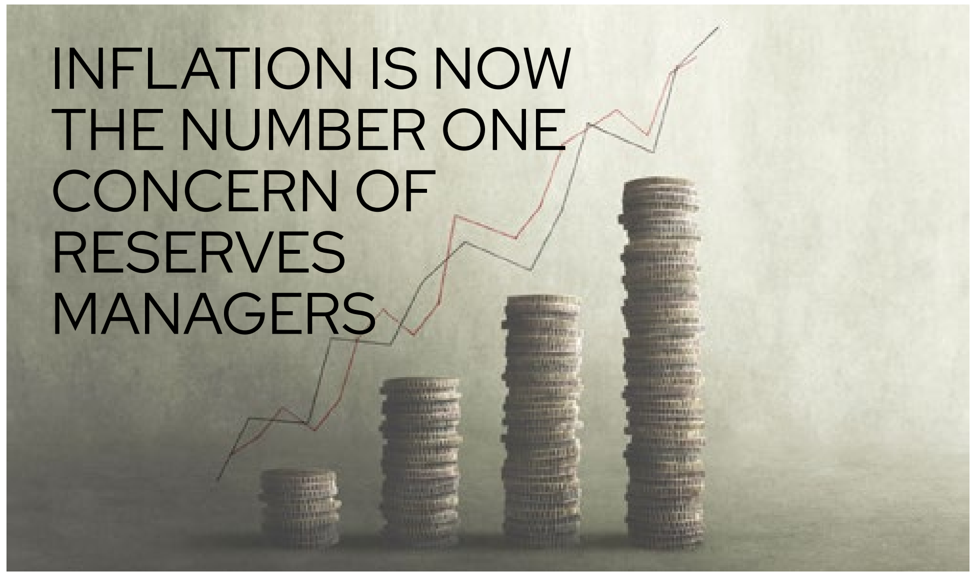
KEY FINDINGS

1

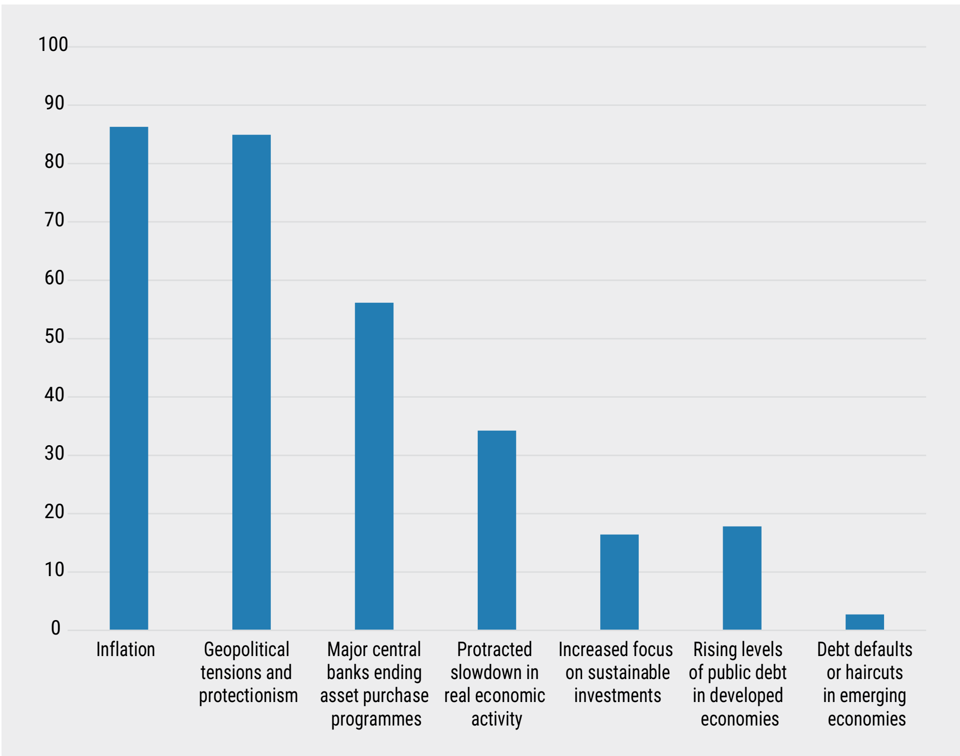


HOW the world has changed. Close to 90% of reserves managers now count inflation as one of the three most important factors affecting their performance. Last year, inflation wasn't even considered a major factor. The impact of the war in Ukraine is clear, with geopolitics now cited by more than 80% of the central banks surveyed, whereas in 2021 just 17% were factoring in such tensions. It seems ironic now, as global interest rates rise, that just 12 months ago the main factor affecting reserves managers was the expectation of major central banks moving further into negative rate territory. Expect a rise in the importance of a protracted slowdown in real economic activity to become more of a concern in the 2023 iteration of the GPI.

INFLATION AND GEOPOLITICS TOP LIST OF MACRO FACTORS

What are the three most important factors affecting reserves management in the current economic environment?

