CHALLENGES AND OPPORTUNITIES FOR INTERNATIONAL RESERVE MANAGERS AFTER THE MONETARY RESPONSE TO COVID

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XIV (DIGITAL) MEETING ON INTERNATIONAL RESERVES MANAGEMENT

CEMLA AND BANCO DE MEXICO

April 14th, 2021
The COVID-19 pandemic provoked an unprecedented contraction of activity in 2020, and a reduction of inflation expectation not seen since the sovereign debt crisis.

Source: Datastream.
I. Asset Purchases

- **APP: Asset Purchase Programmes** (Public Sector bonds, Covered Bonds, Corporate Bonds and ABS)
  - Additional envelope of 120 bn € to invest in 2020
- **New PEPP: Pandemic Emergency Purchase Programme:**
  - Envelope 750 bn €.
  - APP eligible assets + commercial paper + s/t public debt + Greek bonds

- **PEPP**
  - Increase in envelope up to total 1350 bn€
  - Extension of net purchases until June 2021 and reinvestments until end 2022

- **PEPP**
  - Increase in envelope up to total 1850 bn€
  - Extension of net purchases until March 2022 and reinvestments until end 2023

- **PEPP**
  - Increase in pace of purchases
II. Liquidity providing operations

2020

- March
  - Additional **Longer Term Refinancing Operations (LTRO)** at DFR rate
  - Improvements in **Targeted Longer Term Refinancing Operations (TLTRO III)** conditions:
    - Rate for period June 20-June 21 as low as DFR-25 bps
    - Increase in borrowing allowance
- April
  - Improvement in **TLTRO III** conditions:
    - Rate during June 20-June 21 as low as DFR-50 bps
  - **Pandemic Emergency Longer Term Refinancing Operations (PELTRO)**
- December
  - Improvement in **TLTRO III** conditions:
    - Rate during June 20-June 22 as low as DFR-50 bps
    - Increase in borrowing allowance
    - Additional TLTROs
  - **Additional PELTROs**

2021
MONETARY POLICY MEASURES ADOPTED BY THE ECB

III. Collateral framework

2020
- April
  - **Collateral easing Measures:**
    - Reduction in haircuts applied in securities and loans posted as collateral
    - Grandfathering of securities downgraded below Investment Grade
    - Expansion of eligible loans (in particular to Covid related loans)
- December
  - Extension of **collateral** easing measures until June 2022

IV. Fx swaps & repo lines with Central Banks

2020
- March
  - Coordinated action of 6 CBs (ECB, US, CA, JP, CH, UK) for **USD liquidity provision**
- April
  - Reactivation **swap line** with CB of Denmark
  - New **swap lines** with CBs of Croatia and Bulgaria
- June
  - **Repo Line** with CB of Romania
  - **EUREP**: new temporary repo facility to provide EUR to non Euro Area CBs
- July-Nov
  - **Repo Lines** with Albania, Hungary, Serbia, San Marino and North Macedonia
- December
  - Extension of swap & repo lines and EUREP until March 2022
There has been a widely use of new **Lending** Operations, interest rate **cuts**, **asset purchases** and **Swap Lines*** across regions

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**Measures by markets and regions**

- **Interest rate**
- **Lending operations**
- **Foreign exchange**
- **Asset Purchases**
- **Reserve policy**

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**Lending operations**

- **DM**: developed Markets
- **EM**: emerging Markets

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**Purchase Programs**

- **Public**
- **Corporate**
- **Covered**
- **Public/Corporate**
- **All**
- **other**
- **CP**
- **equities**

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**Source**: Central Banks. **DM**: developed Markets, **EM**: emerging Markets. Pre-crisis: measures taken before Covid-19. *Swap lines are included in Foreign Exchange*
Projections point to a global economic recovery in the short term.

Source: IMF World Economic Outlook April-2021.
CHALLENGES AND OPPORTUNITIES FOR RESERVE MANAGERS

COVID – 19 CRISIS

- A unique stress test for systems and Procedures (WFH)
- Temporarily (?) lower risk appetite. Liquidity concerns

INCORPORATION OF SRI CONSIDERATIONS

- Sustainability: a new objective beyond the traditional triad. An opportunity for diversification
- Eurosystem common stance on SRI principles for NMPP

CHALLENGES AND OPPORTUNITIES

REFLATION SCENARIO

- The end of low (negative) rates era?
- Lower expected returns: search for yield and diversification
- Higher market and credit risks
REFLATION TRADE: A TURNING POINT?

Source: Bloomberg
Challenging typical reserve management:

- Lower expected returns
- Higher tolerance for both market and credit risks in a (still) low volatility context

Reinforcing the need for:

- Defensive strategies: lower duration & HTM portfolios, FRNs, TIPS, +MM activity
- Keep on diversification efforts (assets & currencies) despite changing correlations
- Return enhancers: Sec Lending, Hedged Swaps...
- More active management
- External mandates as diversifiers
Climate change and NGFS recommendations: one of the greatest challenges for this century and a source of financial risk for central banks, who have accelerated action towards Climate Change mitigation.

The Eurosystem central banks have agreed on a common stance for applying SRI principles in the euro-denominated NMPP

- aligned with NGFS recommendations
- promotes disclosures and understanding of climate-related risks
- Eurosystem to start climate-related disclosures for some NMPP in the next 2 years, using TCFD recommendations

Banco de España has subscribed to the Eurosystem common stance

- In 2018, BdE joined NGFS and in 2019 incorporated SRI principles in NMPP investment framework
- BdE has direct green bond investments and participates in open-ended investment funds for green bonds launched by the BIS in different currencies
THANKS FOR YOUR ATTENTION