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German Savings Banks Association

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Statement by

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A warm welcome to today's press conference of the German Savings Banks Association during the Annual Meeting of the World Bank Group and the International Monetary Fund. This meeting is overshadowed by concerns about a slowdown of the global economy. In the European Union, we should counteract the factors that have led to the current crisis. That is what I would like to concentrate on in my statement. Three points are particularly important in this context:

<u>First:</u> The European Central Bank's monetary policy stabilised the euro area over a long period of time. Under the present circumstances, an expansionary monetary policy is now doing more harm than good. For this reason, we believe that it is important that monetary policy should return to a solid and sustainable path.

<u>Secondly:</u> An enhanced growth policy should now be pursued to seize opportunities for a sustainable recovery. In Germany, for instance, there is a need for more public investment.

And <u>thirdly</u>: The European financial sector will be facing extremely tough business challenges in the next few years due to regulation and the expansionary monetary policy. We believe that policymakers should pay particular attention to preserving the efficiency of the European financial sector.

Let me briefly address these three points.

I.

The global economy is burdened above all by the current political environment. The economic impact is becoming more and more apparent: In many industrialised nations, signs of a slowdown in growth were already observed in 2018. The growth momentum continued to decline in 2019. Of course, monetary policy alone cannot remedy the situation; that would be expecting too much. Between the end of 2015 and the end of 2018, the Federal Reserve in the United States already normalised interest rates to some extent and took initial steps to reduce its unnaturally high total assets. In the euro area, no steps were taken to normalise monetary policy despite solid growth prospects.

In fact, the bond purchasing programmes had been put on hold for a mere ten months – and only in terms of net asset purchases. As of November, net purchases will be resumed. The ECB has become the key market player for purchases of government bonds and increasingly also of corporate bonds. While the negative interest rate has been cushioned by the introduction of staggered interest rates, the bond purchasing programme has a strong impact on funding conditions. In roughly a dozen European countries, lenders are repaid less than the amount of the loans after ten years.

This shortage of interest-bearing investment opportunities poses a major challenge, not only for savers but also for institutional investors – at least if they want to avoid excessive risks. For insurance companies, social security institutions, foundations, as well as Savings Banks, this severely restricts their scope for action. Conversely, however, extremely low interest rates no longer motivate companies to invest more. I don't know any entrepreneurs who would be guided in their investment decisions by the last few basis points of the interest rate. Instead, it is more likely that their actions will be influenced by the current economic uncertainties.

In addition, we believe that there is a risk that the current monetary policy will increasingly divide our society. People with significant assets benefit substantially, whereas all those who have little capital of their own, who are tenants – and not homeowners – and who rely on fully-funded pension schemes are adversely affected. In our view, the ECB should devote more attention to these unwanted side-effects of its monetary policy. It should review its decision to resume the bond purchases.

And we also hope that the ECB's new President will prepare the markets through careful communication for the fact that the ultra-low-interest-rate policy cannot continue forever – at least not if we want to avoid irreparable damage to our economic structure.
The very negative development that has unfolded in Japan as a result of many years of ultra-low interest rates demonstrates the risks that Europe is also facing. In this situation, effective economic and financial policies are of crucial importance.

II.

In Europe – and specifically in Germany – we can make an important contribution to a positive economic development. In many industrialised nations, there is a disparity between savings and investments, partly due to demographic factors, but also to neglect of necessary investments. Only one-third of German savings, for instance, is invested domestically. Two-thirds of German savings are exported to other countries as current account surplus.

For many years, our country has therefore been called upon at the Annual Meetings to increase public investments. Just a few days ago, this was reaffirmed by the new IMF chief. Of course, Germany has flourished due to its strong competitiveness for many years. And rightly, German representatives have repeatedly drawn attention to the fact that the current account surplus was the result of our country's own efforts and efficiency.

It was not wrong to call on other countries to increase the competitiveness of their own economies. However, the times are now changing: The global economy is slowing down; isolationism and trade wars characterise the world. We must now summon the strength to respond politically to this new situation – and also review current core beliefs in this context.

And as far as the public sector is concerned, government frugality is not an end in itself; instead, its purpose is to provide for the future, so that investments can be made at the right point in time. The time has now come. In 2018, the public sector in Germany – across all levels – accumulated a general government surplus of EUR 62 billion. That is 1.9 percent of Germany's GDP. The federal government alone accounted for a surplus of EUR 20 billion, which is as much as 0.6 percent of the GDP for the federal government alone. With a view to the current cyclical situation and international imbalances, this could serve as a significant stimulus. And it would be a wise political objective to put more domestic savings to productive use in Germany once again – beyond the short-term cyclical perspective – and to channel these savings into investments.

There is sufficient need for investments, for example, to ensure the ecological renewal of industrial society. Our goal should be to play the role of a front runner in this field worldwide. The climate package that has been initiated is a first step in this direction. There is an urgent need for us – and for the EU as a whole – to catch up with the investment lead of the United States and China in the field of digitalisation. And we need to strengthen our position as a knowledge-based society. For this reason, we will need to invest more in education, to say nothing about necessary replacement investments in today's infrastructure: the buzzwords are road and rail. This is not just about public investments. A better business environment should also encourage German companies to begin investing more in Germany. A corporate tax reform could be helpful in this respect. In the past few years, many large industrialised nations have reformed their corporate tax regimes and have thereby improved their competitiveness.

