Andreas Dombret: International cooperation is the answer – shaping the regulatory and supervisory architecture

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at a reception to welcome Ms Jenny Kilp, Bundesbank representative in South Africa and financial attaché at the German embassy in Pretoria, Pretoria, 29 August 2016.

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Ladies and gentlemen,

Thank you, Ambassador Streicher, for hosting this event here at the German Embassy in Pretoria. I am more than pleased that Governor Kganyago and Deputy Governor Mminele is here today. Thank you for your remarks, Governor.

Deutsche Bundesbank today introduces, with Ms Jenny Kilp, its first representative to South Africa – and the African continent as a whole. The step marks the beginning of a frequent exchange of information on financial and monetary policy issues, the aim being to allow each country to better understand the other's economic and financial interests and to facilitate cooperation in international fora.

By expanding its representative network, the Bundesbank pursues the goal of being present in the main industrialised and emerging countries and of following developments in almost all G20 countries, either directly or indirectly.

In this sense, South Africa has been something of a white spot on the Bundesbank's map of representative offices and representatives at German embassies, given the growing role played by the country and the African continent at large in international economic and financial policy. The Bundesbank recognises the economic importance and potential of the continent and of South Africa in particular by delegating Ms. Kilp to Pretoria.

Ladies and gentlemen, international cooperation is the answer to a world that has been growing together ever closer for decades. The world in which we live has become rather small. And in a small world, every policymaker in every country must be aware that his or her decisions can influence other countries as well.

This holds especially true for financial sector: Financial markets in particular have become integrated to such a degree that a small distortion at one end of the world can quickly spread and affect the entire system.

We as central bankers and banking supervisors have adapted to these developments by cooperatively harmonising regulation and supervisory practices across the globe, step by step. The evolvement of the Basel Accords since the mid-1970s is one of the most prominent outcomes of this process.

In 2007, the financial crisis shook up financial markets and challenged governments, central banks and supervisory authorities worldwide. And from the beginning, there was a broad consensus that it would be in everyone's best interest not only to preserve but indeed to strengthen cooperation with each other.

To do justice to the global dimension of the crisis as well as to the growing importance of emerging market economies, the task of formulating a strong and coordinated response to the crisis was elevated to the level of the G20. The Financial Stability Forum was superseded by the more influential Financial Stability Board, which also had a much broader membership. The Basel Committee broadened its membership as well, inviting countries from the G20 to join – among them South Africa. Meanwhile, central banks across the globe provided each other with swap lines to ensure a sufficient supply of liquidity.

Since then, we have worked closely together to better understand what went wrong before and during the crisis, and to reform the regulatory and supervisory architecture accordingly. This has brought about yet another wave of changes to the environment we operate in.

Certainly, one of the defining changes was the emergence and growing importance of macro-prudential policy. We have come to understand that monetary policy and micro-prudential supervision alone are not sufficient to ensure macroeconomic financial stability. The consequence is a whole new additional perspective on the financial system, and we are still in the process of understanding this perspective, determining how it interacts with our other tasks as supervisors and central bankers, and how to best utilise the new macro-prudential toolset at hand. Here, we can learn from the experience of emerging market economies, some of which had been using macro-prudential tools long before the crisis of 2007.

Meanwhile, the micro-prudential perspective remains as relevant as ever. Therefore, we have comprehensively revised and extended the Basel Accord over the last couple of years. The greater part of the work has been done, and Basel III is already being implemented by regulators across the globe. However, there is still some fine-tuning left to do, and in the Basel Committee I am working together with my colleague from the SARB to finalise Basel III by the end of this year.

Looking at all of these developments we can say that – less than a decade after the crisis erupted – central bankers and banking supervisors find themselves in a wholly new landscape few of us would have imagined just a couple of years ago.

And while, as I have said, we are still in the process of fine-tuning and gradually implementing the new framework we have built, we have to grapple with very specific challenges. In Europe, the markets have already put the new regulatory and supervisory architecture to the test.

But even though we have not wholly overcome all our problems in Europe yet, the situation has stabilised, and economic performance is picking up as well. In June, the Eurosystem macroeconomic staff projected that real GDP would grow by 1.6% this year and 1.7% in both 2017 and 2018. This would mean that aggregate economic capacity utilisation in the euro area as a whole may come close to normal levels by the end of the projection horizon. The recovery is mainly due to domestic demand, which is benefiting from low energy prices and the expansionary monetary policy.

Then, about two months ago, yet another challenge arose: The vote of the citizens of the United Kingdom to leave the European Union. Politically, this was a wake-up call for the EU. It's the first time that European integration has hit a major roadblock. The EU now has to determine how to react to the outcome of the referendum and win back the people that have become alienated from the process of European unification.

But let me return to the economic perspective. The immediate financial market reaction to the British vote was strong but remained orderly. Even though the decision obviously took market participants by surprise, both financial institutions and central banks were well prepared. Supervisors had asked banks to prepare for market volatility, and thanks to stricter capital and liquidity regulation Eurozone banks are in better shape today than at the start of the financial crisis. Central banks' immediate commitment to provide liquidity certainly helped to calm the markets.

The question that concerns us now is what impact the referendum will have on future economic performance in Europe. It is a question of great relevance to South Africa as well. The UK is the largest source country of foreign direct investment (FDI) in South Africa and the third-largest destination of outward FDI from South Africa. There are also sizable trade linkages, as the Eurozone together with the UK account for 19% of South Africa's goods exports.

With the Brexit vote, one of the downside risks to economic growth projections for the euro area and the UK has materialised. Early indicators and model estimations suggest that the impact will be largely focused on the UK itself, while the euro area will be affected only moderately.

But we shouldn't jump to conclusions at this stage. It's still too early to assess the overall impact on the economic outlook, as there are currently insufficient post-referendum data available. Furthermore, the impact depends considerably on the outcome of negotiations between the UK and the EU regarding future formal relations. In my opinion, neither party has anything to gain by re-erecting barriers. It is essential that we maintain the cooperative culture we have built up over so many years.

Ladies and gentlemen, international cooperation always starts at the personal level. This is where our representative in South Africa comes into play. Her task is to build networks, to share information and ideas, to explain the Bundesbank's positions and to facilitate cooperation.

Tonight, I would like to take the opportunity to welcome Ms Jenny Kilp. Ms Kilp graduated from Liebig University in Giessen with a Diploma in Economics, and after gathering several years of experience in the academic world, joined the Deutsche Bundesbank in 2004. Since then, Ms Kilp has been an expert in the Bundesbank's Directorate General Financial Stability, where she was in charge of policy issues regarding the International Monetary Fund (IMF). She has analysed the economic situation of a vast number of countries for the Bundesbank and gained a sound overview of the problematic issues facing various parts of the world, also in terms of the spill-over effects of industrial countries' policies on other parts of the world. Ms Kilp is already familiar with South Africa as she worked on a project here while she was a student. Now she is committed to moving with her family to this great country for at least two to three years. I value her openness, excellent specialist knowledge and ingenuity – all traits which will serve her well in her new post! Some of you have already met her, and I am sure that she will be a great first Bundesbank representative to South Africa.

I wish Ms Kilp all the best and a good start for her new appointment!

Thank you.