Share of respondents, %



Source: OMFIF GPI survey 2022

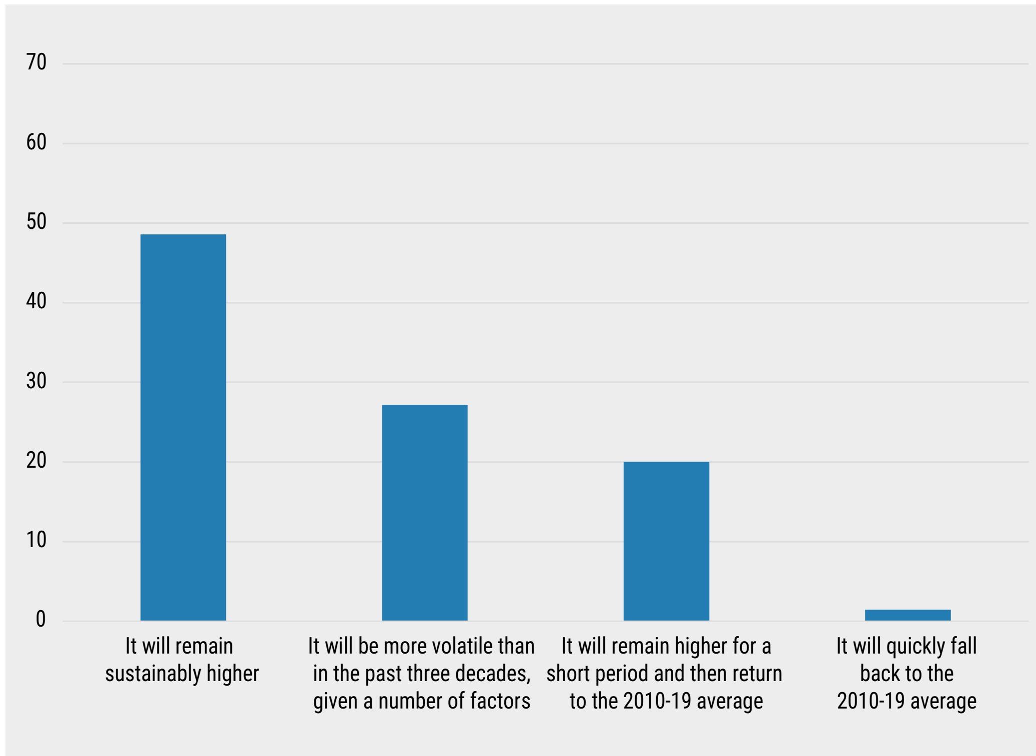
2

ALMOST half of the reserves managers surveyed by OMFIF think inflation is set to go high and remain higher. This suggests they don't believe their central banking peers in charge of monetary policy have the tools to suppress the surge in inflation any time soon. Strip out the responses of Asian central banks – where the majority believe inflation will be more volatile, but not persistently higher – and the proportion of reserves managers expecting price rises to remain sustainably higher rises to nearly 60%. Just 20% of respondents now believe that the spike in inflation will be transitory, the line followed by many senior central bankers over the past 12 months.

RETURN OF INFLATION WILL NOT BE TRANSITORY

How will the rate of inflation evolve across most major economies over the next 24 months?

