EUROPEAN CENTRAL BANK

EUROSYSTEM

DIRECTORATE GENERAL MARKET OPERATIONS ECB-PUBLIC

INSTITUTIONAL INVESTOR DIALOGUE

13 November 2024, 13:30 to 15:30 CET
(hybrid event)

Participants

- Representatives of Allianz Global Investors, ATP, Aviva Investors, Generali, J.P. Morgan Asset and Wealth Management, Nissay Asset Management Corporation, Norges Bank Investment Management, Santander Asset Management, 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, Macroprudential Policy and Financial Stability, Economics, Secretariat and the Compliance & Governance Office

Summary

Outcome of the survey of participating members

The meeting started with a presentation of the results of a survey conducted among the participating investors. The results showed that over 90% of the respondents continued to see the path of future interest rates as the most critical element of the ECB's future monetary policy, followed by forward guidance on policy rates. At the same time the pace of ECB balance sheet normalisation associated with the asset purchase programmes declined further in importance. Most respondents continued to believe that a shift in the global economic outlook would be the main trigger of volatility in financial markets. However, "political uncertainty and geopolitical risks" had jumped higher, becoming the second most mentioned factor. Geopolitical risks were also seen as the single biggest risk to financial markets over the next 12 months, followed by political uncertainty. The replies to survey questions about investors' geographical asset allocation preferences suggested that most investors see broadly stable allocations. However, investor appetite for European investments weakened at the margin compared to the May survey. It should be noted that respondents completed the survey ahead of the US elections on 5 November 2024.

In the subsequent discussion, several investors inferred that the Republican win of the US election for President, Senate and House of Representatives was expected to be positive for US equities and negative for US bonds, because it paved the way to business de-regulation policies and increased inflationary risks in the US. Several investors were of the view that certain implications of the election outcome had not yet been fully priced by financial markets. Most notably, they mentioned the possible inflationary effect of strict immigration policies and new trade tariffs, as well as consequences for the fiscal trajectory of the US. Several participants noted that the election outcome increases the scope for diverging market developments between the euro area and the US, also linked to a decoupling of monetary policy expectations.

Regarding the landscape for environmental, social and governance focused (ESG) investments, most surveyed participants believed investors' engagement on ESG topics remained broadly at the same level as before. However, some participants indicated that excitement around ESG was waning, with complicated regulatory requirements seen as dampening retail client demand. The friction perceived by some participants between compliance with ESG regulation and expected investment performance was mentioned. In this context, investments in the defence industry were given as an example, as certain investments within this sector are often faced with restrictions under ESG exclusion criteria, while some retail investors currently see these investments as important and having promising return prospects on a longer timeframe.

Global investment trends

The participant introducing the global investment trends presented a view on the global economic outlook, fiscal trends, risk assets' performance and geostrategic considerations. While in the near-term inflation was seen converging to policymakers' targets, market pricing of longer-term real policy rates pointed to expectations of an approaching end to the disinflationary trend and scope for bigger regional divergence, in particular between Europe and the US. As the main factors explaining this inflation outlook, the presenter mentioned the lack of fiscal consolidation, sustained demand and higher prices for services, the risk of higher tariffs between relevant trade zones and costs related to the green transition.

The ensuing discussion delved into various risks and observations about the current global economic landscape. Participants pointed out that fiscal consolidation remains important but politically challenging. The US was seen as benefitting from its ability to issue debt in the world's most important reserve currency, which is bolstered by substantial economic growth and relatively low taxation levels. However, concerns were raised about the sustainability of this growth as fiscal spending was seen as a major growth driver. Participants also discussed the implications of higher energy prices in Europe, in particular for electricity, which could hinder industrial growth, and the possibility that retaliatory trade policies impact global markets. Despite the positive trend for equities and earnings per share in the US, a participant highlighted the risks associated with high market concentration, as now a significant portion of equity assets worldwide are tied to a few companies and with a high share of US companies. The potential for a reflationary trend to impact consumer spending was noted as a significant risk to future growth. Concerns were also raised about the long-term implications of trade wars on emerging markets and commodity prices. Additionally, the divergence between US and European economic performance was attributed to structural issues in the EU, such as competitiveness and the level of energy prices.

The potential for political instability in some European jurisdictions was mentioned as a factor that could decouple economic trajectories within the EU.

Artificial Intelligence in financial markets and the investment industry

A participant gave a presentation on the application of artificial intelligence (AI) in financial markets and the use of it in investment processes of institutional investors. The presentation highlighted the potential for productivity and GDP growth driven by AI, albeit with significant caveats. Some concerns were expressed about the limitations of Generative AI, particularly because of the risk of hallucinations that were said to currently restrict its use in investment decision-making. Additionally, the presentation highlighted concerns related to the high energy consumption associated with AI technologies and the challenges in developing methods for measuring and managing AI’s impact.

The discussion encompassed the economic and environmental aspects of AI deployment. One member noted a major disconnect in market valuations of AI service providers and AI adoption costs, suggesting that while AI services offered to asset managers currently come at low prices, in the future either these services may increase in costs for clients, or the valuation of some AI providers may be overestimating future cash flows. The debate on substantially higher electricity consumption underscored the potential for sustainable energy sources to mitigate emissions associated with AI, with nuclear energy mentioned as one distinct potential source. However, also some concerns were raised about the possibility of increased reliance on nuclear energy, as it is not widely available in all European jurisdictions.

Specific areas already benefiting from AI within the realm of asset management were discussed, including coding, research and reporting, with some participants mentioning notable improvements in efficiency in these activities. AI's impact on reducing headcounts in back and middle office operations was highlighted by one participant. The session concluded with discussions on AI's role in forecasting and the potential it could have for high-frequency and non-linear data analysis.