

18 April 2017

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 5 April 2017
10.00 a.m. to 13.00 p.m. CET, Sonnemannstrasse 20

SUMMARY

Participants

- Representatives of Aegon Asset Management, Allianz SE, Amundi, Assicurazioni Generali, Aviva Investors, BlackRock, MAPFRE S.A, Pioneer Investments, Singapore GIC, State Street Global Advisors, 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

Outcome of the survey of participating investors

The majority of the respondents explained the rising euro area inflation expectations with global reflation and stronger growth as well as the disappearance of deflationary tail risks. Some investors argued that inflation expectations have increased as a result of the effectiveness of the ECB's policy measures. In previous surveys, respondents had already highlighted the role of expansionary fiscal policies and higher commodity prices with respect to supporting euro area inflation expectations.

When assessing the impact of the ECB's purchase programmes, most investors agreed that in the case of the Public Sector Purchase Programme (PSPP), reducing the funding costs of the economy was the most important transmission channel. Some investors were of the view that funding costs were already low for those entities that had access to credit and the broader impact of the PSPP is taking place through freeing up bank balance sheet capacity for lending (portfolio rebalancing effect). With regards to the Corporate Sector Purchase Programme (CSPP), the most widely acknowledged consequence of the programme was spread tightening, followed by reduced financial fragmentation. Increasing issuance, which was expected to be the main impact of the CSPP in the responses received last year, has become less important.

Investors considered the deterioration of market liquidity, US economic policy and the upcoming elections in several euro area countries as main drivers of volatility for the medium term. In the

previous survey, most participating investors had ranked uncertainty about major central banks' monetary policy and geopolitical risks highest.

Global Investment Trends

One Governing Council member explained that the recent improvements in euro area economic sentiment and employment indicators have been partly attributable to the favourable financial conditions (resulting in particular from accommodative monetary policy) and noted that more time is needed to assess how self-sustained the recovery is. There have also been no convincing signs of pick up in core inflation. For the time being it is therefore important to preserve the current degree of monetary policy accommodation.

In terms of improving euro area growth prospects, one investor pointed out that although the overall picture is positive, significant cross country divergences persist. Regarding the recent positive inflation developments, he warned of fragility as wage dynamics remain weak.

One investor explained that low real rates in developed markets force income-oriented investors into the equity market, which would be more suitable for long-term investors with capital gain objectives. This incentivises corporates to prefer dividends over investments. One Governing Council member responded that real rates cannot be higher if investments do not increase.

One Governing Council member inquired about the prospects of infrastructure investments in the euro area, to which one investor responded that the main hurdles are the lack of attractive infrastructure projects and the high capital requirements for (insurance) investors in the Solvency II framework. As regards the maximum share of illiquid investments allowed in portfolios, a couple of investors mentioned that those would be capped at around 20% as a self-imposed limit.

One investor explained that the low yield environment and the unfavourable regulatory treatment of securitisation create one of the biggest challenges for asset managers. While low rates challenge the sustainability of defined benefit pension plans and drive risk taking, regulation might distort the level playing field for institutional investors. Another investor noted that in general, in financial markets, regulation can facilitate the restoration of investors' confidence. However, one of the investors noted that too many resources are spent on adjusting to new regulation, which leaves investors with less time to think of solutions and products that benefit their clients.

Several Governing Council members warned that income inequality has increased since the financial crisis, also giving rise to increased support of populist parties in Europe, and wondered if the current technological advancement in the economy would have a more persistent impact on inequality.

One Governing Council member inquired about the underlying reasons for the insufficient cross border capital flows, to which one investor responded by emphasising the importance of trust that deteriorated since 2010, the lack of sustainable growth and the uncertain long-term outlook. Investors would therefore pile up cash despite the prevailing negative interest rates.

Regarding recent developments in the US, some investors warned that the current high expectations on expansionary economic policy may be prone to disappointment. One investor assessed the US

economic policy agenda as being beneficial in the short run but entails more downside risks in the medium to long run. Nevertheless, several investors expected capital expenditures in the US to increase on a sustainable basis.

ETF market – recent trends and outlook

One investor presented the characteristics, structure (including participants) and recent developments in the ETF markets in the global and European context, also highlighting the key differences between ETFs and mutual funds. He explained that the regulatory environment is favourable for ETFs as fee transparency has become a key requirement applicable to the asset management industry.

One Governing Council member highlighted that (i) the role of ETFs' in price discovery has become more prominent in some market segments and that (ii) liquidity transformation in the ETF market is a key concern from a financial stability perspective.

One investor provided two examples when ETFs played an important role in market turbulences. First, in August 2015, heightened market volatility hampered market makers' ability to provide liquidity and market makers were unable to determine the value of ETFs due to a lack of information on cash equities. This underlined the importance of having consistent trading rules across futures, options, stocks and ETFs. Second, in December 2015, when the spike in volatility originated in the underlying high-yield bond market, ETFs provided additional liquidity as the majority of trading occurred in the secondary market for the ETF shares. In the latter case, ETF markets worked as expected with no trading halts of ETF shares.

Several participants acknowledged the stabilising impact of ETFs but warned that their increasing role in price discovery is a double-edged sword in the sense that price signals may feed-back from ETFs to the underlying markets and could contribute to market-wide stress.

One investor explained that the provision of non-transparent ETFs (i.e. ETFs that don't disclose their asset holdings on a daily basis, allowing for active asset management) could be justified only in a very limited number of cases, like multi-asset ETFs for which market making and hedging is difficult and regulatory treatment is challenging.

One investor mentioned that liquidity in ETFs is typically comparable to that of the underlying assets and often better. Investors, however, need to keep in mind that liquidity conditions can change significantly and rapidly.