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We mourn the death of the following members of our staff

Wolfgang Andersen	18 January 2013
Silvia Hildinger	15 April 2013
Bernd Kubernus	28 April 2013
Bernd Eugen Hanzely	23 May 2013
Wolfgang Peter Aubart	19 June 2013
Anja Schönberg	8 July 2013
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René Dubitzky	1 September 2013
Frank Ehnert	26 September 2013
Bernd Kurt Kuse	5 October 2013
Stefanie Deininger	15 October 2013
Werner Schätz	24 October 2013
Michaela Knuth	12 November 2013
Detlev Hick	3 December 2013

We also remember the retired staff members
of the bank who died in 2013.

We will honour their memory.

DEUTSCHE BUNDESBANK

Deutsche Bundesbank
Wilhelm-Epstein-Strasse 14
60431 Frankfurt am Main
Germany

Postal address
Postfach 10 06 02
60006 Frankfurt am Main
Germany

Tel +49 69 9566 0
Fax +49 69 9566 3077

http://www.bundesbank.de

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Abbreviations and symbols

p Provisional
r Revised
e Estimated
pe Partly estimated
… Figure available at a later date
. Figure unknown, not to be published or not meaningful
0 Less than 0.5 but more than nil
– Nil

Discrepancies in the totals are due to rounding.

Round-up of the Bundesbank's key and current topics

Round-up of the Bundesbank's key and current topics

Persistent efforts needed to overcome the sovereign debt crisis

The financial and sovereign debt crisis continued to have a defining influence on economic developments in 2013, although the situation on the financial markets generally improved. The narrowing spreads on government bonds issued by the countries worst affected by the crisis is a sign that some measure of confidence has been restored. This is due, in part, to the discernible progress that these countries have made in the necessary process of adjusting their economies. In view of the ongoing challenges, however, it would clearly be premature to declare that the sovereign debt crisis is over. Substantial and persistent efforts will be needed at both the national and the European level to achieve a lasting solution to the crisis and its underlying structural causes.

In 2013, the Bundesbank and its staff therefore continued to resolutely work towards ensuring that the crisis resolution measures taken in the euro area are compatible with stability policy principles. Preserving and safeguarding the euro area as a union of stability will remain the prime criterion for the Bundesbank's work in the future.

It is undisputed that central banks have to play their part in times of crisis. The Eurosystem has therefore taken a whole raft of measures over the past few years to help prevent the crisis from escalating. Yet central banks can, at best, merely alleviate the symptoms of the crisis; they cannot rectify its root causes. It remains the case that politicians hold the key to a lasting solution to the crisis.

Ultimately, the crisis will only be solved if and when the euro-area member states put their public finances and banking systems in order, the countries worst affected by the crisis implement the structural reforms needed to make them more competitive and, finally, the regulatory framework of European monetary union (EMU) is reinforced and coherently structured. Making substantial progress in these three areas is the only way to lastingly restore the necessary confidence in the stability and functional viability of EMU. Yet none of the parties involved should be under any illusions: there are no quick fixes to the crisis. The process of overcoming the crisis will be more of a marathon than a sprint.

Crisis measures must not jeopardise independence

When the single currency was launched more than 15 years ago, the Bundesbank went from having sole responsibility for the D-Mark to having a shared responsibility for the euro and its stability. It is not despite but because of our shared responsibility for the single currency that the Bundesbank contributes its stability-oriented viewpoint to the discussions within the Eurosystem and to the public debate. A frank and open debate is needed to ensure that policy decisions meet with broad public acceptance, especially in cases where crisis measures sometimes involve controversial decisions that threaten to breach the bounds of the monetary policy mandate. It is crucial to ensure that none of these decisions gives cause to doubt that Europe's single monetary policy is still unambiguously focused on its primary objective of ensuring price stability in the euro area. Even non-standard crisis measures must not push monetary policy beyond its bounds by, for example, straying into fiscal policy territory, from where it might then find it very hard

to return to the straight and narrow path. This would threaten the credibility and, ultimately, the independence of monetary policy.

The central bank's independence in monetary policy matters is clearly not a self-evident feature of a sovereign democracy and therefore warrants explicit justification. The rationale for central bank independence is that both academic theory and practical experience have shown it to be an important prerequisite for a stable currency. And a stable currency protects society's weaker members, in particular, from suffering the harm caused by inflation, as they are usually unable to offset the associated loss of purchasing power. Yet independence does not give a central bank *carte blanche* to do as it pleases; it obligates the central bank to interpret its monetary policy mandate narrowly. A central bank's independence and its strict adherence to its monetary policy mandate are therefore two sides of the same coin – not least in the euro area, where responsibility for fiscal and economic policy decisions still lies with the sovereign member states.

Economic situation improved, outlook brighter

Over the course of 2013, the world economy picked up speed again. In the industrial countries, this was driven in part by a particularly expansionary monetary policy. At the same time, the balance of contributions to global growth tipped to a certain extent towards the industrial countries and away from the emerging economies. Although the aggregate economic output of the emerging economies will probably continue to grow at above-average rates, the need for structural reform is likely to somewhat reduce the pace of expansion in this group of countries compared with previous years. All in all, global economic growth should increase distinctly over the medium term, while remaining below the high pace seen prior to the financial and economic crisis.

In the euro area, too, there are increasing signs that the economic recovery which began in spring 2013 will continue in 2014 and 2015, although various countries still face lingering burdens caused by the debt and adjustment crisis. Capacity utilisation remains low in many cases, and high leverage in the corporate sector is weighing on domestic demand in some euro-area member states. As a result, the recovery in industrial investment is retarded in these countries. In many cases, private consumption demand is also being dampened considerably by high unemployment and high household debt. Given that economic activity in the euro area is subdued and price pressures are expected to remain low for the foreseeable future, an expansionary monetary policy stance is appropriate for the euro area.

It is, however, encouraging that most of the countries hit hardest by the crisis are now making progress in the necessary task of adjusting their cost structures. In addition, enterprises based in these countries are increasingly tapping new export markets. This should allow these economies to benefit to a greater extent from global growth. Higher export growth should then also stimulate their domestic economies as time progresses.

The German economy likewise picked up speed in the course of last year, and thus recovered from the brief dip seen in the latter part of 2012 and early part of 2013. Overall, it is thus probably back within the normal range of capacity utilisation. While external factors were the driving force behind the upturn in the German economy during the rebound that followed the financial and economic crisis, growth in Germany has been sustained for some time now by domestic activity. The dynamics of economic momentum have thus changed thanks to the robust state of the German economy. This is reflected, notably, in a comparatively low unemployment rate, ongoing employment growth and a distinct rise in earnings; employees' gross wages and salaries rose in 2013 by 2.3% in nominal terms and by 0.8% in real

terms. Combined with the low level of interest rates, these factors are fuelling housing construction, in particular, while foreign trade has not provided any positive impetus of late. Even so, Germany's current account surplus remains high. Not least in view of the economic policy debate that has arisen on this issue, one of the two in-depth articles in this *Annual Report* focuses on Germany's current account balance.

All in all, having accelerated over the course of last year, the pace of growth in the German economy is likely to increase again in 2014 and 2015. It can therefore be assumed that employment will also continue to rise, with these additional jobs mainly being taken by new immigrants attracted by the labour market situation in Germany.

General government posted a balanced budget in 2013, and thus a very similar outcome to 2012. The general government debt ratio remains high, but was reduced markedly last year. When considering Germany's public finances, it is important to remember that political projects and sound public finances are not contradictory aims; they must complement one another. It would be advisable for government to seek to achieve structural budget surpluses immediately, especially in view of the favourable underlying conditions, the foreseeable budgetary strains due to demographic change and the deficit limits attached to the debt brake.

However, both the external setting and the domestic economy continue to harbour risks which could dim the fundamentally bright economic outlook for Germany. Both the European and the global economy remain very vulnerable to shocks; in the euro area, this is due in particular to the heavy debt burden and the structural problems in the countries worst affected by the crisis.

Yet there is no room for complacency in Germany, either. We need to act now to tackle the challenges of demographic change and globalisation and successfully manage the policy switch to non-nuclear energy generation. In the longer run, a number of the measures announced or already introduced by the new German government could hamper the structural efficiency of the country's labour and product markets. The introduction of a statutory minimum wage, for example, is a substantial intervention in the existing system of wage negotiation; depending on how it is framed, it may be a source of medium-term risks for the employment situation in Germany. In addition, pension policy has aimed up to now to reduce the burden on future generations by limiting the rise in the pension contribution rate, to contain non-wage labour costs and to restrict the shrinkage in the labour force due to demographic change by refraining from measures which encourage early retirement. This general approach is still fully appropriate and should not be abandoned in favour of doling out short and medium-term favours to specific groups of pension recipients.

Banking union under construction

As noted earlier, work also has to be done on the regulatory framework of European monetary union in order to lastingly overcome the crisis. In this connection, the banking union that is currently under construction indisputably constitutes the greatest change in the European financial architecture since the introduction of the single currency. The banking union comprises, as its first pillar, a European Single Supervisory Mechanism (SSM), which is located at the European Central Bank (ECB) and which will work according to uniform rules and high standards. The establishment of the SSM is a response to the emergence of various shortcomings in national banking supervision in a number of member states during the financial crisis, which ultimately became a burden for the euro area as a whole. The move to joint and uniform banking supervision in Europe should thus play a key part in improving financial stability in EMU.