Share of respondents, %



Source: OMFIF GPI survey 2022

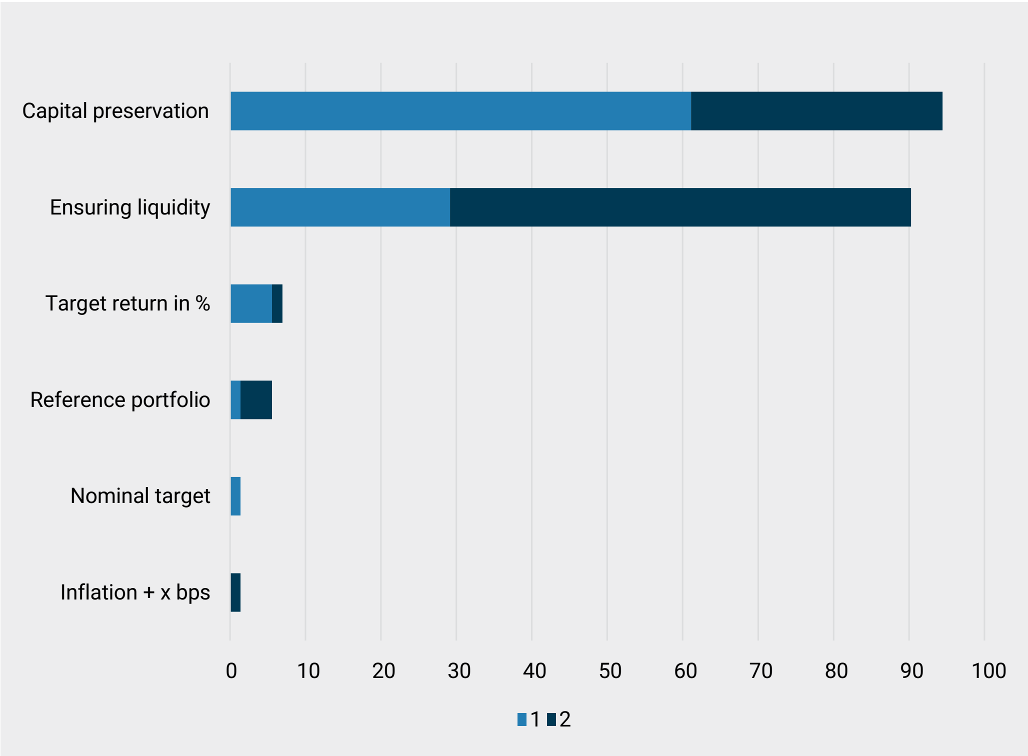
3

CENTRAL banks have traditionally been risk-averse investors, putting capital preservation and liquidity at the heart of their approach. Upheavals in the macroeconomic environment have only served to reinforce this. More than 90% of reserves managers cite capital preservation and ensuring liquidity as their top-two investment objectives. In our 2021 survey, capital preservation was a top-three objective for 75% of respondents. Capital preservation is also the most important factor in diversifying reserves, cited by 44%. Less than 30% of respondents in 2020 ranked capital preservation as a top-three factor in diversification. The question in the months and years to come for many reserves managers will be whether capital preservation actually equates to minimising capital losses.

CAPITAL PRESERVATION AND LIQUIDITY MORE IMPORTANT THAN EVER

Respondents' top-two most important investment objectives (1 = most important)

Share of respondents, %



Source: OMFIF GPI survey 2022

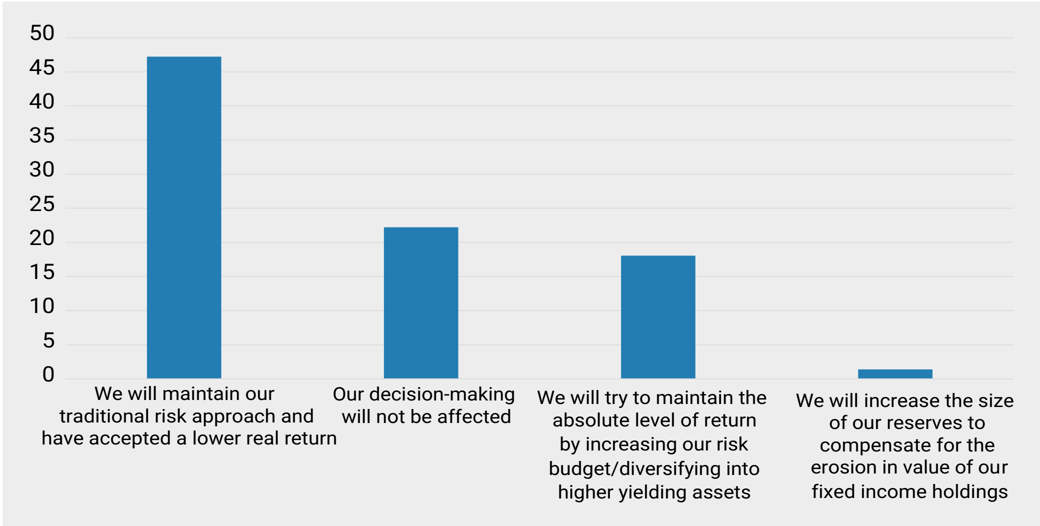
4

AROUND 70% of reserves managers say they will not make any fundamental changes to their investment approach despite the surge in inflation. Of these, two-thirds say they have accepted their real returns will fall. The remainder might consider that they are already well positioned for the longer term, or perhaps are hoping for the best. That doesn't mean reserves managers are going to just sit on their hands – a slight majority of respondents will become more active in their portfolio management. Expect that activity to involve marginal shifts in asset allocation, rather than major strategic changes, at least for the time being.

RISK-TAKING OFF THE AGENDA FOR MOST RESERVES MANAGERS

How will the elevated rate of inflation across most major economies affect your decision-making?

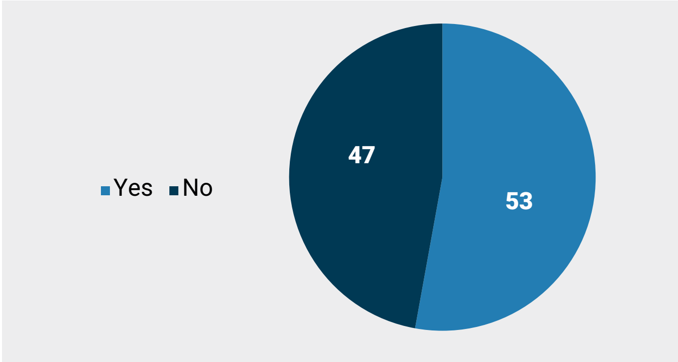
Share of respondents, %



CHANGES IN MACRO ENVIRONMENT WILL DRIVE MARGINAL PORTFOLIO SHIFTS

Do you anticipate that economic and market volatility will prompt you to adopt a more active approach to portfolio management?

