Andreas Dombret: Keeping in touch - news from Europe and from the European banking sector

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, in celebration of the change of office at the embassy in São Paulo, São Paulo, 27 October 2016.

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1. Introduction

Dear Mr Zeidler

Dear Mr Le Grazie

Ladies and gentlemen

First of all, I would like to thank the Consul General for hosting this event here at his impressive residence in São Paulo. Mr Zeidler, I must say, this is a stunning working environment – congratulations. For my part, this event is an auspicious occasion where I would like to officially thank Mr Marc Rennert as the departing Bundesbank representative and welcome Mr Eike Berner as his successor.

2. News from Europe and from the European banking sector

But I would also like to use this opportunity to sketch recent developments and, specifically, the state of Europe and European banks. A lot is happening in the Old World – and the sheer volume of news may sometimes even be overwhelming, putting into question the value of information. In fact, I don't blame anyone overseas for taking cover from the bombardment of information coming out of Europe.

European banks, in particular, have often made it on the front pages to non-European newspapers and journals. The repercussions of the financial crisis and clean-up operations are still putting a strain on all parties involved. EU banks have since strengthened their capital positions, which now stand at more than 15%. Prior to the crisis in early 2008, the same ratio was 6 percentage points lower. As the phase-in of the new regulatory environment continues, difficult times still lie ahead. Let me add: This isn't bad news. It is largely still part of the expected clean-up operations after the financial crisis.

As if this were not enough, banks also find themselves in a wholly different business environment than a few years ago, characterised by persistent low interest rates and the digital transformation of the entire banking sector. Earnings from interest-bearing assets still account for the lion's share of banks' earnings – for example, in Germany, where bank lending is particularly prominent, net interest income accounts for roughly 75% of overall operational income. Traditional money-making strategies in banking are called into question. The same is true in the face of partly disruptive digital innovations. As a result, nowadays almost every banking conference and every article on banking points to challenging earnings prospects and the need to fundamentally overhaul business models.

The thing that European banks have in common is that they are not having an easy time of it these days. Prominently, bank shares have sharply declined over the past year. Comparing the EURO STOXX 50 and EURO STOXX Banks indices, bank shares have dropped by over 30%, while other shares have roughly maintained their market value.

In addition, the European financial sector and the European Union were subjected to another, wholly different and quite unexpected challenge. I am speaking of the British referendum, where a majority of British citizens voted against remaining part of the European Union. The British government recently reemphasised its intention to initiate the exit process by the end of March 2017. Depending on the subsequent political negotiations, relations between European Union and United Kingdom may change quite drastically. For instance, financial institutions based in the United Kingdom might lose access to the single market. In any case, the referendum has brought the European integration project of an "ever closer union" to a standstill. Furthermore, Europe is faced with a steep rise in the number of refugees as well as growing nationalism in response to ubiquitous sources of insecurity. Now it would be ignorant to characterize headwind to the European project as a new phenomenon. But given today's high political uncertainties and disorientation, the European Union is prone to being conceived as the problem rather than the solution.

3. Whose responsibilities?

To sum up, Europe has recently proved to be a reliable source of headlines for those in the employ of the international media and the information industry. But for those who need to make sense of information – be they citizens or financial sector employees – the news overload and accompanying waves of changes sometimes serve to make this already complex world even more confusing. It comes as no surprise, then, that disorientation leads to quick accusations and overly hasty appeals to move in new political directions.

This is observable in the banking sector, where discontent is being increasingly put at the feet of public authorities. A recurrent move by banks has been to compare past profits one on one with their present outlook. If an unchanged business strategy leads to a poorer outcome or deterioration in prospects, it would make sense to attribute this to the transformed landscape of low interest rates and stronger regulation.

It goes without saying that causal interactions exist. For example, it is taken as read that monetary policy has an impact on the banking environment.

However, first of all, banking happens in a very complex environment in which no simple causalities apply. In addition, banks are often faced with rather idiosyncratic situations and challenges.

More importantly, causalities and responsibilities are not one and the same. While euro-area monetary policy causes alterations in many parts of the economy, its mandate also prescribes clear responsibilities – price stability is an overarching goal.

Rather, the transformed landscape urges banks to concentrate on their own responsibilities.

Banks still play an important role in the market economy. Nevertheless, they are also part of it.

