changes in the economic landscape owing to the COVID-19 pandemic.

Another investor noted that long-term investment returns will remain relatively weak but could increase in the future due to productivity gains in the health care and education sectors.

Regarding the new EU bonds issued under the SURE programme and the upcoming Recovery and Resilience Facility, the participants confirmed that these assets could become an anchor point for the euro area bond market. Participants perceived the investor demand for such European safe assets – even from investors based outside the EU – to be strong and sustained.