The Future of Reserve Management: An Emerging-Market Perspective

High-Level Reserve Management Conference

Mexico City, 31 March 2017

BANGKO SENTRAL NG PILIPINAS

BSP's Framework

- GIR
  - Cash & Securities
    - Liquidity
    - Investment
    - Long-Term
  - Gold

- Commodity
- Liquidity
- Duration (real, nominal and spread)
- Curve
- Inflation (actual and expected)
- Currency

BANGKO SENTRAL NG PILIPINAS

Our Challenges

Reaching the limits of benchmark-investing

- It can sometimes force you to do something that you may not be comfortable with (e.g., negative yields and extension of duration as a result), and

- Sometimes positive returns are not apparent in the short-term or as investment conditions change (e.g., as policy normalizes)

Asset-class based approach to asset allocation → Massive concentration to only a few risk factors

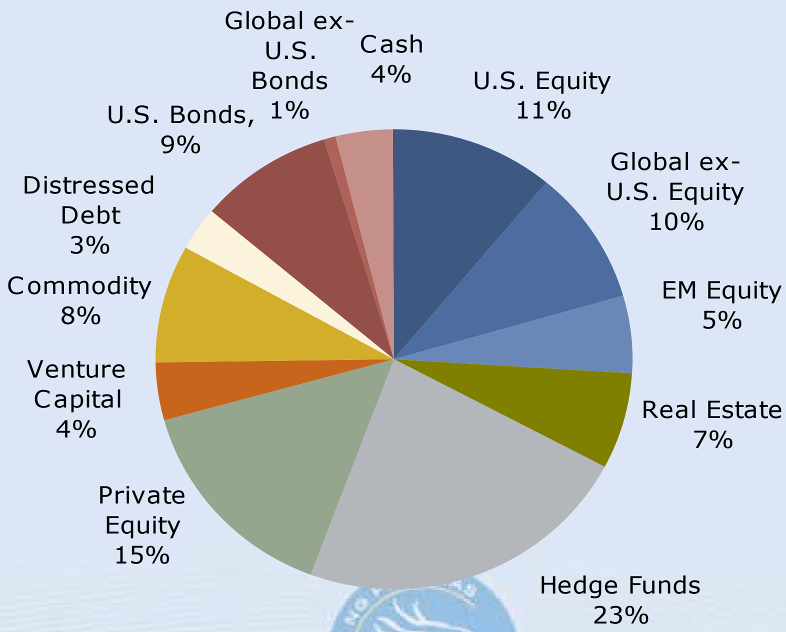
BANGKO SENTRAL NG PILIPINAS

Future Reserve Management Trends

Addressing the benchmark problem: total/absolute returns

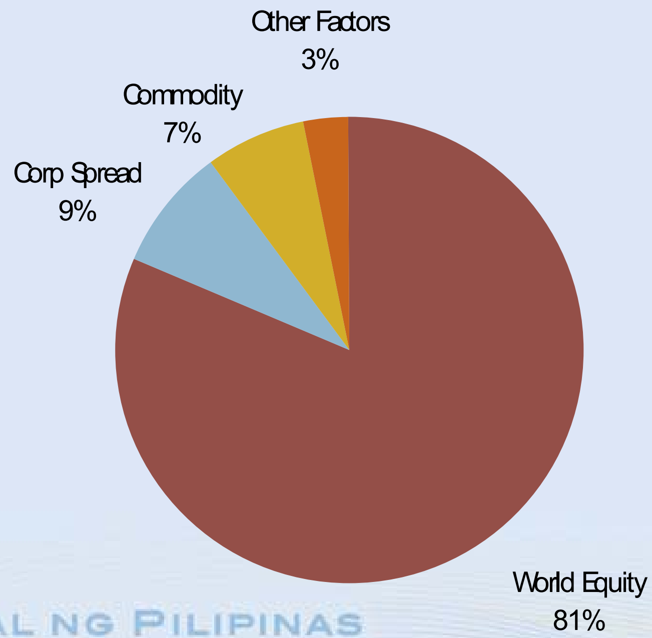
- May continue to be a trend given the current environment of very low yields…but until when?

Asset allocation approach: Asset-class or risk-factor-based?



* *Source: PIMCO*

Asset-Class-Based



Risk-Factor-Based

Future Reserve Management Trends

Reviewing the numeraire

- Consider the tranche and its objective, and determine the numeraire for each tranche

The future of reserve management will be determined by the environment within which the reserve manager operates

Central Banks - Profile and Constraints*

	Intense Public Scrutiny	Ownership Structure	Good Neighbor & Other Constraints	Little Control Over Portfolio Size	Size & Market Position	Institutional Culture
Unique constraints	Portfolio losses attract public attention; impact credibility & independence Opportunity costs can be debated publicly, especially in countries with large development agendas	Annual revenue sharing with gov't can impede development of a capital buffer Limits incentive to sell (e.g. gold) Accounting treatment may drive behavior (e.g. realize losses but not gains)	Not ok to target other countries' currencies Buying certain assets (e.g. inflation protection) may send unintended signals Credit risk difficult to manage; withdrawal can exacerbate problems	Portfolio size & flows depend on policy regime & exogenous factors	Large portfolio size can create market dislocation Often limited to most liquid asset classes Reserves accumulation can be inflationary Sterilization may introduce negative carry	Incentive structures are asymmetric for individuals and the institution Budget / resources often limited. Hard to retain experienced staff
Conservative investors	Preservation of capital more important than achieving high returns Acceptable loss horizons very short Seek relative vs. absolute returns	Tendency to manage risk at asset level not portfolio level Risk often mitigated by delisting rather than diversifying However, risk approach continues to become more sophisticated	Settlement delays, fails & operational problems attract high level of attention Tendency to outsource middle / back office functions	Liquidity buffers needed to support implementation of monetary & exchange rate policy Investment horizon typically short (1-3 years)	Gradual and sequential expansion to new asset classes	Long decision making process Little upside to making change Procurement rules require RFP process, transparency
	Safety Over Return	**Risk Avoidance**	**Operational Risk is Critical**	**Liquidity is Paramount**	**Tiered Approach**	**Long Time Frame**

** Source: JPMorgan New Trends in Reserve Management (August 2016)*