Share of respondents, %



Source: OMFIF GPI survey 2022

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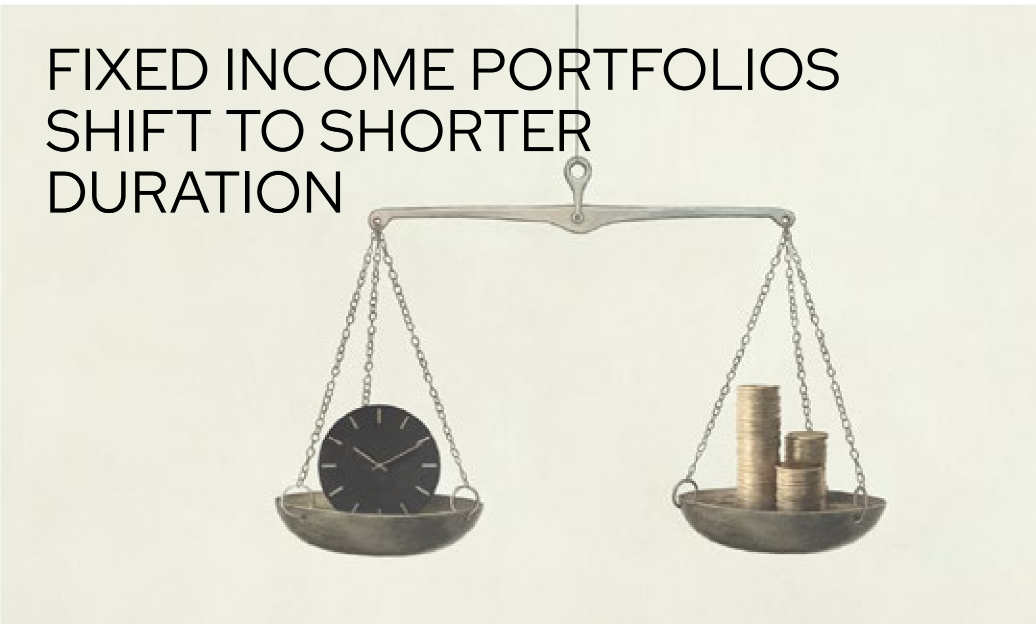
FIXED INCOME PORTFOLIOS SHIFT TO SHORTER DURATION

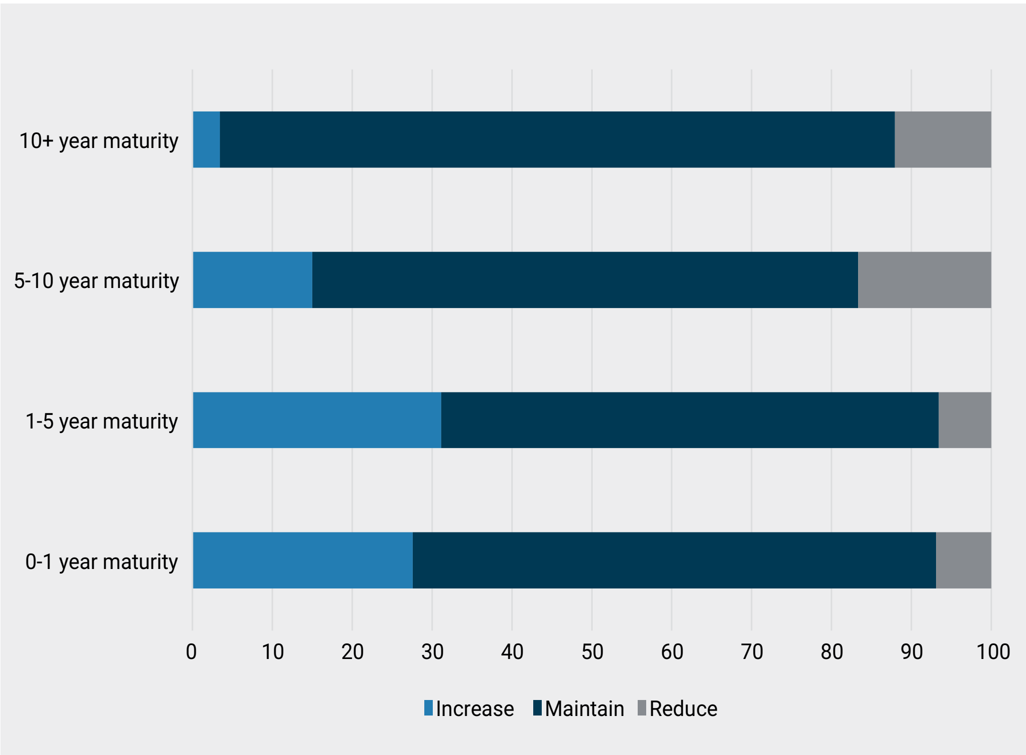


YEARS of ultra-low interest rates have seen government bond markets moving further along the maturity curve, with investors locking in higher returns via more duration. With liquidity at a premium, that trend could now be over. Reserves managers are set to reduce their holdings of longer-term debt, while moving into more liquid holdings at the shorter end of the curve. These anticipated shifts also mirror investors' expectations that inflation will remain higher for longer. In 2021, by contrast, bonds with maturities of more than five years showed a net positive shift in allocations.