Allusions to the past will not lead us anywhere, simply because there is no customary law that provides specific banking services with revenue guarantees. If allusions to the past rely on some shaky profitability indicator, the case is even stronger. As all of you know, the return on equity, one of the key indicators of profitability, can rise when returns increase or equity decreases. Before the financial crisis, the weakness of banks was due, in part, to their low capital ratios. High profitability was misleading in quite a few cases. I am convinced that institutions – despite their admonitions – are now comforted by the fact that they have built up their capital, which directly translates into higher risk-bearing capacity. Profitability is very welcome, but it should no longer be accompanied by low risk-bearing capacity.

Instead, any long-term strategy for profitable banking must be built on its value added for customers, business partners and society. As Europe's low-interest environment persists and digital transformation continues, the economic value of banking services is co-evolving. Adaptation is taking place right now. German banks already increased their share of commission and fee income last year. Banks will have to lower their high costs and adapt to the digital age in the years to come.

Which of the traditional business models and organisational set-ups still fit into today's financial landscape? Is the revenue pie still big enough for everyone in the banking sector to be guaranteed a slice in the long run? These questions will continue to be asked of the banking sector over the coming years. But forecasts remain presumptuous. While low profitability has many root causes, there are just as many potential ways to provide relief. Clearly though, banking has become a tough business.

To be fair, public authorities cannot dodge their own responsibilities, but the scope of these is different. Interestingly though, pointing fingers and shifting responsibility are daily fare in a similar fashion. This is particularly true with respect to the relationship between Europe and its national constituents. The British referendum may be regarded as a current example. But there are other instances. In banking supervision, a common regulatory framework in the euro area that has been operational for almost two years now, is directed at dampening national interests. Keeping institutions credible and effective is an ongoing task. And finding and deploying governance mechanisms that are congruent with our view of European cooperation will continue to be at the forefront of our public duties in the future.

4. Role of Bundesbank representatives

Ladies and gentlemen, in a world of broadband internet and market movements synchronising within seconds across the globe, one might question why there is a need to work together like we do here in São Paulo. But, as I have outlined for Europe and the European sector, filtering and interpreting our complicated world, remains a challenge. This remains especially true with respect to the globalised financial sector. High-quality information and close cooperation have not lost their value – in fact, I deem them more important than ever. The Bundesbank's network of international representatives is in place to comprehensively observe economic developments and the expected evolution of financial markets from within key countries and regions.

Our representation here in São Paolo is no exception. Economic ties are on the rise – just take the increase in direct investment from the euro area to Brazil from 1.6% in 2008 to almost 4% in the first quarter of this year. Exchanging expertise and nurturing fruitful personal networks with central banks, financial authorities, supervisory authorities, banks and others is more important than ever.

Dr Marc Rennert has represented the Bundesbank in South America since December 2012. During this time, he has played a vital role in substantially stepping up the exchange of information between the Bundesbank and the region's central banks foremost in Brazil, Colombia, Peru, Chile, Argentina, Uruguay and Paraguay.

During his time here in São Paulo, Dr Rennert has been committed in particular to deepening ties with the Banco Central do Brasil. One of his milestone achievements was undoubtedly the preparation of a memorandum of understanding formalising close cooperation between the Banco Central do Brasil and the Bundesbank with respect to knowledge transfer and education and training opportunities for staff members. More than 12 projects have already been carried out since the MoU was signed in 2015, and the list of projects in the pipeline is very long.

Last but not least, Dr Rennert's profound expertise on macroeconomic and political developments in the region has helped shape opinion at the highest echelons of the Bundesbank.

In view of Dr Rennert's excellent achievements here in São Paulo, I am delighted that he will be applying his skills and expertise to a strategic position in the Directorate General Financial Stability from January onwards.

I am very pleased to present Dr Eike Berner as the new Bundesbank representative at our office here in São Paolo, starting on 1 December. I am certain that Mr Berner is a very suitable successor for this position. During his time at the University of Kiel, he acquired a thorough understanding of international trade by pursuing academic research and lecturing on the economic analysis of trade. At the Bundesbank, he joined the ranks of the International and Euro-Area Macroeconomic Analysis Division of the Directorate General Economics. Since his arrival, he has made significant contributions to our economic analyses of euro-area topics and countries. Having worked in diverse macroeconomic and political fields, he has become quite the versatile economic expert. Thanks to his expertise, openness and dedication, he has already paved the way to success here in São Paolo.

Thank you.