The SSM will be augmented by the establishment of a European Single Resolution Mechanism (SRM) as the second pillar of the banking union. The guiding precept behind this mechanism is the principle of liability – in other words, the basic rule that, in a market economy, enterprises must also be allowed to fail and, in the upshot, exit the market. As a logical consequence, ailing banks, too, may face restructuring or even resolution. A crucial condition for this, however, is that – in contrast to the situation hitherto – this is done without endangering financial stability and, wherever possible, without using taxpayers' money. In the event of recovery and resolution proceedings, it is therefore envisaged that banks' owners and creditors will bear an appropriate share of the losses. It is only after this that a common resolution fund financed by the banking sector will step in. Public funds are to be used only as a last resort, and then only if financial stability would otherwise be jeopardised.

The legal basis for the ECB's assumption of prudential supervision tasks in the form of the SSM as of 4 November 2014 was created by the EU Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, which came into force on 3 November 2013. The Bundesbank, too, is providing active conceptual and staffing support in order to make rapid headway in performing the extensive and demanding groundwork on the first pillar of the banking union by November.

Before the launch of the SSM, among other things, a comprehensive balance sheet assessment is being conducted on the 128 banks (including 24 German banking groups) currently classified as "significant". In future, such institutions will be supervised directly by the ECB. This assessment is being performed by the ECB in close cooperation with the national authorities and the European Banking Authority (EBA). If it emerges from this comprehensive assessment that individual institutions need recapitalising, this is to be covered, at least to a certain extent and depending on the type of capital shortfall, before the start of the SSM. Primarily, private funds are to be used for this purpose. If this is not possible and the bank possesses a sustainable business model, it may be recapitalised by the government of its home country. Direct recapitalisation of banks by the other member states is not appropriate, however. This is in keeping with the logic that the elimination of balance sheet legacy burdens is a matter of liability for past failings in national banking supervision, primary responsibility for which lay with the individual member states and not with the other countries of the EU or at the Community level. In order to perform its banking supervisory function, the ECB will have to increase its staff numbers considerably, which, owing to the expected transfer of employees to the ECB, will also have an impact on the Bundesbank's human resources situation.

At the end of 2013, the Economic and Financial Affairs Council (Ecofin) additionally took the fundamental policy decision on the second pillar of the banking union, ie the creation of a Single Resolution Mechanism (SRM). To enable the SRM to enter into force at a point in time close to the launch of the SSM, it is now necessary to bring the negotiations with the European Commission and the European Parliament to a swift conclusion.

The fact that the SSM has been placed under the aegis of the ECB must not be allowed to lead to any conflicts of interest with the single monetary policy. As before, the latter's primary objective must be to maintain price stability. With regard to potential conflicts of interest, the current arrangement, which assigns ultimate responsibility for banking supervisory decisions to the Governing Council of the ECB, is not satisfactory. For the banking union to have a sustainable structure, it is vital that its two pillars (SSM and SRM) are placed on a sound legal foundation. Ultimately, this is likely to require an amendment of EU primary law which also takes account of potential conflicts of interest with respect to the SSM. Further details on the

project of banking union are the subject of the other article in this *Annual Report*.

Capital backing for loans to governments

The question of whether a European bank can be resolved in future without jeopardising financial stability and without a significant contribution by taxpayers cannot be answered by the establishment of a single supervisory mechanism alone, however. As the crisis in the euro area has shown, the sometimes very close links between banks and member states have proved dangerous in various cases. In the crisis, distress in the banking system of some countries led to their governments, too, facing considerable financial strains on account of their necessary rescue commitments. However, this hazardous "doom loop" between banks and their sovereigns also means that sovereigns, in turn, can have a negative impact on banks. Banks holding large portfolios of bonds issued by governments at risk of insolvency can be exposed to a considerable strain or even be dragged down along with them. The potentially dangerous doom loop between banks and sovereigns has to be broken so as to contain this source of risk in the future.

Along with the establishment of the banking union outlined above, amendments to banking regulation are therefore also needed. In the medium term, it should be the case that bank loans to euro-area countries are treated in just the same way as loans to private borrowers. This means that bank claims on governments – in contrast to the present procedure – should be backed with a level of capital that is commensurate with the degree of sovereign risk. Similarly, upper limits for loans to the public sector should be introduced in the banking books. The current regulatory assumption that loans to any euro-area government are a risk-free investment was, after all, clearly disproved by the experience of the crisis.

Transposition of Basel III into national law

One of the key lessons learned from the financial crisis is that banks have to become more resilient. To this end, it was decided at international level as long ago as 2011 that banks will have to hold more and better-quality capital. Last year, significant progress was made regarding the EU-wide implementation of this regulatory framework for banks' capital and liquidity requirements, known as Basel III. In spring 2013, following protracted negotiations, the European Parliament and Council concluded an agreement on this. The extensive legislative package consists of a regulation and a directive – the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV) – and has been applicable since 1 January 2014. While the CRR can be applied directly, CRD IV first had to be transposed into national law. This was done in Germany by amending the Banking Act (*Kreditwesengesetz*) and relevant banking regulations, such as the Solvency Regulation (*Solvabilitätsverordnung*) and the Regulation governing large exposures and loans of €1.5 million or more (*Grosskredit- und Millionenkreditverordnung*). Besides implementing the CRD IV requirements, which included new provisions on capital buffers, the amendments to German banking rules also exercised the national options envisaged in the CRR and specified the discretionary scope in national law.

Financial Stability Committee became operational in 2013

While the banking union that is currently under construction is likely to have a positive impact on stability in the euro area, it does not obviate the need for a detailed analysis of the risks to financial stability at the level of the member states. On the contrary, one of the key insights gained from the crisis is that misguided national policies can engender destabilising macroe-

conomic imbalances which cannot be eliminated through the single monetary policy.

In terms of macroprudential oversight in Germany, 2013 brought considerable progress as the Financial Stability Committee (FSC) became operational early in the year. The Bundesbank is represented in this new macroprudential institution alongside the Federal Ministry of Finance, the Federal Financial Supervisory Authority (BaFin) and the Financial Market Stabilisation Agency (FMSA), and has assumed a key role in it. The Bundesbank is responsible for analysing developments that have a key bearing on financial stability and for identifying risks to it. If necessary, the Bundesbank can also make proposals to the FSC concerning countermeasures to combat perceived risks to financial stability. In mid-2014, the FSC will present its first report to the Bundestag (lower house of the German parliament) on the state of and developments in financial stability as well as on its own work.

Stability situation in Germany shaped by low-interest-rate environment

Macroprudential analysis focuses not on individual market participants but rather on the financial system as a whole, its interconnectedness and its resilience. Viewed from this panoramic perspective, the stability situation in Germany in 2013 was shaped primarily by the prevailing low-interest-rate environment. Life insurers, in particular, are seeing their earnings coming under intense pressure on account of the disparity between their current low levels of investment income and the high rates of remuneration guaranteed under their outstanding policies.

Depressed profit levels persisted in the German banking sector, too. Major German banks' aggregate earnings in the first nine months of 2013 were down on the prior-year level, even though their earnings were buoyed by low risk provisioning in a multi-year comparison and by an upswing in the volatile net trading result. The major German banks did, however, reinforce their capital base, thereby improving their resilience. Even so, a core future task for the FSC, and thus for the Bundesbank as well, will be to analyse the repercussions of an environment marked by persistently low returns and its impact on financial markets and market participants.

Residential property prices in German towns and cities rose by just under 6½% in 2013, thereby matching the 2012 increase. Prices grew fastest in attractive big cities. However, the relevant valuation metrics for Germany's residential property market as a whole offer no indication as yet that the market is significantly overvalued. Growth in household mortgages likewise remains moderate, which does not support the thesis of credit-driven housing price inflation.

The longer the low-interest-rate environment persists, the more challenging the eventual exit from the non-standard monetary policy measures becomes. The US Federal Reserve has been taking its first steps in this direction since late 2013, trimming its expansionary monetary policy stance by gradually tapering its monthly purchases of US Treasuries and mortgage-backed securities. Financial market participants have taken this in their stride so far. But if US capital market rates were to suddenly spike later on, interest rates in other regions might well follow suit. Another likely outcome is that the exodus of capital from emerging market economies, signs of which have already been observed of late, would accelerate further, thereby intensifying the pressure on local policymakers to take action.

Robust financial market infrastructure important for financial stability

The infrastructure facilitating payment operations and securities settlement likewise con-

tributes to the robustness of a financial system. That is why the Bundesbank is also involved *inter alia* in overseeing relevant financial market infrastructures. This oversight is based on the Principles for financial market infrastructures (PFMI), which were adopted in April 2012 by the Basel Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (lOSCO) and which the Bundesbank helped to draw up. Compliance with the PFMI, which are designed to enhance the security of cashless payments and securities settlement, has been mandatory since 1 April 2013.

The Eurosystem's TARGET2-Securities (T2S) project likewise made good progress last year. The T2S platform, which the Bundesbank co-developed and co-operates, is intended to create a single European platform for securities settlement, which represents a critical step towards improving the integration, efficiency and stability of financial markets across Europe. The ECB Governing Council agreed in March 2013 on the composition of the participating groups that are due to switch to T2S in the forthcoming migration waves. The 24 central securities depositories now participating in the scheme will be migrating to the single settlement platform in four waves starting in June 2015. Germany's central securities depository, Clearstream Banking Frankfurt, will be connecting together with its customers in the third wave, meaning that it will switch to settling securities on the T2S platform as from September 2016.