RESERVES MANAGERS PLAN TO SHIFT OUT OF LONGER-TERM DEBT

Reserves managers' expectations to increase, reduce or maintain allocation to government bonds in the following categories

Share of respondents, %



Source: OMFIF GPI survey 2022

6

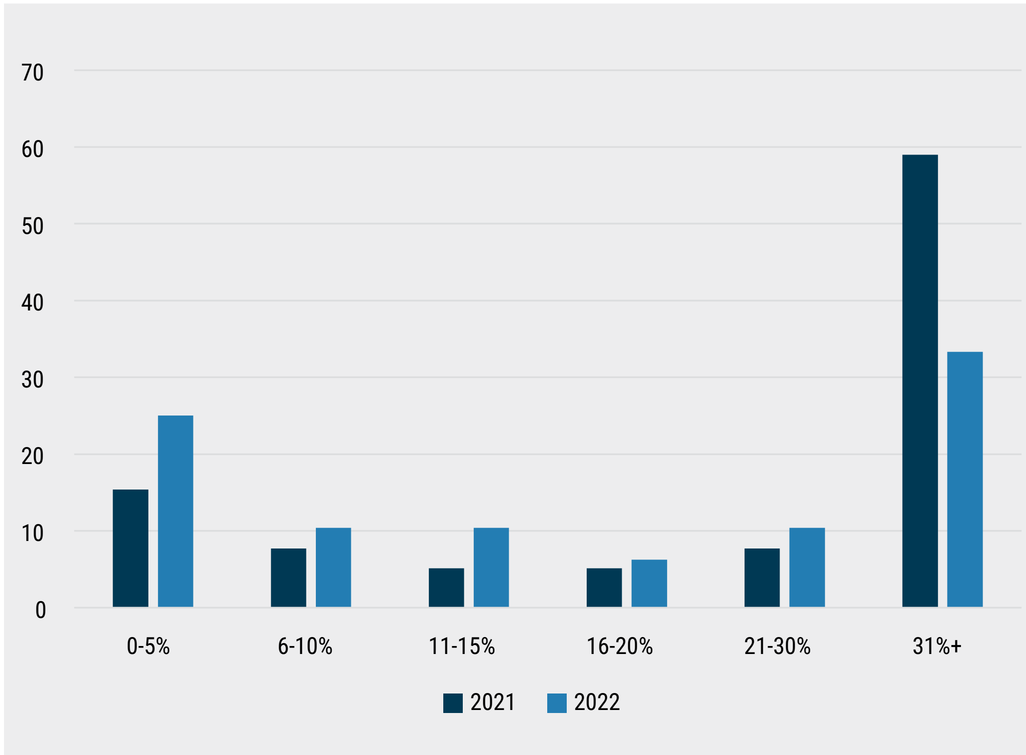
CENTRAL BANKS PREPARED TO USE FEWER RESERVES IN A CRISIS

SOME 49% of reserves managers see a case for continued accumulation of foreign exchange reserves, while only 16% do not. Almost 60% consider a draw-down of FX reserves as the most effective safety net during a period of stress, up from 47% last year. And yet the percentage that would deploy more than 30% of their reserves in the event of a currency crisis has almost halved, from 59% in 2021 to just 33% this year. Almost as many would now be prepared to use only a minimal amount of reserves. Are central banks moving towards a position that deployment of reserves during currency crises is ineffective? And if so, are they prepared to put more reserves to work in order to generate returns?

CENTRAL BANKS MORE CAUTIOUS ABOUT DEPLOYING RESERVES

What is the maximum share of your reserves you would be willing to use in the event of a currency crisis?

