ECB’s foreign reserves management

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Monika Znidar, DG Market Operations
Overview

1. General information on ECB’s foreign reserves
2. ECB’s foreign reserves management
General information on ECB’s foreign reserves
Origin of the ECB’s foreign reserves

- Since 1 January 1999 (launch of the euro)
- Established by transfers of foreign reserves from the national central banks (NCBs) when joining the Eurosystem
  - The last NCB (for now) joined in 2015 (Lithuania)
- The contribution of each NCB is fixed in proportion to its share in the subscribed capital of the ECB
- Further calls of foreign reserve assets may be requested by the ECB
- Each NCB also has its own foreign reserves
ECB’s foreign reserves mostly consist of foreign currency reserves

- Total reserves: EUR 75.8bn (end-2020)
  - Foreign currency reserves: EUR 50.1bn
  - Gold: EUR 25.1bn
  - SDR: EUR 0.7bn
- Main purpose:
  - to ensure that the ECB can, at any time, conduct foreign exchange operations, if needed
  - Very few FX interventions so far (some coordinated):
    - September and November 2000
    - 18 March 2011 (earthquake in Japan)
ECB’s foreign reserves as shown on the ECB’s balance sheet

Main components of the ECB’s Balance Sheet

Source: ECB Annual Accounts 2020
US dollar is the main component of the ECB foreign currency holdings

Currency composition:
- USD: 76%
- JPY: 23%
- CNY: 1% (since 2017)

Source: ECB Annual Accounts 2020
Gold is not actively managed, holdings have been increasing due to the increasing price

Source: ECB Annual Accounts 2020
Foreign currency reserves invested in highest quality instruments with relatively low residual maturity

Composition of foreign currency investments

Maturity profile of foreign currency-denominated securities

Eligible instruments:
- Government bonds
- Supras, agency bonds
- Commercial bank deposits
- Repos, reverse repos
- Certain derivatives

Source: ECB Annual Accounts 2020
ECB’s foreign reserves management
**Liquidity the most important principle, decentralised management**

- **Main principles in the order of importance:**
  - **Liquidity** – has priority in order to fulfil the main purpose
  - **Safety** – high creditworthiness of the issuers and the relatively short duration
  - **Return** → active portfolio management with incentives to make use of risk budget

- **Involvement of the ECB + all Eurosystem NCBs**
  - NCBs act as agents of the ECB → “internal external” managers
  - Dedicated working group

**Country | Capital key**
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Germany | 26%
France | 20%
Italy | 17%
Cyprus | 0.2%
Malta | 0.1%
The management of ECB’s foreign reserves has three layers

- **Strategic benchmark**
  - annual review approved by the Governing Council
  - long-term risk/return preferences

- **Tactical benchmark**
  - monthly review by ECB’s Investment Committee
  - based on investment proposals by ECB portfolio managers
  - medium-term (3-6 months) risk/return preferences

- **NCB portfolios**
  - day-to-day active portfolio management by NCBs
  - currency specialisation
  - 11 portfolios in USD, four portfolios in JPY and one in CNY

Internal target for outperforming the SB set each year for each currency → important element in the overall performance of ECB portfolio managers
Actual management (3rd layer) and its incentives to outperform the TB

- Returns measured against the tactical benchmark
- Some pooling arrangements
- Diversification of portfolio styles
- Performance-based ranking of NCBs
  - Provides for competition
  - Important tool in fostering risk-taking
  - Monthly ranking
  - At the end of each year the final ranking is shared with GovC
- Benefits: information sharing, promoting best practices

Result: Over time, all active layers have made a positive contribution to the SB returns for all reserve currencies
Prudent risk management

• Centralised: ECB’s independent risk management function
• Various limits: individual issuer limits, sector limits etc.
• Active portfolio management (2\textsuperscript{nd} and 3\textsuperscript{rd} layer) takes place within a specific risk budget
• Defined in terms of relative value-at-risk (VaR)
• Minimum usage target set for the relative VaR budget
• The risk usage is monitored and discussed periodically
Thank you!