SEPA in the public eye

But the cashless payments topic that was most hotly debated in recent weeks and months was without doubt the changeover of national credit transfers and direct debits to the Europe-wide SEPA standards. The idea behind SEPA (single euro payments area) is to make the settlement of cross-border euro transactions just as cheap, quick and secure as it is for national payments. SEPA will make today's costly duplication of national and European cashless payment procedures for euro-denominated credit transfers and direct debits a thing of the past, benefiting the general public and enterprises in equal measure, even if many people regard the changeover as a burden.

The Bundesbank has actively campaigned to make the public more aware of the changeover to SEPA, the statutory deadline for which was originally scheduled for 1 February 2014. In mid-January 2014 the European Commission proposed to introduce an additional, six-month transition period to 1 August 2014 for SEPA migration. The Bundesbank's SEPA outreach campaign seeks to raise awareness among the general public of the international bank account number (IBAN), which is a necessary component of SEPA payment standards. In a similar vein, the Bundesbank has repeatedly reminded enterprises and associations that they, too, needed to migrate to SEPA, enlisting the support of third parties such as chambers of industry and commerce and industry associations to support its outreach activities.

Bundesbank keeps key role in cash management cycle

Besides an efficient and reliable infrastructure for cashless payments, cash transactions, too, retain a key role in the payment system. To fulfil its mandate of safeguarding the supply of cash to the German economy, the Bundesbank maintains a nationwide branch network and plays a key role in the cash management cycle.

Public confidence in the security of cash payments can only be sustained if banknotes and coins satisfy strict criteria, including a high degree of protection against counterfeiting. The number of counterfeit banknotes in Germany diminished by 6% year on year in 2013. This means that the incidence of counterfeits in the German cash cycle is exceptionally low by international standards. This is attributable in part to the Bundesbank's targeted and inten-

sive awareness courses for cashiers in the retail and banking industries. The launch of the second series of euro banknotes, which began with the new €5 note in May last year, will help to further enhance the counterfeit protection of euro banknotes.

First gold repatriated under new gold storage strategy

Few central bank topics attract as much media attention in Germany as the Bundesbank's gold reserves. As at 31 December 2013, the Bundesbank's gold holdings stood at 3,387 tonnes (108.9 million fine ounces). In January 2013, the Bundesbank unveiled its new gold storage strategy, which envisages that half of Germany's gold reserves will be stored in Germany from 2020. This will entail a phased relocation to Frankfurt am Main of 300 tonnes of gold from New York and 374 tonnes from Paris. Over the medium term, the Bundesbank will concentrate its reserves in just three locations (rather than four at present) and switch its main storage location from New York to Frankfurt am Main. Last year the Bank repatriated a total of 37 tonnes of gold to Frankfurt am Main – 32 tonnes from Paris and 5 tonnes from New York. The Bank's meticulous preparations ahead of the shipments ensured that the entire transport chain – from the removal of the gold from the foreign vaults through to their storage in Frankfurt am Main – satisfied the highest security standards at all times. Significantly larger volumes of gold will be repatriated to Frankfurt am Main in 2014 and the coming years than was transported in the course of 2013.

Output of statistics expanding

Central banks have always been reliant on comprehensive and robust statistical datasets as a basis for their work. There is a growing need for more deeply disaggregated information and flexible evaluation and utilisation capabilities, particularly in the fields of monetary policy and macroprudential analysis. To satisfy this broader set of requirements, statistics departments at national central banks and the ECB have pressed ahead with the collection of statistics and the development of their database systems. A key milestone was reached in summer 2013, for instance, when the first expansion phase of the securities holdings statistics database (SHSDB), a joint Bundesbank/ECB project, went live. This database captures data on itemised securities holdings in the financial and non-financial sectors across all countries of the European System of Central Banks (ESCB). In the next phase (to be implemented by summer 2015), the SHSDB will also record the Eurosystem central banks' own holdings as well as those of major banking groups. This will decisively enhance central banks' knowledge of major securities holders and their behaviour in different market settings.

Growing importance of economic education

A stability-oriented monetary policy needs to be underpinned by understanding and support among the population of Europe as a whole. The Bundesbank is therefore looking to increase public awareness of what it means to have a stable currency and hence a sound monetary policy in Europe. The Bundesbank's wide array of public education programmes is primarily geared to schools. It offers both training courses for teachers and seminars and information events for pupils. The Bundesbank also extended its range of online educational services during the year under review.

Besides providing economic education services for the general public, the Bundesbank has always placed a high value on training its employees. Banking supervision has long been a key topic in the Bundesbank's in-house training courses. During the year under review, the Bank also teamed up with the ECB and other central banks as well as Eurosystem supervisory

authorities to develop a comprehensive training programme for the banking supervisors who will operate in Europe's forthcoming SSM environment, bearing in mind that the quality of harmonised banking supervision in Europe will hinge on the professional knowledge and expertise of the banking supervisors themselves.

Progress towards gender equality

The Bundesbank's Executive Board is particularly keen to improve gender equality among the Bank's staff. Making the best possible use of the potential and creativity of well trained and highly motivated female members of staff is vital, not least in view of the demographic challenges that lie in store for the Bundesbank as an employer. That is why the Bundesbank has already initiated a raft of measures aimed at promoting equal treatment of male and female employees over the past years.

These measures have lifted the proportion of women holding managerial positions at the Bank from 12.8% to 22.3% during the last ten years. The Bundesbank intends to rigorously continue this progress in the future. This was one reason why the Executive Board and the Bank's two senior management tiers highlighted the issue of gender equality at a conference last autumn. The outcome of their deliberations will be factored into a Gender Equality Action Plan that is to be unveiled in the first quarter of 2014. An additional benefit of further reconciling family and working life is that it enhances the Bundesbank's attractiveness as an employer not just among women but for all employees with family commitments.

I would like to take this opportunity to thank all members of staff, both on behalf of the Executive Board and also personally, for their input in 2013. Without their intense dedication and motivation, the Bundesbank would not have been able to cope as it did with the challenges it faced last year. My thanks also go to the staff representation committees for their invariably constructive cooperation.

Frankfurt am Main, March 2014

Dr Jens Weidmann
President of the Deutsche Bundesbank

Progress towards a European banking union

The banking union, which was conceived in the wake of the financial and economic crisis, has set in motion a fundamental reform of the European financial architecture. The banking union comprises a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM) and a harmonised system of deposit guarantee schemes. The objective of the banking union is to strengthen financial stability in the euro area, to take better account of cross-border financial activities and to loosen the doom loop between financial sector debt and sovereign debt, which exacerbated the crisis in the past. The banking union can help make the European banking sector more stable. This effect could be amplified if it were flanked by further European integration in the fields of economic policy and fiscal policy, too.

Significant progress has been made since the first political talks were held in mid-2012. The legal basis for the SSM under the aegis of the European Central Bank (ECB) entered into force in November 2013. This marked the beginning of a 12-month transition period, after which the ECB will assume responsibility for banking supervision. Preparations are in full swing, with the structure and modus operandi of the future SSM clearly taking shape. The ECB will directly supervise significant banks in the participating countries with support from the national competent authorities[1] (NCAs) in the day-to-day duties of off-site supervision and on-site inspection. The ongoing supervisory tasks will be carried out by joint supervisory teams (JSTs) comprising supervisors from the ECB and the NCAs. The supervision of less significant banks will, for the most part, remain the responsibility of the NCAs, which will carry out their tasks in line with the regulations and directives issued by the ECB. Consequently, banking supervision will become increasingly harmonised within the jurisdictional reach of the SSM. Nonetheless, there are still several challenges to overcome before the SSM is launched in November 2014. A comprehensive assessment of significant banks' balance sheets will be carried out with the aim of enhancing the transparency of institutions' risk situation as well as strengthening confidence. At the same time, the supervisory teams will have to be prepared for their supervision tasks and the newly developed supervisory processes subjected to practical testing.

The SRM is also starting to take shape. The legislative process to introduce the European Directive on the recovery and resolution of credit institutions and investment firms (also known as the Bank Recovery and Resolution Directive – BRRD) will soon be completed. This will provide the necessary legal instruments to deal with ailing banks. Furthermore, in December 2013 the Council of the European Union agreed on key points of a mechanism designed to elevate the decision-making process for the resolution of banks within the jurisdictional reach of the SSM to the European level. The Council is currently in the middle of negotiations with the European Parliament on this mechanism, which will also contain a European resolution fund. There are currently no plans for setting up a single deposit guarantee scheme. Nonetheless, in December 2013 a far-reaching consensus was reached on further harmonising national deposit guarantee schemes.

1 These include national central banks which share responsibility for banking supervision with a supervisory authority.

Conceptual background of the banking union

Lessons from the financial crisis kick-started work on the European banking union

The financial and economic crisis has shown that the supervisory structures previously in place were no longer adequate to deal with the highly interconnected European financial markets. Banking supervision that is primarily carried out at the national level makes it difficult to identify all of the risks of cross-border banking groups. Furthermore, the complex group structures of financial institutions require a single European mechanism to deal with distressed banks. Several countries were forced to support some of their domestic banks with large volumes of financial assistance because such mechanisms were not in place in the past, forcing taxpayers to shoulder a massive burden. These events set in motion a project which will completely change the European financial architecture: the European banking union.