Share of respondents, %



Source: OMFIF GPI survey 2021-22

7

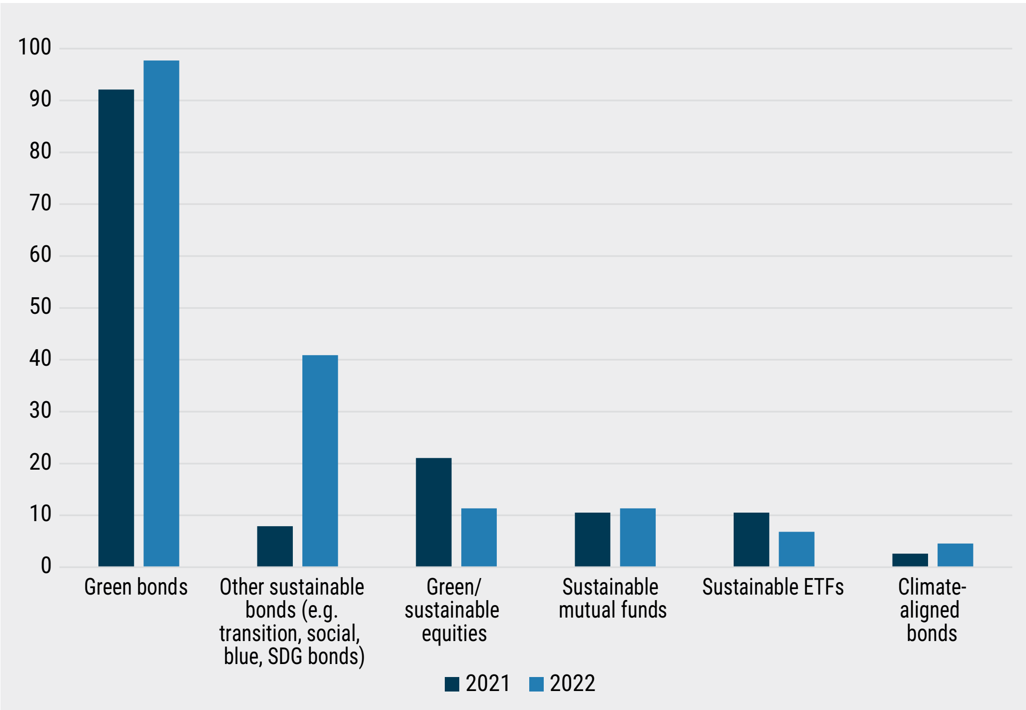
GREEN BONDS ARE BECOMING A UNIVERSALLY ACCEPTED ASSET CLASS

OF the reserves managers that responded to this year's survey section on holdings of ESG assets, just one – from a conflict-torn developing market – does not have any green bonds in its portfolio. Interest in other forms of sustainable assets, such as social bonds, has grown rapidly over the past 12 months, with more than 40% of central banks now owning them. The proportion of reserves managers that do not implement environmental, social and governance criteria in their investment approach is falling, from over 50% in 2020 to 43% in 2022. That's the positive news. But barriers remain. The problems caused by lack of relevant and accurate data or information – long a critical failing of the drive for ESG investment – are actually growing. More than 60% cite lack of data as a major issue, compared to less than 50% in 2022. It seems likely that, as reserves managers invest more, they are becoming more familiar with the difficulties of monitoring their ESG portfolios.

ALLOCATIONS TO NEW FORMS OF SUSTAINABLE BONDS RISE SHARPLY

Which sustainable assets do you invest in?

Share of respondents, %



Source: OMFIF GPI survey 2021-22

8

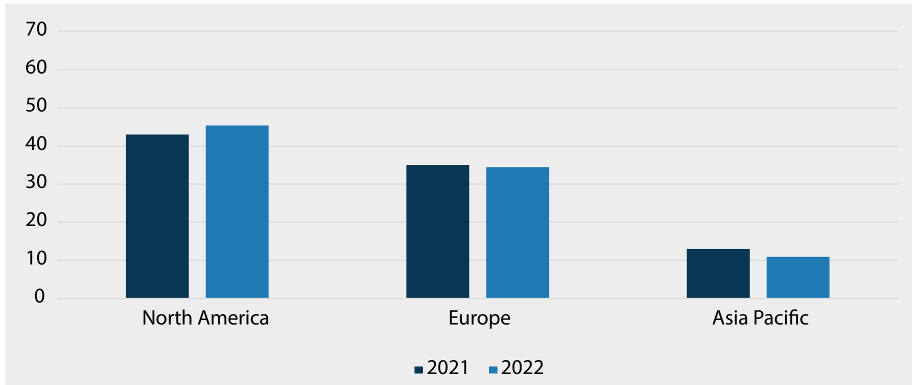
RESERVES MANAGERS MAY STRUGGLE TO EXECUTE ASSET ALLOCATION PLANS IN ASIA

ASIA PACIFIC remains the favoured destination for further investment for many reserves managers. More than 33% plan to increase their allocations to the region. But assets to invest in can be hard to find. This year's research shows that the aggregate portfolio invested in Asia actually fell compared to 2021, to 11% from 13%. That's despite the fact that, in last year's survey, more than 40% of respondents said they planned to increase their holdings in the region. External managers report that many official institutions in Asia are changing their mandates to invest more in overseas markets because they lack investment opportunities in their domestic markets. The competition for Asian assets is therefore likely to be fierce, leaving many reserves managers disappointed.

ALLOCATIONS TO ASIA PACIFIC DECLINE…

What percentage of your total portfolio is invested in the following regions?