In Germany, there is fortunately room for manoeuvre in fiscal policy for public investment and for creating tax incentives for corporate investments. The important thing is that this room for manoeuvre should not simply be redistributed today. After all, investing in sustainability is also a question of fairness towards future generations. Managing climate change is a paramount challenge in this context, which can best be mastered by the ecological renewal of industrial society. This, however, will require huge investments.

I would like to clarify two points in order not to be misunderstood.

- First: The "debt brake" needs to be upheld. Even so, however, it will be possible to raise a certain amount of new debt for investment purposes under certain cyclical conditions.
- And secondly: We need genuine **net** investment. It's not a matter of politically showcasing only mandatory replacement investments to maintain the status quo because, over many years, net investments were negative in Germany.

This means that depreciation was higher than investments. We have lived off our reserves. And in 2018, government investment was about EUR 1.3 billion higher than depreciation.

I therefore recommend that not only ecological but also economic sustainability should be made a policy focus. In light of the climate crisis, it is therefore also wrong in my view to boost today's consumption at the expense of future generations by pursuing an expansionary monetary policy. This is not sustainable – neither from an economic nor from an ecological perspective.

III.

As far as the regulatory environment in the financial sector is concerned, we also need to be very careful to ensure that we do not back away from the principle of sustainability. More stringent regulation was of course a response to the financial crisis. This was an understandable political concern. However, we are now approaching the point where monetary policy and regulation have too much of an adverse impact on the very part of the financial sector that has provided stability in the past. Experience gained during the financial crisis has shown that credit institutions with high deposit volumes and a broadly-based and diversified financial sector will safeguard the liquidity and stability of a financial centre.

It is precisely these credit institutions that are most strongly affected by the current regulatory environment: The absolutely essential income from the traditionally stable interest-related business has decreased sharply. Furthermore, regulation designed for big banks places a disproportionate burden on small and medium-sized credit institutions. These are the reasons why we are observing increasing concentration trends in the financial sector and why banking fees are rising for a broad range of customers.

The European banking industry – and in particular the German banking industry, which in the past has relied heavily on deposit-taking and the traditional lending business – is facing very difficult years. However, if Savings Banks and co-operative banks, for instance, turned to increasingly high-risk types of investment for the savings deposited by the population at large, this would not be the solution. All the stakeholders who want a stable and sustainably acting financial sector in the future should therefore do something about it politically. One example of options for political action can be seen here in the United States. The full range of the Basel Framework is applied here only to the truly big banking groups operating across national borders – which are referred to as “megabanks”. However, for the vast majority of the institutions – which are referred to as “main street banks” – the rules are applied only in part, or not at all. Many of these banks still work with the Basel II standard.

This applies in particular to the nearly 6,000 community banks that are rooted in their respective regions. They are exempted, for instance, from the Basel capital buffers, the liquidity coverage ratios and the stress tests. Even institutions with total assets of up to USD 250 billion are exempted from specific requirements. The United States has therefore adopted an approach that differs significantly from that of the European Union with its “single rulebook”, where all the rules are always rolled out for all the insitutions. This shows that there are by all means policy areas where we in Europe can learn from the United States. The upcoming implementation of the “Finalisation of Basel III”, which was adopted by the Basel Committee on Banking Supervision in December 2017, will provide a good opportunity to make changes.

It was exactly here at this location two years ago that we warned that the “output floor” of 72.5 percent – which had been subject to a very long and very controversial debate – would mainly place a burden on Germany’s credit institutions. At the time, this was denied – even by representatives of the German regulator. However, the results of the European Banking Authority’s impact study, which was published in August, have shown that capital requirements of the banks concerned will increase by an average of 25 percent in the European Union. On the other hand, Germany’s credit institutions will be confronted with an increase of 40 percent. This difference is not due to the fact that the German banks’ models are worse than those in other EU countries. Instead, it is is due to the fact that Germany has a pronounced bank-based financing structure. The floor will therefore need to be implemented prudently in Germany – especially since the methodological requirements to be met by internal models have already been steadily increased in the past few years.

Almost without exception, Germany’s Savings Banks apply standard methods, so that they are not affected by the output floor. Nevertheless, their capital requirements will also increase by a total of 15 percent. This also applies to the “bread-and-butter business” such as real estate financing and the very normal overdraft facility of Savings Banks. The EBA has recently proposed that established European instruments such as the SME Supporting Factor should be abolished. Here, Europe must demonstrate backbone. The SME Factor is needed to ensure reasonable financing conditions for small and medium-sized enterprises. This is justified because SME loans involve better risk diversification.

Banking regulation must not be allowed to distort structures in banking markets. For this reason, intensive thought will need to be given once again within the framework of CRR III to relieving small and medium-sized institutions of administrative burdens. Any differentiation in regulation should be based on objective criteria. The categorisation of an institution as “systemically important” is an example of an objective criterion, while a total assets threshold of EUR 5 billion is not.

I hold the current and future EU Commissioner Dombrovskis to his word. He said that “the Basel III reforms need to be implemented in a way that will take into account European particularities and the diversity of Europe’s banking sector”.

Thank you very much for your attention.