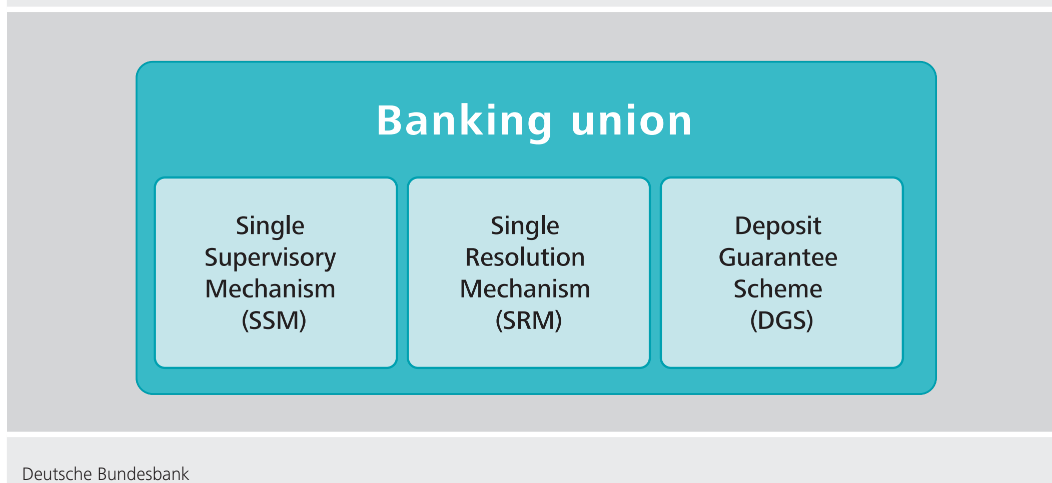
The banking union comprises banking supervision, recovery and resolution as well as deposit protection

The banking union project is made up of several components. One component is a Single Supervisory Mechanism (SSM) for euro-area banks as well as for banks in EU member states which opt into the SSM. This will be based at the ECB. A second component is the Single Resolution Mechanism (SRM), set up to deal with ailing banks, which is closely related to the Bank Recovery and Resolution Directive (BRRD). The two components of the banking union SSM and SRM must be considered together as shared liability for bank resolutions will require centralised supervisory oversight. A single deposit guarantee scheme was originally envisaged to be the third component of the banking union but is currently not a subject of political talks. Instead, efforts are being made to harmonise national deposit guarantee schemes.

One of the goals of the banking union is to sever the link between public finances and the banking sector

High hopes have been vested in the banking union. The objective of the SSM is to ensure the convergence of supervisory practice for solvent banks and to create a level playing field. The SRM will make it possible for large banks to be wound down in an orderly manner and to involve investors in the recovery and resolution costs. One of the overarching goals of the banking union project is to loosen the close ties between bank and sovereign risks. The severe burdens which arose as a result of bailing out ailing banks with public funds during the financial crisis led to a considerable increase in

The constituent elements of the European banking union



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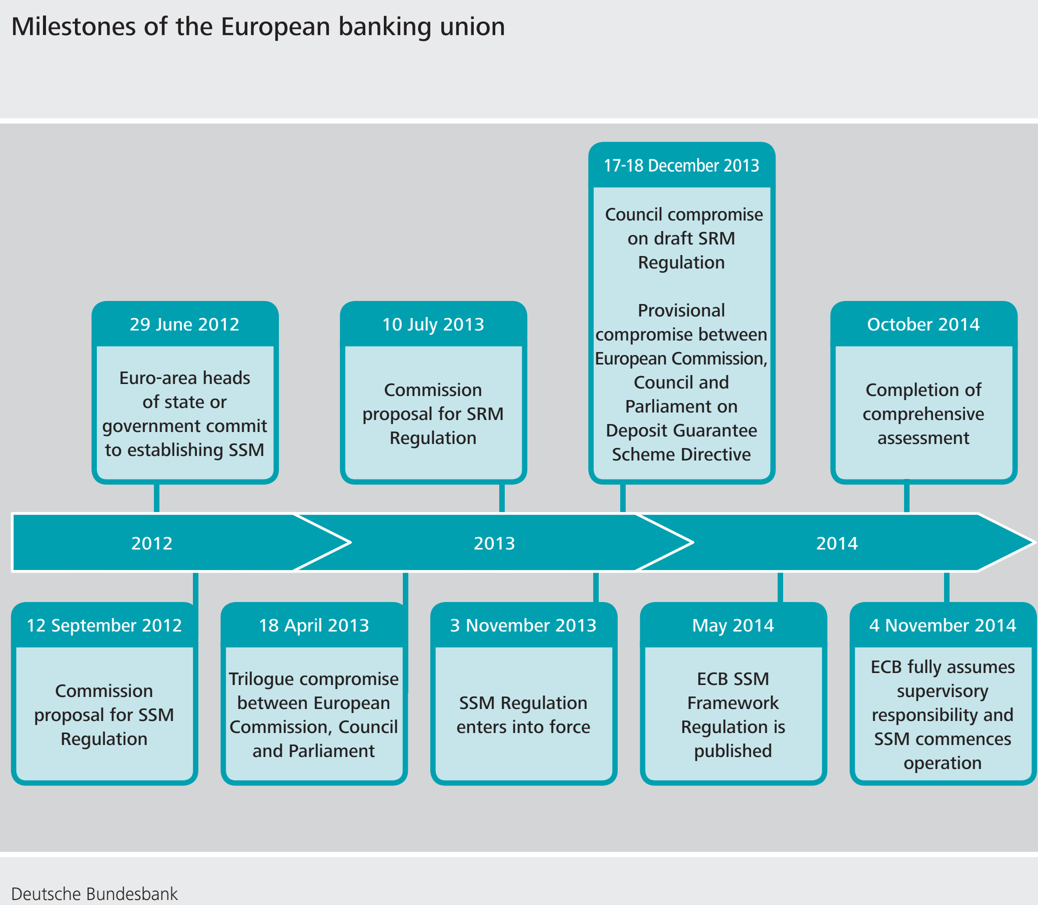
Milestones of the European banking union



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funding costs for the governments in question. The downgrade in sovereign ratings placed an additional strain on the banks as many of these institutions held a disproportionately high volume of domestic government bonds. Anticipation of the need for further financial support caused confidence in the governments' resilience to fall even further. The banking union is intended to sever this doom loop by recognising and mitigating risks at an earlier stage and spreading the costs of restructuring banks across a broader base. However, stricter requirements regarding banks' investments in government debt instruments – for example, a revision of the privileged regulatory treatment of sovereign debt in banking regulation – are not yet planned.

SSM preparations already well advanced …

Of the various components of banking union, the preparations for the SSM are most advanced. As early as 29 June 2012, euro-area heads of state or government called for the establishment of a Single Supervisory Mechanism as one of the conditions for banks receiving direct funding from the European Stability Mechanism (ESM). After the European Commission put forward a set of proposals in September 2012 for establishing the SSM, the Council adopted the legislation on 15 October 2013 following an assenting opinion by the Parliament. On 3 November 2013, the SSM Regulation[2] entered into force. The ECB will assume its new task as the European supervisory authority one year after the regulation coming into effect. Before this happens, a comprehensive assessment of significant banks in the euro area will be carried out and the practical arrangements for the cooperation between the ECB and the NCAs under the SSM Regulation will be specified in a Framework Regulation to be adopted by the ECB Governing Council. This

2 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

Framework Regulation is scheduled to be published no later than May 2014 following public consultations.

… and the other components of the banking union are making headway, too

The European Commission has also already put forward a draft regulation for the SRM in July 2013. Following the compromise reached by the European heads of state or government in December 2013, the European Commission, Parliament and Council are now in trilogue negotiations. Furthermore, the Parliament and the Council have agreed on key points of a European directive on the harmonisation of national deposit guarantee schemes, which has been the subject of ongoing negotiations since 2010.

European Single Supervisory Mechanism

The legal framework of the SSM

SSM Regulation establishes legal basis for the new supervisory mechanism

The SSM Regulation, which has been in place since 3 November 2013, establishes the legal basis for the Single Supervisory Mechanism. It has been supplemented by the concurrent Regulation amending the EBA Regulation,[3] which adjusts the EBA's powers and decision-making processes following the conferral of supervisory tasks on the ECB by the SSM Regulation.[4]

ECB maintains overall responsibility for all deposit-taking and credit institutions

Under the SSM Regulation, the SSM's remit extends to all banks whose business is to receive deposits or other repayable funds from the public and to grant credits for their own account, ie those banks classified as a deposit-taking credit institution under EU law. Its geographical scope initially covers those member states of the European Union which have adopted the euro. The remaining EU member states may opt into the SSM as part of what is defined as "close cooperation".