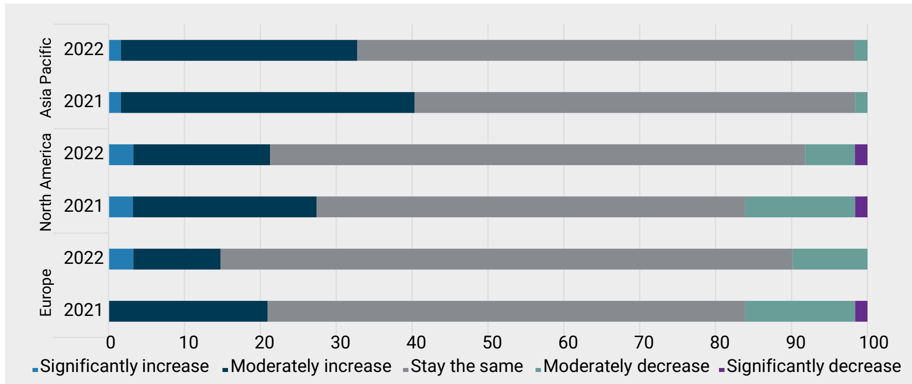
Average response, %



…WHILE REMAINING TOP OF RESERVE MANAGERS' EXPECTED INVESTMENT PLANS

Reserves managers' expectations to increase, reduce or maintain exposure to the following regions

Share of respondents, %



Source: OMFIF GPI survey 2021-22

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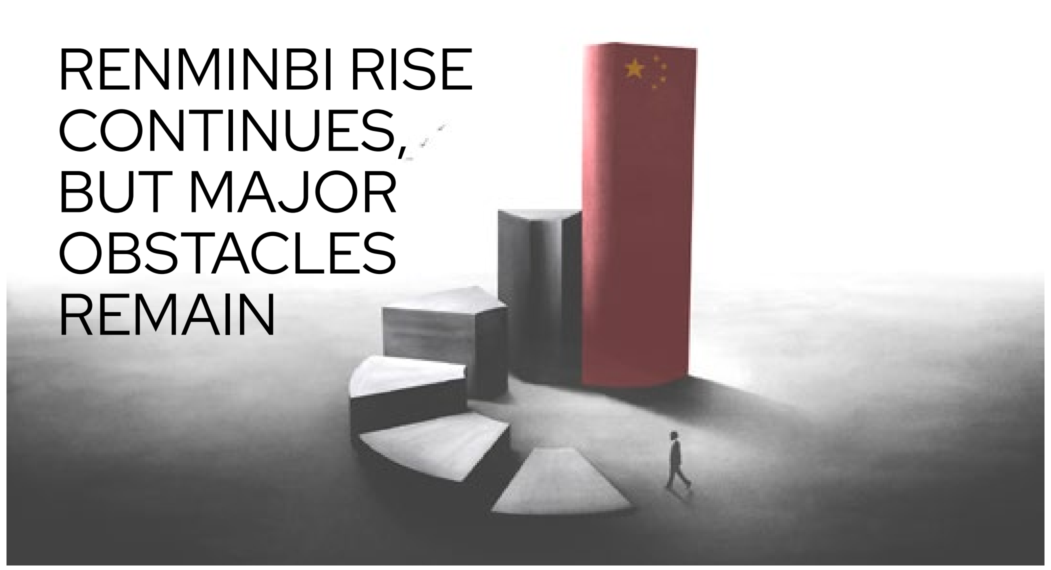
RENMINBI RISE CONTINUES, BUT MAJOR OBSTACLES REMAIN



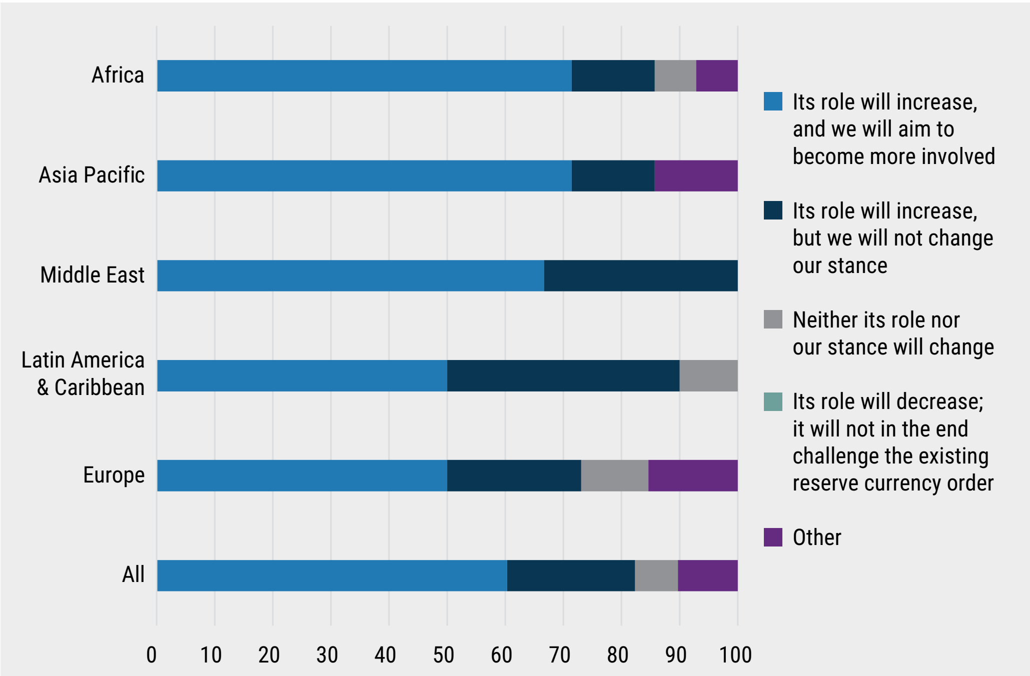
ALLOCATIONS to renminbi reserves rose year on year, from 1.75% to 2.5%. In Asia Pacific and Africa, close to 5% of all reserves are now held in the Chinese currency. Around 30% of respondents plan to increase their renminbi holdings, a small rise on last year. Diversification, the increasing importance of China in the global economy and higher yields are all cited as factors encouraging central banks to invest more in Chinese assets. More than 80% of reserves managers who answered our survey questions on China now own Chinese government bonds.

