Andreas Dombret: The marathon has only just begun – what will come after the stress test?

Opening statement by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the press conference following publication of the comprehensive assessment results, Frankfurt am Main, 26 October 2014.

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1. Introduction – the marathon has only just begun

Ladies and gentlemen

What we have just completed – a comprehensive balance sheet assessment and a tough stress test for the 130 largest banks in the euro area – can only be described as a tour de force. Dr Elke König has just presented the results of the exercise.

I will now look ahead to the future. I will use the same metaphor which Dr König has already used, and which appears entirely appropriate here in Frankfurt today.

While we are sitting here in this room, a couple of thousand people are still outside running the Frankfurt Marathon. A marathon is, without a doubt, an enormous challenge. And anyone who intends to run a marathon should first undergo a rigorous health check to find out whether he or she will even be physically up to the task.

The comprehensive assessment was an extremely thorough check-up, including a demanding "cardiac stress test". You now know the outcome: Germany's large banks are robust enough to withstand even severe stress.

This is certainly an encouraging result, as for the banks, the marathon is only just beginning. Competition is becoming tougher and more international; regulation is becoming stricter, and supervision more European; in addition, the economic setting is challenging – think "low-interest-rate environment" – and technology is continuously evolving.

Surviving and prevailing under these conditions is akin to a marathon. In addition, theoretically being able to withstand even severe stress will not automatically guarantee that the runner will finish the race. Even though he or she may be in very good shape at the starting line, the runner can still make many mistakes during the race. And, in future, there will be no more "sovereign paramedics" at the side of the road to help stumbling banks back on their feet.

2. Profitability – competition is tough and international

What the exercise conducted over the past 12 months has shown is that Germany's largest banks are able to withstand even severe stress. That will certainly help them to finish the marathon – but will not be enough to enable them to win it. That aim will require not only resilience but also the ability to outrun the competition – over a very long distance.

And competition in the banking industry is becoming increasingly tougher and more international. Not only competition for customers, but also competition for investors. Global regulation and European supervision are creating an international "level playing field" in which investors will put their funds where the returns are greatest.

German banks are therefore increasingly being forced to face international competition. And they are not performing all that well. In the current issue of its Global Financial Stability

Report, the IMF notes that return on equity in the euro area is low compared with that in other regions such as the United States or Asia.[1]

German banks are underperforming the rest of Europe, too: in 2013 their return on equity, at 1.26%, and return on assets, at 0.06%, were both below the European average. A recent study has concluded that currently only 6% of Germany's banks even earn enough to cover their cost of capital.[2]

A business model which is relatively dependent on interest income is the main culprit for these weak earnings. In a protracted phase of very low interest rates, this imposes a particularly severe strain. At the same time, commission income and net trading income are insufficient to provide adequate compensation.

Given these factors, German banks would be well advised to rethink their business models and to gear them towards the objective of sustainable profitability. However, the IMF sees Germany as being more towards the bottom of the international rankings with regard to overhauling business models.

There is yet another important aspect to profitability: if the circuit is clogged with runners, they will get in each other's way. Mergers could therefore be beneficial, particularly in the German banking industry – the focus here should, of course, always remain on achieving a sustainable business model.

To sum up: In the comprehensive assessment, German banks demonstrated that they are robust enough to withstand even severe stress but have to increase their profitability in order to cross the finishing line at the front of the pack.

3. Stability – much progress already made but a good deal left to do

However, investors are not only interested in banks' profitability but also in their stability – and the same is true of us supervisors, of course. And when measuring a bank's stability, capital is still the crucial factor. The stress test has shown that German banks are sufficiently capitalised even in a very adverse scenario – after all, the German banks that were examined were found to have a common equity tier 1 (CET1) capital ratio of 9.1% at the end of 2016 even in the adverse stress scenario.

And we must not forget that this calculation is based on figures from the end of 2013. Since then, German banks have raised a total of €14.4 billion in CET1 capital. If this increase is taken into account in the stress test results, this gives the German banks that were examined a CET1 capital ratio of 9.94% as at the end of 2016. And that figure does not even include the capital measures taken in 2014 which do not count as CET1 capital.

So the large German banks do not have any gaps in their risk-weighted capital ratios. Yet the markets and supervisors are also interested in the banks' unweighted capital ratios, of course. This metric, known as the "leverage ratio", has improved among German banks over the past few months. Of the 25 banks that were examined, a total of 20 already fulfil the minimum leverage ratio requirement of 3% which will apply from 2018 onwards under the Basel III regime. Even so, a cross-Europe comparison shows that German banks still have some catching-up to do.

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1 International Monetary Fund (2014), Global Financial Stability Report, October 2014. Washington, DC.

2 Sinn, W and Schmundt, W (2014), Deutschlands Banken 2014: Jäger des verlorenen Schatzes. Bain & Company, Munich and Zurich.

4. Conclusion – after the stress test is before the stress test

The markets look to the future, and banks need to do the same. None of the German banks should rest on their laurels because they have passed the stress test – to paraphrase a common German saying, after the stress test is before the stress test. That applies, above all, to those banks which only just made the grade. The markets and supervisors will be watching these banks particularly attentively in future.

All in all, I consider the comprehensive assessment a success. It has helped to lift the veil of uncertainty that has surrounded the European banking system since the crisis. It has been a credible process, and one which will help to restore confidence in the banking sector and reassure the markets.

But the comprehensive assessment is not the end of the road. The overall setting in which banks operate is changing, and they need to adapt – in Germany, Europe and around the world.

Yet politicians must also play their part. The crisis has shown how dangerous an unstable banking system can be for the real economy. The most important step to address this issue is, of course, to improve regulation and supervision. That has been achieved.

But especially in Europe it would be worthwhile to take measures to ease the real economy's access to alternative sources of funding. Some initial ideas on a European capital markets union are already being discussed; let's seize the opportunity to make these ideas a reality.

So I should actually correct what I said at the beginning of my remarks. It isn't just the banks which are now standing at the starting line of a marathon – so are politicians. And it is in everyone's interest to arrive safely and swiftly at the finishing line together.

Thank you very much.