Significant institutions supervised directly by ECB

The SSM Regulation confers supervisory responsibility for all banks within the jurisdictional reach of the SSM on the ECB. Despite this wealth of powers, the ECB will not perform all supervisory tasks directly itself. Instead, the SSM will be composed of the ECB and the NCAs and founded on the principles of cooperation and decentralisation. As a result, only institutions classified as "significant" within the meaning of the SSM Regulation will be supervised by the ECB directly. The ECB will be given decision-making powers for virtually the entire spectrum of supervisory activities with respect to these institutions. It will also have far-reaching data collection and verification powers. Faced with the challenge of creating a functioning European supervisory mechanism in a short space of time, use will be made of the existing resources and expertise of national supervisors for day-to-day supervisory activities. Joint supervisory teams (JSTs), composed of staff from the ECB and the NCAs, will be established for each significant bank and will be headed by the ECB.

National supervision for less significant institutions

For institutions classified as "less significant", the power to take decisions regarding many supervisory tasks will initially remain with the NCAs. However, the ECB will be responsible for issuing and withdrawing authorisation as well as assessing notifications of the acquisition and disposal of qualifying holdings in credit institutions for all credit institutions, regardless of whether they are significant or less significant. Furthermore, it will also be responsible for en-

3 Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013.
4 For further information, see Deutsche Bundesbank, European Single Supervisory Mechanism for banks – a first step on the road to a banking union, Monthly Report, July 2013, pp 13–31.

The Supervisory Board and the mediation panel

Supervisory Board

The members of the Supervisory Board are the chair, vice-chair, four representatives of the European Central Bank (ECB) and one representative of the national competent authority (NCA) of each participating country. Article 26 (12) of the SSM Regulation provides for the Supervisory Board to adopt rules of procedure, which supplement the SSM Regulation and the ECB rules of procedure.

Where the national competent authority is not a central bank, that NCA's member of the Supervisory Board may bring a representative from the central bank of the member state to the Supervisory Board meetings. For the purpose of voting, the representatives of the authorities of one member state will be considered as one member.[1]

The Supervisory Board will be supported by a steering committee from among its members with a more limited composition, which will also be responsible for preparing Supervisory Board meetings. The steering committee, which has no decision-making powers, will be led by the chair, or in the latter's absence, by the vice-chair of the Supervisory Board. Pursuant to the SSM Regulation, the steering committee will have no more than ten members. The composition of the steering committee must ensure a fair balance and rotation between NCAs. The Supervisory Board is responsible for appropriately implementing these rules set out in the SSM Regulation.

Mediation panel

Article 25 (5) of the SSM Regulation instructs the ECB to create a mediation panel to resolve differences of views expressed by the competent authorities of the participating member states concerned regarding an objection of the ECB Governing Council to a draft decision by the Supervisory Board. It further empowers the ECB to adopt a regulation setting up the mediation panel and its rules of procedure. That regulation envisages that the members of the mediation panel will be chosen by the participating member states from among the members of the Supervisory Board and the ECB Governing Council and that the vice-chair of the Supervisory Board will chair the mediation panel meetings as the chair of the mediation panel without voting rights. The mediation panel's opinions cannot, however, have a binding character for the Supervisory Board and the ECB Governing Council since the ECB Governing Council, by virtue of its status as the supreme decision-making body, has the ultimate responsibility and hence the sole decision-making competence.

1 See Article 26 (1) second subparagraph of the SSM Regulation.

suring coherent and high-quality supervision throughout the SSM. To ensure that this is the case, the ECB will cooperate with the NCAs. If the ECB determines a need for action, it will have various tools at its disposal ranging from issuing general instructions to, as a last resort, taking on responsibility for a bank that was previously supervised nationally. A separate ECB Framework Regulation[5] will specify the co-operation arrangements between the ECB and NCAs, the criteria to determine whether an institution is significant and additional provisions of the SSM Regulation.

New ECB Supervisory Board will govern SSM

The central governing body of the SSM will be the newly established Supervisory Board, which will undertake the planning and execution of the supervisory tasks conferred on the ECB. In line with the ECB Governing Council's position as the supreme decision-making body of the ECB as enshrined in primary law, the Supervisory Board will not be equipped with its own decision-making powers but will submit draft decisions for specific supervisory measures to the ECB Governing Council which are considered to have been accepted if the Council raises no objections to the draft ("non-objection" procedure). However, this procedure will not apply to decisions regarding the general framework for supervisory decisions, such as the above-mentioned SSM Framework Regulation. A mediation panel will be created to resolve differences of opinion between the ECB Governing Council, the Supervisory Board and the NCAs. Details regarding the way in which the Supervisory Board and the mediation panel work will be set out in the rules of procedure. The complex governance of the SSM is intended to create a "Chinese wall" between monetary policy and banking supervision within the framework of the ECB's decision-making structures as enshrined in primary law.

Preparations for the SSM

Preparations for the SSM were well under way before the SSM Regulation came into force. The High-Level Group on Supervision met for the first time in August 2012. Under the chairmanship of the ECB President, this group of representatives from the ECB, NCAs and national central banks led the preparations for the SSM and laid the foundations early on for the structure that is now in place. The High-Level Group has since been replaced by the new Supervisory Board, which met for the first time on 30 January 2014 and is chaired by Danièle Nouy. Following her move from the Bundesbank's Executive Board to that of the ECB, Sabine Lautenschläger was named Vice-Chair of the Supervisory Board.

High-Level Group on Supervision led initial preparations for SSM …

… and was replaced in January 2014 by the Supervisory Board

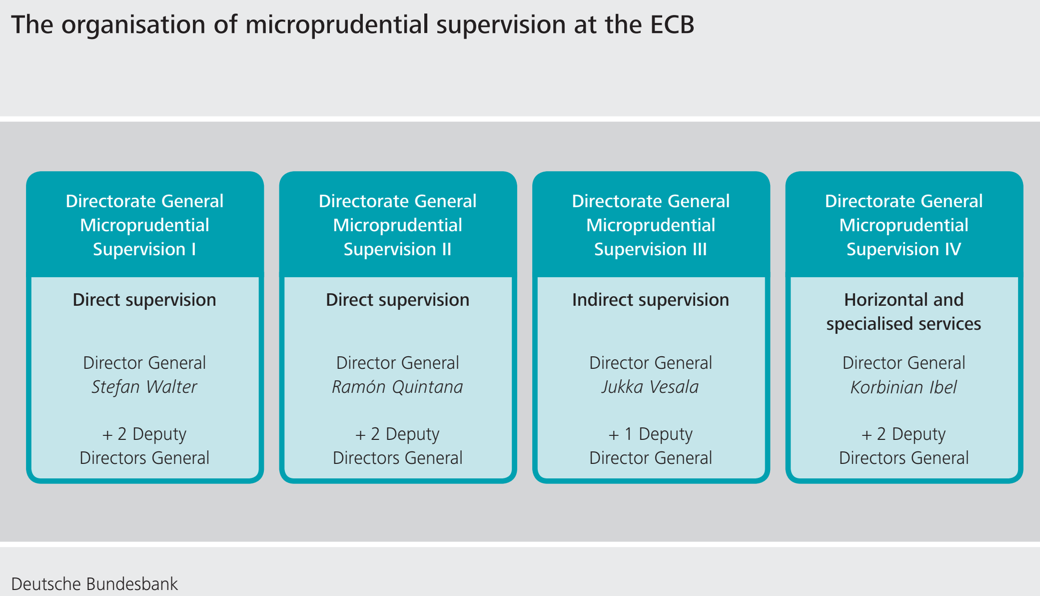
Bundesbank is helping to set up SSM by providing technical expertise …

On a technical level, the Task Force on Supervision has played a crucial role. Under its leadership, various working groups, whose members include many Bundesbank staff, developed and finalised methods and organisational structures for the SSM. The main focus was on five core areas.

- Drawing up a "map" of the European banking sector to give an overview of the structure of the banks in the SSM and to serve as a starting point for identifying "significant" institutions.
- Clarifying legal issues with regard to the SSM and drafting the SSM Framework Regulation pursuant to Article 6 (7) of the SSM Regulation.
- Developing a supervisory model for the SSM and, in particular, drafting an SSM Supervisory Manual that defines supervisory structures and processes as well as a risk assessment system (RAS) for banks.
- Identifying the data requirements for the SSM arising from the supervisory model and developing a reporting system accordingly.
- Planning and developing the comprehensive assessment of the credit institutions to be carried out by the ECB and NCAs as defined in Article 33 (4) of the SSM Regulation.

5 See Article 6 (7) of the SSM Regulation.

The organisation of microprudential supervision at the ECB



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Over the coming months, this provisional set-up of working groups and committees will be gradually switched over to a more permanent structure. Some of the working groups will continue to exist until the SSM is launched in November 2014.

… and staff

It had already become evident at the preparatory stage that close and constructive cooperation between the ECB and the NCAs would be vital for the SSM to achieve its aims. The Bundesbank is thus contributing more than just its technical expertise to the process of setting up the SSM. In April 2013, the Bundesbank began sending what would become a total of 11 members of its staff to the ECB to provide direct assistance in getting the SSM up and running. In October 2013, the ECB also began advertising around 1,000 positions which had been created for the SSM. The Bundesbank has been actively encouraging its staff to move to the ECB, as qualified and experienced individuals are required for the SSM to get off to a good start. However, the NCAs are faced with the huge challenge of replacing these members of staff. The Bundesbank took early action, posting additional vacancies for the banking supervision departments at Central Office and its regional offices.

Microprudential supervision at the ECB is divided into four DGs

At the ECB, microprudential banking supervision is divided into four newly established Directorates General (DGs). DGs I and II deal with the direct supervision of significant banks in the SSM. DG III, in close cooperation with the NCAs, is responsible for indirect supervision of all other less significant banks. DG IV handles horizontal and specialised services.