But there are signs that the rise of the renminbi is slowing. Some 60% of respondents in 2022 say the role of the renminbi as a reserve currency over the next 10 years will increase, and they will become more involved, compared to almost 70% holding that view last year. And geopolitical concerns are the top reason why reserves managers might not invest more in China (71%), closely followed by poor market infrastructure (63%).

RISE OF THE RENMINBI MAY BE STARTING TO SLOW

How do you see the role of the renminbi as a reserve currency developing over the next 10 years, and how will you respond?

Share of respondents, %



Source: OMFIF GPI survey 2022

10

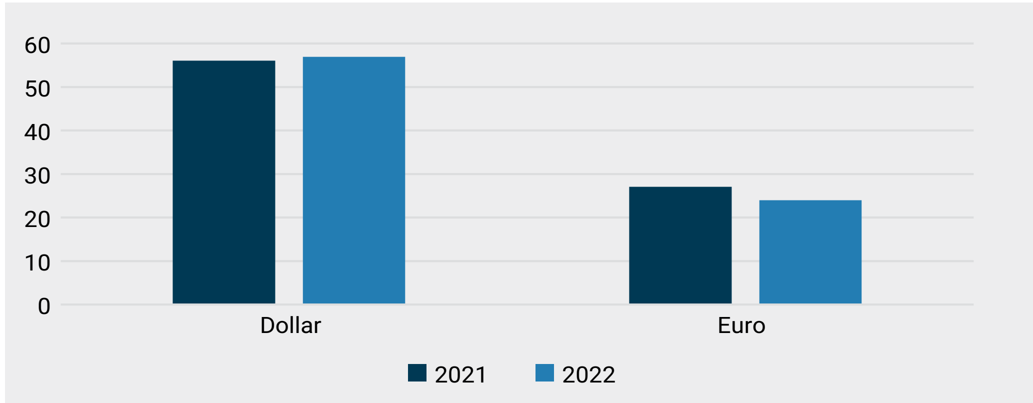
EURO STRUGGLING TO GAIN TRACTION AS RESERVE ASSET

NEXT Generation EU bonds were launched to great fanfare in 2021, a new €750bn borrowing programme which would not only rebuild Europe post-Covid-19, but also transform the region's bond markets and promote the euro's position as a reserve asset. But just 13% of reserves managers surveyed have purchased NGEU bonds to date, including only 27% of European central banks. The euro's share of currency allocations fell slightly this year, to 24% from 28%. However, close to 50% of respondents believe NGEU bonds will become a permanent feature of reserves portfolios in the future, and 67% think that plans to issue one-third of all NGEU bonds in sustainable format will boost the global green bond market.

ALLOCATIONS TO EURO ASSETS HAVE DECLINED OVER THE PAST 12 MONTHS

What percentage of your portfolio is allocated to the following currencies?

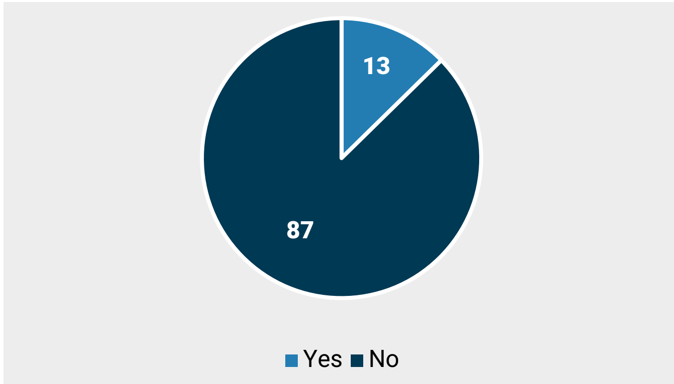
Average response, %



MOST RESERVES MANAGERS HAVE SO FAR SHUNNED NGEU BONDS

Have you purchased bonds from Next Generation EU since issuance began in 2021?

Share of respondents, %



Source: OMFIF GPI survey 2021-22