Andreas Dombret: Remarks on current developments in Europe

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the Reception of the Bundesbank Representative Office, New York, 1 November 2012.

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Introduction

Dear Governor Dudley

Ladies and Gentlemen

It is a pleasure for me to be here with you today in New York and to welcome you all. Due to "Sandy" it was not easy for me to get over to New York, but I can imagine it was much more uncomfortable for all of you staying in the area over the last couple of days. And please let me express my deepest sympathies for the hardships New Yorkers are facing right now.

Bill Dudley will speak to you in a couple of minutes about cooperation between central banks. In the long tradition of this cooperation, trust and mutual understanding have been established among central banks worldwide. And Joerg Stephan, the Head of our Representative Office, has already mentioned the history of the cooperation between our two central banks. I am proud of this history, and we are committed to upholding it with the same degree of trust and mutual understanding in the future.

I will come back to this later. Before doing so I would like to make a few brief remarks on developments in Europe.

Remarks on current developments in Europe

From abroad, I must admit that developments in Europe are hard to follow and may well appear complicated. This can result in risks being overstated and the progress already made being neglected. As regards the European Monetary Union, significant steps in the right direction have been taken to overcome the crisis. In this context I will briefly comment on three topics tonight.

First, adjustments in the periphery countries are unavoidable, but they are under way. For example, wage moderation has gained some momentum, exports in some of the crisis countries have been rising, and current account as well as budget deficits are shrinking.

My favourite example is Ireland, which shows that trust can be regained if the agreed measures are adopted and implemented.

As concerns the specific case of Greece, we are way behind the programme goals due to the standstill in consolidation and basic structural reforms in this member state. Politicians and the EU are willing to assist Greece, but Greece must, first and foremost, help itself. Announcing and passing laws is not enough if the administration and the general public undermine them. It is now the task of the Troika to decide impartially whether Greece meets the conditions for further assistance.

I will be brief but positive about my second point: the need for changes in the framework. Last Sunday, ECB President Draghi stated that mutual consensus about the need to transfer some fiscal sovereignty to the European level is growing. So we can look forward to the outcome of his report on the future of the EU framework, which will be presented and discussed at the next EU Council meeting in mid-December.

Finally, the public debate in Europe recently focused on the topic of a "banking union", i.e. a single European supervisory mechanism. A banking union can very well be a major step towards breaking the link between banks and sovereigns – but by harnessing the disciplinary forces of the market, not by doing away with them.

In order to minimise the risk that bank rescues pose to government finances, creditors have to be the first in line when it comes to bearing banks' losses. Taxpayers' money can only be the last resort. With regard to spillovers from sovereigns to banks, sovereign-bonds need to be adequately risk-weighted to strengthen market signals and improve resilience in case of market turmoil. In addition, there should be caps on banks' maximum exposure to individual sovereign creditors, as is already the case with private creditors.

In summary, I wish to remind you that we need both short-term crisis management as well as long-term structural adjustments and reforms, as structural problems and "macroeconomic imbalances" did not appear overnight. Similarly, reforms will not achieve their desired effects all at once, but the time bought by short-term crisis management measures must be used wisely.

Remarks on German gold reserves

Please let me also comment on the bizarre public discussion we are currently facing in Germany on the safety of our gold deposits outside Germany – a discussion which is driven by irrational fears.

In this context, I wish to warn against voluntarily adding fuel to the general sense of uncertainty among the German public in times like these by conducting a "phantom debate" on the safety of our gold reserves.

The arguments raised are not really convincing. And I am glad that this is common sense for most Germans. Following the statement by the President of the Federal Court of Auditors in Germany, the discussion is now likely to come to an end – and it should do so before it causes harm to the excellent relationship between the Bundesbank and the US Fed.

Let's get back to facts and figures: I would like to remind you that our gold reserves are part of the German currency reserves. These were accumulated over time thanks, in part, to Germany's economic boom in the 1950s and 1960s. Germany's growing economic strength, especially its strong external position, resulted in rather large trade account surpluses, most of them acquired in US dollars. At that time, the International Monetary System, known as the Bretton Woods System, was dominated by the US currency. As long as this system was in force, which was up until 1971, the US Fed was obliged to exchange its currency for gold.

Any current account surplus thus resulted in an increase in Germany's gold reserves. This gold was stored in US vaults for obvious reasons. This was not only the case for the gold hold by the Bundesbank – it was, in fact, common practice. By the way: it was the only practical thing to do, since running a trade account deficit meant a decrease in gold stocks.

Thus, we are now looking back at sixty years not only of fruitful cooperation in many fields and international fora, but also of storing gold and trading via the New York Fed. As a matter of fact, it is sensible for us to do so in New York, as Frankfurt is not a gold trading venue.

Throughout these sixty years, we have never encountered the slightest problem, let alone had any doubts concerning the credibility of the Fed. And for this, Bill, I would like to thank you personally. I am also grateful for your uncomplicated cooperation in so many matters. The Bundesbank will remain the Fed's trusted partner in future, and we will continue to take advantage of the Fed's services by storing some of our currency reserves as gold in New York.

At the same time, you can be assured that we are confident that our gold is in safe hands with you. The days in which Hollywood Germans such as Gerd Fröbe, better known as *Goldfinge*r, and East German terrorist Simon Gruber, masterminded gold heists in US vaults are long gone. Nobody can seriously imagine scenarios like these, which are reminiscent of a James Bond movie with *Goldfinger* playing the role of a US Fed accounting clerk.

While gold is important, we have to combat a crisis of confidence in the euro area. This is the task we need to concentrate on. And we will do so.

Thank you for your attention.