How will the SSM work?

Structure of SSM will require outstandingly clear organisation and processes

The SSM will cover the national jurisdictions of the 18 participating euro-area member states and will be based on cooperation with a wide range of supervisory authorities. Under these conditions, an outstandingly tight organisational structure and clearly defined processes will be essential to maximize the efficiency and consistency of supervision. A package of SSM rules will govern the way in which the SSM works. The SSM Regulation, the SSM Framework Regulation and the SSM Supervisory Manual will be of key importance.

Distinction between significant and less significant banks

The SSM Regulation defines both quantitative and qualitative criteria for determining whether a bank is significant. As a rule, the significance

Basic criteria for determining a bank's significance: size, economic importance and importance of cross-border activities

of an institution is assessed using the following criteria: size, importance for the economy of the European Union or of any participating member state and importance of cross-border activities. In concrete terms, this means (1) banks with total assets in excess of €30 billion or 20% of national GDP; (2) banks that the NCAs consider to be of significant relevance for the domestic economy, subject to the ECB confirming such significance; (3) banks that have established banking subsidiaries in more than one participating member state and whose cross-border assets or liabilities represent a significant part of their total assets or liabilities. In addition, the three largest institutions of a participating member state qualify as significant. By focusing on the most significant banking groups, more than four-fifths of total assets in the SSM countries are under the ECB's direct supervision.

Supplementary criteria for determining significance: public assistance requested or direct supervision necessary to ensure consistent supervisory standards

Those institutions that have requested or received direct public financial assistance from the European Financial Stability Facility (EFSF) or the ESM will also be supervised directly by the ECB. And finally, after consulting with the NCA, the ECB can classify an institution as significant if it believes that this is necessary in order to ensure the application of consistent, high supervisory standards.

The SSM's supervisory model

JSTs to conduct day-to-day supervision of significant institutions

Under the SSM Regulation, the ECB will be responsible for the direct supervision of the above-mentioned institutions. To ensure the appropriate involvement of the NCAs, a joint supervisory team (JST) consisting of ECB and NCA staff will be established for each of these institutions. Every team will be headed by a JST coordinator appointed by the ECB. National sub-coordinators will be the link between JSTs and NCAs. A core JST consisting of ECB coordinators and sub-coordinators will steer the respective JST.

Composition of JSTs to depend on banks' significance, risk profile, complexity and business model

The composition of the JSTs will follow a risk-based approach and take into consideration the principles of proportionality and efficiency, depending materially on the significance, complexity, business model and risk profile of the supervised entity. Moreover, the composition of the JSTs will reflect a supervised entity's share of business activities in the individual SSM member states.

JSTs key in SSM decision-making process

The JSTs will be responsible for implementing decisions made by the ECB Governing Council and the Supervisory Board. They will also be in charge of preparing and organising the annual supervisory programme and of the operational supervision of all banks subject to direct ECB supervision on a consolidated, sub-consolidated and solo level. Within the decision-making process, the JSTs will be tasked with preparing specific draft decisions and coordinating them with the NCAs, the ECB's Directorates General and the horizontal services. The Supervisory Board will subsequently review the drafts and decide on the final proposals to be passed on to the Governing Council of the ECB for decision. The Supervisory Board may also put proposals to the ECB Governing Council that it has drawn up itself and are not based on a previous JST draft or NCA proposal.

Within the SSM countries, the SSM will replace current framework for supervision of cross-border institutions

For participating member states, the SSM will partially replace the current framework for the supervision of cross-border credit institutions, which is based on colleges of supervisors. The new supervisory model will make a distinction between consolidated and non-consolidated supervision and between participating member states, non-participating member states and third countries. Consolidated supervision will be exercised by the JSTs with greater involvement of ECB staff. Supervision of SSM institutions on an individual or sub-consolidated basis will also be carried out by the JSTs, albeit with greater involvement of national JST members. The existing model of supervisory colleges for cross-border cooperation will be maintained for the supervision of subsidiaries or branches established in non-participating countries of the European Economic Area (EEA) by banking groups domiciled in SSM member states or,

Composition of the joint supervisory teams (JSTs)

Assume a bank is resident in a euro-area member state (country A) and that, according to the size criteria laid out in the SSM Regulation, the bank is classed as a significant institution and is therefore supervised by the European Central Bank (ECB).

Based on the institution's significance and taking into consideration other parameters, in particular the complexity of supervision, a joint supervisory team (JST) is assembled, to which the ECB allocates the JST coordinator and up to seven additional staff members. Other members are nominated by the national competent authorities (NCAs) or central banks of country A and the SSM countries in which the bank has subsidiaries or significant[1] branches. By contrast, the core JST, which comprises only the JST coordinator and the respective national sub-coordinators, involves only country A and the SSM countries with significant[2] subsidiaries or branches.

1 Branches with total assets of more than €30 billion.
2 Subsidiaries with total assets of more than €5 billion, branches with total assets of more than €30 billion.

conversely, subsidiaries or significant branches established in SSM member states by banking groups domiciled outside the SSM.

National authorities will initially continue to supervise less significant institutions

The NCAs will continue to supervise less significant institutions. This is in line with the risk-based nature of the SSM and will affect not only operational supervision, but, with a few exceptions, prudential decisions as well.[6] The ECB will essentially assume a monitoring and coordinating role. In particular, the ECB will also be empowered to issue regulations, guidelines and general instructions to the NCAs relating to the conduct of supervision. These may also be pertinent to the supervision of individual groups of institutions. The less significant institutions will be grouped into three risk classes based on their individual risk assessment. Depending on an institution's risk class, the NCAs will have to meet different requirements in terms of reporting their supervisory activities and decisions to the ECB. Where the NCA does not comply with the SSM standards, the ECB is entitled, upon a decision by its Governing Council, to take over direct supervision of one or several less significant institutions.

Supervisory responsibility will remain with NCAs during the transitional phase

Responsibility for supervision will remain with the national supervisor until the ECB assumes full control over supervisory activities on 4 November 2014, at which point it will move to the ECB. This will ensure that supervisory responsibilities are clearly defined even during the transition. The NCAs will also carry out all supervisory planning for the 2014 calendar year. Even during the transitional phase, the ECB will, however, gradually be incorporated into the flow of information and the supervisory process.

6 Pursuant to Article 6 (4) and (5) of the SSM Regulation, the tasks listed in Article 4 (1), namely making authorisation decisions and assessing qualifying holdings, for which the ECB is responsible for all banks, are exempt from this division of labour.

Organisation of on-site inspections

On-site inspections will generally be carried out by the NCAs …

On-site inspections of significant banks will be commissioned and directed by the competent JST and – from an overarching perspective – by the ECB's Directorate General IV. NCAs will generally be responsible for the operational performance and management of the on-site inspections, although the ECB can take the lead in an inspection in exceptional cases.

… and will be based on instructions given by the JSTs and the procedures described in the Supervisory Manual

The starting point for determining the contents of the individual inspections will be the main focus of the inspection as outlined in the overall inspection plan and inspection areas specific to the institution, which will be derived from the ECB's risk assessment for the respective bank. The procedure and responsibilities for on-site inspections will be derived, first, from the JSTs' concrete inspection mandate and, second, from the inspection approaches and guidelines defined in the SSM Supervisory Manual. The principle of dual proportionality[7] must be observed when carrying out inspections, and they must be risk-based. It has thus been possible to confer upon the SSM important basic principles on which the Bundesbank has based its inspection activities to date.

Supervisory review and evaluation process

ECB to take responsibility for SREP, …

The ECB will, in future, also be responsible for determining a uniform supervisory review and evaluation process (SREP) pursuant to Article 97 of CRD IV for the SSM banks and for its execution, at least for the significant banks. A newly developed risk assessment system is a fundamental component of the SREP. The risk assessment system is intended to help assess risks to banks as well as their ability to manage such risks, and to justify supervisory measures and allow future supervisory activities to be planned in a more targeted manner.

… which is based on newly developed risk assessment system

As the second key element of the SREP, the ECB will also decide whether banks' capital and liquidity levels are appropriate and, if necessary, impose capital add-ons over and above the requirements of the CRR (according to Pillar 1 of the Basel standards[8]). The SREP quantification method is currently undergoing testing and development, and it is not yet certain whether the specifications will yield the appropriate overall results. It is likely, however, that the newly developed uniform SREP requirements in the SSM Supervisory Manual will be key in determining the supervisory approach in the SSM countries.

SREP quantification method will be used to calculate liquidity and capital requirements

Reporting framework

SSM focuses on harmonised set of data provided by the EBA's ITS

Centralised supervision by the ECB will require an adequate set of data based on a system of regular prudential reporting. The centralised risk assessment system (at ECB level) also means that data must be as harmonised and comparable as possible. The introduction of the EBA Implementing Technical Standards (ITS) on Reporting, which will also harmonise COREP and FINREP,[9] will create a set of comparable data for the SSM from 2014 onwards. In addition, the ECB will also use other existing datasets for its analyses and will, moreover, initiate *ad hoc* data requests in order to meet specific requirements, for instance when conducting stress tests.

