EUROPEAN CENTRAL BANK

EUROSYSTEM

DIRECTORATE GENERAL MARKET OPERATIONS ECB-PUBLIC

30 November 2016

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 16 November 2016
10.00 a.m. to 13.30 p.m. CET, Sonnemannstrasse 20

SUMMARY

Participants

- Members of the Governing Council of the ECB (or their alternates)
- Representatives of Aegon Asset Management, Allianz SE, Amundi, Assicurazioni Generali, Aviva Investors, AXA, Nomura Asset Management UK, Norges Bank Investment Management, PGGM, Pioneer Investments, State Street Global Advisors, Swiss Re, Union Investment and Zurich Insurance Group
- ECB officials from the Directorates General Market Operations, Communications and Secretariat as well as the ECB's Chief Compliance and Governance Officer

Global Investment Trends

Participating investors from pension funds and insurance companies explained their concerns and challenges created by low long-term bond yields in the euro area. A few of them mentioned that the flat slope of the yield curve is more critical than the (low) yield level.

Direct infrastructure investments were told to be an attractive asset class for long term investors like pension funds who are looking for stable and inflation linked returns. There are increasing ways to conduct such investment including use of different type of partnership models, for example with pension funds and banks. Additionally, investors would welcome more structural reforms in the euro area and public sector initiatives like the Juncker plan to underpin further development of this and other asset classes for long-term investments. One investor expressed the view that the low interest rate environment disincentivises structural reforms.

It was also noted by participating investors that long-term investors may be less well positioned to take on infrastructure development risks. Here, the European Fund for Strategic Investments and other public funds may be geared more to first loss stakes in the greenfield phase of infrastructure development to increase the supply of projects relevant to long-term investors.

One investor reported also on the pension funds' experience where direct mortgages have been

provided targeting pension fund members instead of investing in residential mortgage backed securities.

One investor mentioned that the regulatory environment for central clearing of certain derivatives used for hedging the portfolio risk is suboptimal because the required cash collateral forces institutional investors to hold large cash buffers instead of using their existing bond holdings e.g. high quality liquid assets. One investor mentioned the need to consider granting access to a broader group of institutions than just banks, including CCPs or pension funds. It was also mentioned that the US banks can provide favourable collateral treatment for such derivative positions while their European peers' ability in that respect is limited. One Governing Council member reminded that the goal of central clearing is to save overall collateral needs and capital requirements for investors and to avoid exacerbating scarcity issues in some jurisdictions.

Several Governing Council members noted that the last few months have proven that financial markets were more resilient to risk shocks than they were ten years ago. The financial sector has been made stronger and the main issue now seems to be low profitability, but – in the context of recent market speculation about the possible consequences of the US presidential election – it was noted that returning to de-regulation would be a big mistake. It was noted by one investor that the uniformity of regulation may lead to increased concentration in the industry, which can magnify strains in volatile markets, impairing pension funds' traditional stabiliser role in financial markets.

Many participating investors explained the recent increase in global sovereign bond yields as well as rising equity prices by increasing inflation expectations stemming primarily from the anticipated expansionary fiscal policy in the US. Nevertheless, all participants agreed that it is too early to draw detailed conclusions on the impact of the US presidential elections on the economic growth and sustainability of public finances.

Several investors held the view that equity markets in the US are currently more attractive than those in the euro area. The former are being supported by the anticipated fiscal stimulus and possible regulatory easing while in the euro area no significant changes are expected.

Outcome of the survey of participating investors

Based on an internal survey, many participating investors considered that expansionary fiscal policies and higher commodity prices could be the most likely ways to raise inflation expectations in the euro area, while further ECB asset purchases were mentioned less than in previous times. Participating investors mentioned that the outcome of the US presidential election has quickly created higher inflation expectations due to more business friendly approach to the economy, which has also resulted in steeper yield curve. However, the yield increase was received positively because it reflected increased growth and inflation expectations.

When assessing the ECB's purchase programmes, most investors agreed that the Public Sector Purchase Programme was the most effective given its large size and capability to anchor bond yields. With regards the Corporate Sector Purchase Programme (CSPP), the most widely acknowledged consequence was spread tightening in the corporate bond market and in other (non-eligible) credit

markets while increased issuance activity was not mentioned as frequently as in June 2016. Participating investors explained the CSPP's impact on the banking system in two respects. On the positive side, it has freed up spaces for SMEs on banks' balance sheets all around Europe. Another view was that bond market financing competes with bank financing which can lead to further compression in banks' interest rate margins. Some investors also mentioned that the ECB's purchases affect private investors' allocation strategies.

Most participating investors expect financial market volatility to be driven by the uncertainty about major central banks' monetary policy and geopolitical risks.

Credit market – recent trends and outlook

Participating investors were of the view that despite the significant corporate yield spread tightening in the last six months in the euro area, the investment grade sector shows signs of some degree of overvaluation while the corporate high yield sector and other segments of the market (i.e. financials) offer more value.

Several participating investors were of the view that various metrics show that the credit cycle in Europe has not yet entered its mature phase. One of them explained that corporate fundamentals are strong in Europe as reflected in ample interest coverage and low default rates. In addition, referring to the banking sector, non-performing loans are country-specific problems rather than a systemic issue.

One investor told that European investment grade corporate bond funds have experienced strong inflows over the last six months and that investment grade corporate bonds both in the US and in Europe are apparently among the most crowded trades at the moment. It was said that more retail investors have moved from bank deposits to higher yielding but riskier credit instruments. Another clear trend has been also the increasing share of passive management mandates and ETFs. This trend may raise the question of market liquidity in case of sudden exit.

One investor noted that European corporates are not heavily involved in share buybacks because investors have no alternatives to invest their cash. Instead, shareholders ask corporates rather to reduce costs and look for growth opportunities and new products.

Investors considered the three most important risk factors in the European credit market to be (i) the sensitivity to global risk premium shocks, (ii) the skewed maturity structure (particularly in the investment grade sector) and (iii) the rising liquidity risk.