Central banks shift into higher yield assets

By Elizabeth Fry

Central banks are investing in new asset classes in a bid to increase yield, according to a new survey from BNY Mellon.

Many are undertaking a “gradual but definite expansion” of investment and trading activity beyond their traditional remit, the US asset specialist found.

So what do experts think about central banks shifting into riskier assets - albeit ultra cautiously?

This is not so much a comment on current conditions but rather where central banks have gotten to on the back of a sustained period of tightening spreads and lower absolute yields, according to Realm Investment House portfolio manager, Andrew Papageorgiou.

"However, this shift ultimately devalues the skilled allocator of capital and favours the individual that is skilled in rent seeking and navigating central bank flows and is conscious of regulatory arbitrage.

"Over the long term that can’t be healthy."

New asset classes

BNY found that while most central bank portfolios remain weighted toward major currency government bonds and money market instruments, some are investing in a wider range of asset classes, currencies and instruments as they look “well beyond the traditional focus on G-10 currency-denominated government debt.”

“Looking to the future, a third of survey respondents indicated they had recently or were planning to invest in new markets of asset classes,” BNY said

“In most cases, the motivation is to increase yield, with a wide range of instruments targeted, including equities, corporate bonds, and real estate.”

The results of the survey - released jointly by BNY Mellon and the University of Cambridge’s Judge Business School - also found that 39 per cent of central bank respondents already invest in equities; one third currently undertake securities lending; and 61 per cent confirmed active participation in repo deals, with 39 per cent investing in time deposits.

“While central banks’ responsibilities make them “relatively cautious” in exploring new investment opportunities, there is “both anecdotal and statistical evidence of growing sophistication and innovation by institutions willing and able to invest beyond established parameters.”

Emerging markets

And while the survey found “little appetite” for larger investment in emerging market assets, some central banks are exploring investments denominated in Renminbi.

Further, as central banks diversify their investments, BNY forecasts that investment guidelines will evolve.

“There are an increasing number of bespoke approaches – including hedging strategies to offset interest rates and commodity price shifts – that can be adopted without central banks breaching mandates."

As Papageorgiou notes, the Bank of Japan is obviously quite active across numerous product classes.

Also, the European Central Bank is a big investor in credit assets as part of their quantitative easing program.

“These central banks have realised that they can have a much more meaningful impact with the same or less money in risk markets than they can in sovereign debt.”

No difference

From where Papageorgiou sits, this would make central banks no different than anyone else.

Ultimately, he added, as sovereign debt delivers less, there is a greater incentive to explore other avenues to increasing income.

“This drives a logical progression from government debt, to high grade corporate debt and ABS, to mid-range corporate debt, to low grade corporate and emerging market debt and then finally equities and other exotics, where liquidity or complexity premia provides a pick up.

"That means, once they have approved a product type and are active, no doubt their presence will add to depth and stability in the short term. However, the efficacy of the decision will be weighed and measured in the fullness of time."

“Anyone with a Libertarian bent will see this kind of a trend as something that will only ferment more significant in balances down the road since central bank intervention is insidious in that it erodes the concept of moral hazard and accountability.”

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