Differences remain for non-harmonised reports and national accounting

The ECB's reporting requirements for significant groups of institutions and/or individual institutions should be largely harmonised to ensure comparability within the SSM. In Germany, this also affects institutions that prepare their accounts according to German GAAP (based on the German Commercial Code or *Handelsgesetzbuch*) rather than international account-

7 A central element in the German approach to supervision, the principle of dual proportionality, mandates that the intensity of supervision must be based on the respective institution's systemic importance for the financial markets and on the bank's specific risk situation and complexity. See, for instance, Deutsche Bundesbank and BaFin, Prudential risk profile as a part of the supervisory review and assessment of institutions, November 2007.

8 See also Deutsche Bundesbank, Banks' internal methods for assessing and maintaining internal capital adequacy and their relevance to supervision, Monthly Report, March 2013, pp 29–41.

9 These ITS determine uniform reporting requirements for own funds and capital requirements (COREP) and financial information (FINREP). See http://www.eba.europa.eu/-/eba-publishes-final-draft-technical-standards-on-supervisory-reporting-requiremen-4.

ing standards and are not, therefore, subject to the EBA's harmonised FINREP regime. These institutions will be allowed to submit their reports based on German GAAP even if they are subject to uniform reporting requirements in the SSM. This discrepancy within the ECB's central set of data will remain, as the SSM will not entail a move towards uniform IFRS accounting requirements. As regards the less significant institutions and/or banking groups that are not subject to the EBA's FINREP reporting because they prepare their accounts according to German GAAP, some thought will have to be given as to how to create as harmonised a dataset as possible for the SSM, although differences remain as a result of national accounting standards.

Language regime

Council Regulation 1/1958 is key to the working language in the SSM

Determining the working language is a key issue for supervisory practice within the SSM. Due account must be taken of the requirements of Council Regulation 1/1958. In terms of the language regime in the SSM, three levels need to be distinguished.

– It initially follows from EU Regulation 1/1958 that regulations and general ECB documents must be translated into all official languages.
– The SSM Framework Regulation will specify that English should generally be used as the common working language for communications within the ECB as well as between the ECB and the NCAs. As Regulation 1/1958 also gives member state institutions, such as the NCAs, the right to communicate in their national official language with the EU institutions, and the network between the ECB and the NCAs is not an official EU body, this provision is predicated on the NCAs' consent.
– The language regime for communications between the ECB and the institutions it supervises also follows from Council Regulation 1/1958: supervised institutions will have the right to have correspondence to and from the ECB drafted in their country's official language. Here, too, the ECB is seeking to establish English as the common working language. As this cannot be imposed by force, the ECB will attempt to reach an explicit agreement with the institutions it supervises directly, although such agreements with effects that extend into the future are subject to revocation. The SSM Framework Regulation will spell out the details.

Comprehensive assessment

Restoring market participants' confidence in banks

Before the launch of the Single Supervisory Mechanism, all SSM banks will undergo a comprehensive assessment, which is designed to ensure maximum transparency regarding the involved banks' risks and burdens before the ECB takes over supervisory responsibilities. The objective is to strengthen market participants' confidence in the banks by creating transparency. This stringent supervisory regime should eliminate the current uncertainties about the clarity of banks' balance sheets. The comprehensive assessment will be carried out jointly by the ECB and the national central banks or NCAs.

Comprehensive assessment comprises three stages

The comprehensive assessment comprises three stages.

First, application of the newly developed risk assessment system is designed to fully capture and classify existing risk factors, which might include liquidity, market, credit and interest rate risk, as well as weaknesses in business models or corporate governance. This risk assessment thus incorporates not only quantitative but also qualitative aspects.

Cooperation between ECB and national authorities basis for comprehensive assessment

Second, a risk-oriented sample asset quality review complements the risk assessment using the risk assessment system. A portfolio selection process has been developed in order to earmark the institutions' assets that are to be examined in the sample. In this process the previously created risk assessment and existing knowledge of the NCAs are used to generate

German banks participating in the comprehensive assessment

Aareal Bank AG
Bayerische Landesbank
Commerzbank AG
DekaBank Deutsche Girozentrale
Deutsche Apotheker- und Ärztebank eG
Deutsche Bank AG
DZ Bank AG Deutsche Zentral-Genossenschaftsbank
HASPA Finanzholding
HSH Nordbank AG
Hypo Real Estate Holding AG
IKB Deutsche Industriebank AG
KfW IPEX-Bank GmbH
Landesbank Baden-Württemberg
Landesbank Berlin Holding AG
Landesbank Hessen-Thüringen Girozentrale
Landeskreditbank Baden-Württemberg-Förderbank
Landwirtschaftliche Rentenbank
Münchener Hypothekenbank eG
Norddeutsche Landesbank-Girozentrale
NRW.Bank
SEB AG
Volkswagen Financial Services AG
WGZ Bank AG Westdeutsche Genossenschafts-Zentralbank
Wüstenrot & Württembergische AG (W&W AG) (for the holding company of Wüstenrot Bank AG Pfandbriefbank and Wüstenrot Bausparkasse AG)

a proposal for portfolio selection based on the ECB's guidance, which, following a national quality assurance process, will be submitted to the ECB for a decision. This approach was adopted so as to ensure, first, the input of the NCAs' experience and, second, the objectivity of the portfolio selection process. Following completion of the portfolio selection process, the relevant NCAs or external auditors are now beginning their on-site inspections of the quality of the sample portfolios. The aim is to identify inappropriate valuations and, where necessary, make corrections. This will permit *inter alia* a review of the adequacy of the write-downs on credit exposures, the valuation of collateral and the classification of exposures (eg non-performing loans). Market risk is being taken into consideration alongside credit risk.

ECB/EBA stress test factors scenario analysis into the process

Third, a stress test to be conducted jointly by the ECB and the EBA will round off the comprehensive assessment. This involves an examination of major European banking institutions' resilience in the face of an adverse macroeconomic scenario (including analyses of sensitivity to country-specific risk factors), taking due account of the results of the other two components of the comprehensive assessment. The capital requirements used in the stress test will comprise a minimum common equity tier 1 capital ratio of 5.5% under the adverse scenario and 8% in the baseline scenario, which assumes a macroeconomic development in line with customary forecasts. Any recapitalisation needs that are identified in the course of the comprehensive assessment will have arisen under national responsibility and should therefore be dealt with primarily at a national level.

Execution within a project structure developed by the ECB

The comprehensive assessment is being executed both at national and European level within a project structure developed by the ECB. At the national level, a dedicated banking team for each institution to be examined is tasked with the portfolio selection and risk-oriented review of the selected portfolios. In Germany, this re-

view is essentially being conducted by external auditors, although with the involvement of NCAs. An additional quality assurance team is responsible for ensuring performance comparability of the assessments at all institutions. A national project management office is in place in each country for the national coordination, collation and transmission of information as well as for communication with the ECB. All project units report to a national steering committee. Mirroring the national structures, there is a central project management office at ECB level, which coordinates and consolidates the work of the national quality assurance teams and project management offices. The entire project is governed by the Comprehensive Assessment Steering Committee, whose members are high-ranking representatives of the ECB and the national central banks or NCAs.

Consistency through joint staff teams across institutions and countries

Not only a uniform methodology, but also cross-country staff deployment is part of the concept in order to assure consistent execution of the comprehensive assessment across all countries participating in the SSM. It is thus envisaged that staff of other NCAs or the ECB will also belong to the national project units.

Single Resolution Mechanism (BRRD/SRM)

In addition to the SSM, the Single Resolution Mechanism (SRM) is an integral part of the banking union. This mechanism actually consists of two elements: a set of harmonised recovery and resolution instruments, which are defined in the Bank Recovery and Resolution Directive (BRRD), and a centralised European decision-making mechanism, which is to be set up under the SRM Regulation.

Directive establishing a framework for the recovery and resolution of credit institutions and investment firms

Existing legal framework insufficient for recovery or resolution of credit institutions

One of the key lessons learned from the recent crisis is that the existing legal framework proved insufficient for facilitating an orderly recovery or resolution of credit institutions. The case of Lehman Brothers showed that liquidating a large institution via insolvency proceedings can endanger financial stability. Hence, governments repeatedly felt obliged to bail out domestic banks using public funds, which, however, can create moral hazard. In response to this, in November 2011 the heads of state or government of the G20 countries endorsed the Financial Stability Board's Key Attributes of Effective Resolution Regimes (Key Attributes). The Key Attributes set out the core elements of an effective resolution regime. The European Commission's draft Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (Bank Recovery and Resolution Directive), which was published on 6 June 2012, is designed to foster EU-wide implementation of the Key Attributes. As joint legislators, the European Council and Parliament reached an agreement regarding the contents of the Directive in December 2013. The legislative process is to be formally completed in April 2014. Member states must apply these provisions from 1 January 2015. An exception is made in the case of the rules for the bail-in instrument, which member states will have to implement from 1 January 2016 at the latest.

Bail-in rules applicable from 1 January 2016, the other new rules from 1 January 2015

BRRD gives member states responsibility for applying new rules

The BRRD applies throughout the EU to all credit institutions, investment firms, financial institutions, financial holding companies and parent financial holding companies, but entrusts responsibility for applying the envisaged instruments to the member states. In addition to obligating each member state to set up a

national resolution authority, the Directive comprises three pillars: prevention, early intervention and resolution in the strict sense of the term.

