Andreas Dombret: Europe's way forward

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, on the occasion of the change of the Head of the Bundesbank's New York Representative Office, New York, 2 July 2013

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Introduction

Governor Powell

Excellencies

Distinguished guests

Ladies and gentlemen

It is a pleasure for me to welcome you to the Bundesbank's reception in New York. Many thanks for taking the time to attend tonight.

Today is a special day for two reasons:

First, today is a good day for international financial stability. This morning the Fed Board approved a final rule implementing Basel III in the United States. This demonstrates the joint determination of the global regulatory community to deliver on the financial reform agenda. As I have said numerous times before, I have never doubted the Fed's commitment to Basel III.

Second, on a more local scale, we bid farewell to our Chief Representative Mr Joerg Stephan. He did an excellent job for which I wish to thank him on behalf of the Executive Board of the Bundesbank. And today, we inaugurate his successor Ms Claudia Stirböck. But before doing so, let me make a few remarks on the current situation on the European side of the Atlantic.

Forging a banking union

Europe is currently very busy. Busy forging a banking union. This banking union represents the largest integration step since the euro came into being in 1999. A single market for banking is the logical complement to the single currency. And a highly integrated banking system is positive news for the real economy. Thus, a banking union is an excellent project and it is actively supported by the Bundesbank.

Of course, we need to get it right. To be successful, any banking union needs strong institutions. This is why we need a thorough asset quality review as soon as possible with credible national backstops. Joint supervision of banks and resolution of insolvent institutions are both critical in this respect.

The planning for a joint banking supervision, for the so-called single supervisory mechanism – or SSM for short – is taking shape. It will be established under the roof of the European Central Bank and will operate in close cooperation with the national central banks of the euro area, including the Bundesbank. A clear separation within the ECB between the monetary policy function and the banking supervision function will be needed to ensure that the independence of monetary policy is properly protected and conflicts of interests are avoided. All of this is a major project and quality should not be compromised to the detriment of speed. I expect the SSM to start its operation in the second half of next year.

I am certain that the SSM will be a reliable partner for US regulators and supervisors. Therefore, in my view, the SSM deserves just as much trust as US supervisory authorities are granted by their transatlantic partners.

Planning for the second critical institution in a banking union, the common resolution framework, is less advanced. Ideally, the single resolution mechanism would be in place at the same time as the SSM. However, it looks as if this is unlikely to happen. Things are still in flux. For a start we will probably have a network of national arrangements with national resolution authorities and national resolution funds endowed by the banking industry. These national institutions will have the same design and will apply common rules.

But as we all know: banking is global. When it comes to supervision – and particularly resolution – of large international banks, it will not be enough to have a European framework. Global financial markets call for global regulations. Coordination and cooperation with other jurisdictions – especially the US –, therefore, is of the utmost importance. The goal must be to head towards a more international, not towards a more national approach. By implementing a global level playing field, we have to avoid regulatory arbitrage likely to result from different regimes.

We should keep in mind that the success of the G20 reform agenda for strengthening the resilience of the global financial system hinges upon the consistency of various initiatives. There are two different aspects. The first is cross-sectoral consistency. That is why it's so important to keep shadow banking on the agenda. The second issue is consistency between the rules in different jurisdictions. That is exactly why international cooperation is of such high importance when reforming the financial sector.

But let me get back to the European reform agenda. Even a European banking union based on sound institutions will not be able to meet expectations if it is not underpinned by prudent macroeconomic policies. Many European countries are currently making progress in cutting public expenditures, strengthening competitiveness, and improving their current account. They very much have to hold their course, since there is no alternative to those efforts. Structural reforms are essential to bring back growth.

Central banks: The "only game in town"?

Some expect central banks to be the ones that can bring back growth. And indeed, over the past few years, many central banks have taken on more and more tasks. Monetary policy nowadays seems to be urged to promote short-term financial stability or to facilitate public borrowing. Evidently, these developments have to be seen against the backdrop of the financial and sovereign debt crises of the past six years. For sure, there have been good reasons why central banks helped contain the crises through additional policy measures. Central banks can do, and are doing, a lot to prevent tail events and are buying time for politicians to undertake the reforms needed to tackle the root of the crisis. But I am concerned to see central banks being pushed into the role of an all-purpose weapon of sorts. This will not do anybody any favours.

In his Andrew Crockett Memorial Lecture held at the Bank of International Settlements a few days ago, Professor Raghuram Rajan from the University of Chicago's Booth School of Business described the situation quite well: "When the central banker offers himself as the only game in town, in an environment where politicians only have choices between the bad and the worse, he becomes the only game in town."

But we should not let politicians lean back. We are not the only game in town. And if we find ourselves alone on the field, we need to bring the other relevant players back and remind them of their responsibilities. Central banks cannot solve the crisis. And we should avoid overburdening monetary policy by trying.

Federal Reserve and Bundesbank

Turning to today's event, it is my pleasure to have Jerome Powell from the Federal Reserve Board of Governors with us. He needs no introduction. Jerome is going to deliver a speech on, among other things, international cooperation among central banks. How mutually beneficial and fruitful such a cooperation can be is shown, for instance, by the long-lasting collaboration between the Fed and the Bundesbank on so many different levels.

The Representative Office of the Deutsche Bundesbank in New York is a good example of this close relationship. And I am sure that Ms Stirböck will contribute to a further deepening of this relationship, just as Mr Stephan did over the last four years. Being a valued partner for discussion not only for our colleagues at the Federal Reserve Bank, but for all our contacts in New York, Mr Stephan – and now Ms Stirböck – help to ensure this important dialog between the Bundesbank and the financial centre New York. Ms Stirböck, I wish you all the best for your new position.

A speaker should exhaust his topic, not the audience. Therefore, two final things – first: thank you for your attention, and second: Jerome, the floor is yours.