BRRD's three pillars: prevention, …

Under the prevention arm, institutions are obligated to draw up recovery or resolution plans. The supervisory authority will examine the recovery plans and identify potential obstacles, in respect of which it may issue instructions to the institution regarding their elimination, eg in connection with reducing its risk profile, changing its funding strategy or altering its management structure. Furthermore, the resolution authority must draw up resolution plans for the institutions and examine their resolvability. The resolution authority will be granted extensive powers to remove any obstacles that may hinder the resolution of an institution. For example, it can stipulate that the institution sell certain assets or change legal or operational structures of the institution or the group companies under its control with a view to reducing its complexity and, in turn, ensuring that critical functions can be separated from non-critical functions using the resolution instruments.

… early intervention …

The second pillar of the Directive is intended to facilitate early intervention in the event of a crisis. The BRRD defines the envisaged measures to supplement supervisory authorities' existing powers of intervention as well as rules for appointing an administrator.

… and resolution

The third pillar contains provisions for actually resolving institutions. It first defines the resolution instruments and powers, as well as the objectives, general principles and conditions. Of key importance are the resolution instruments, which include instruments for the sale of business, bridge institutions, asset separation instruments and bail-ins. One important principle is the requirement for the shareholders and creditors of the failing institution to be called upon first to sustain losses. A key role is assigned in this respect to the bail-in instrument, which makes it possible to write down the institution's liabilities or to convert them into equity capital. In exceptional cases, designated creditor groups may be exempted from the bail-in and – subject to certain conditions – the burden transferred to the resolution fund, provided that, as part of the bail-in, the bank has contributed a minimum of 8% of total liabilities, including own funds, to loss absorption and recapitalisation, and the contribution of the resolution fund is capped at 5% of the bank's total liabilities including the bank's own funds.

Balance needed between harmonisation and national discretion

Furthermore, the BRRD contains rules on group resolutions, on resolutions involving third countries and on a European system of national financing arrangements. Overall, the BRRD lays down a basis for overcoming conflicts of aims between flexibility and harmonisation. Far-reaching harmonisation is required to ensure maximum legal certainty and to maintain a level playing field. On the other hand, a certain degree of flexibility is needed so that resolution measures can be adapted to the varying legal and market structures in the member states.

Single Resolution Mechanism (SRM)

General aspects

Commission publishes draft SRM Regulation in July 2013

On 10 July 2013, the European Commission presented a draft Regulation establishing the SRM. Although the SRM is to take formal effect in all member states, it will only apply to institutions that are domiciled in those member states that are participating in the SSM. The objective of the SRM is to wind down failing banks efficiently and, as far as possible, at no or only minimal cost to taxpayers and to the real economy, thus breaking the doom loop between sovereign funding and bank balance sheets. The SRM is a necessary complement to the SSM within the European banking union project.

As things stand, the SRM will include a Single Resolution Board (SRB) and a European Single Bank Resolution Fund. In December 2013, the

Single Resolution Board and a European Single Bank Resolution Fund are core elements of draft SRM Regulation

Economic and Financial Affairs Council (ECOFIN) agreed a General Approach on these two elements. Under the ECOFIN concept, the decision-making process surrounding a potential resolution would involve several parties, including the SRB, the European Commission and ECOFIN itself. National resolution funds are to be gradually merged and mutualised over the next ten years.

Suitability of chosen legal basis questionable as long-term solution

The SRM is to be based on existing EU primary law, notably Article 114 of the Treaty on the Functioning of the European Union (TFEU). It is questionable whether this legal framework will form a sustainable basis for a long-term solution. Nevertheless, the substance of the compromise put forward by ECOFIN may be considered acceptable for an interim period. It formed a basis for commencing trilogue negotiations with the European Parliament in the hope that the respective legislators could come to an agreement before the European elections in May 2014.

Key elements of the Council's position (General Approach) of 18 December 2013 and initial assessment

According to the Council's General Approach …

The Council's General Approach, like the BRRD, is based on the principle that, if a bank fails, its shareholders and creditors should be first in line to bear any losses before recourse to external funds. This provides a strong incentive to ensure sustainable and responsible management and corporate governance.

… the SRB is to have decision-making powers in resolving banks directly supervised by the ECB

Under the compromise reached within the Council, the SRM will, in principle, cover all of the institutions domiciled in the countries participating in the SSM (ie the euro-area member states and any non-euro-area countries that opt into the SSM). However, it is important to distinguish between this and the SRB, which will decide on the resolution plans and actual resolution of all banks directly supervised by the ECB as well as of banks with subsidiaries in other participating member states. Moreover, the SRB will make decisions in cases involving the use of the European Single Bank Resolution Fund or where the member states have transferred resolution powers to the SRB. In all other cases, resolution will remain within the remit of the national resolution authorities, which will apply the provisions laid down in the BRRD or in their respective national implementing legislation. However, the SRB can take over the resolution of any bank on an *ad hoc* basis and will then apply the rules defined in the SRM Regulation. It is logical for there to be a large degree of congruence between the coverage of the SSM and that of the SRM in order to meet the requirements of aligning liability and control. In view of the different responsibilities assigned to the SRB and the national resolution authorities under the General Approach, however, care must be taken to avoid splitting the banking market in two.

Institutional set-up of SRM provides for a balance between national and European perspective …

The SRB is to have its own legal personality and will consist of an Executive Director, representatives of the national resolution authorities of the participating countries and four full-time members appointed at a European level. This will make it possible to bring national expertise to bear whilst also considering the European perspective. The SRB will be the central decision-making body for the resolution of significant institutions as described on pages 27 and 28. It will take decisions on resolution plans and resolution schemes in the event of an actual bank resolution. The SRB can determine that the prerequisites for resolution have been met upon notification by the ECB or a national resolution authority or on its own initiative. This seems problematic as it gives rise to the risk of different assessments on the part of the supervisory authorities and the resolution authorities.

… but lacks clarity regarding decisions on resolving a bank

The SRB will take decisions, in particular, of a general nature and on the use of the Resolution Fund above a certain financing threshold in its plenary session; all other decisions will be taken in its executive session, composed of the Executive Director, the four full-time members appointed at a European level and the representatives of the national resolution authorities

of those member states in which the banking group being resolved operates.

Decision-making structure reflects legal considerations …

Where resolution entails state aid or Fund resources, the European Commission will become involved in its capacity as the EU's competition watchdog. Therefore, before the SRB can adopt a resolution scheme, it must await a decision from the European Commission regarding the measure's compatibility with the internal market pursuant to Article 107 of the TFEU. The European Commission can object to a resolution scheme irrespective of whether state aid or Fund resources are to be used. The final say on such matters will rest with the Council, however, which will base its decision on a proposal from the European Commission. This structure with the involvement of existing EU bodies was chosen in response to legal considerations concerning the SRB's extensive decision-making powers following on from the judgment in the Meroni case[10] and to safeguard the member states' interests. Although the institutions involved have relatively short deadlines for taking their decisions, the question still arises as to the workability of these complex processes.

… but doubts exist about the solution's workability

SRM includes European Single Bank Resolution Fund …

The Council's General Approach provides for a European Single Bank Resolution Fund financed by bank levies. Its intended use will come if, in the light of general resolution aims (eg to safeguard financial stability), a bank's investors (shareholders and creditors) are not able to absorb losses fully by themselves and external funds are required. Alternative sources of financing, in particular public funds, are to be employed only as a last resort if the Fund's resources are not sufficient. Recourse to taxpayers' money is thus to be avoided as far as possible. Moreover, the member states are to establish financing mechanisms. These will form the national compartments of a European fund. During a ten-year transitional period, the compartments will be progressively merged and mutualised to form a single fund without national distinctions; the details of this transfer of funds are to be laid down in an intergovernmental agreement, which has yet to be established among the participating member states. This is a medium-term process which, given the change to the treaties which the Bundesbank believes it will require, is to be welcomed as it serves to align liability and control.

… in which the element of joint liability will be strengthened gradually

Council's compromise leaves key questions regarding fiscal backstop and dealings with non-euro-area EU member states unanswered

The present compromise reached within the Council still leaves several key issues unresolved, however: despite the new bail-in rule and the Single Bank Resolution Fund, it cannot be ruled out that public support may be required for reasons of financial stability. A credible fiscal backstop must, therefore, be provided for. Difficult legal and economic problems arise here with regard to non-euro-area countries that decide to opt into the SSM and the SRM. This matter is particularly relevant in respect of a fiscal backstop, as support by the ESM is being discussed in this context despite the ESM Treaty currently allowing only euro-area countries to make use of it. Furthermore, the fact that the positions adopted by the Council of the European Union and the European Parliament diverge, quite substantially in part, with regard to the decision-making and financing structures also suggests that amendments will be made to the draft SRM Regulation.

Need for further action

The compromise reached within the Council of the European Union is not the end of this issue, as the formal reservations expressed by the European Commission and the announcements made by the European Parliament also show. The intergovernmental agreement will be crucial in this respect; it should be established as quickly as possible and then ratified by the member states. There is also a need for further action, for instance, with regard to the congruence between the SRM Regulation and

10 Judgment of the European Court of Justice, case 9-56, European Court reports 1958, p 133 – Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community: new agencies set up by means of secondary law may not be granted their own decision-making powers with margins of discretion.

the BRRD, in view of the change to the treaties which will be required in the medium term in order to create a sound legal basis, or regarding the question of how to plug existing capital shortfalls in banks' balance sheets ("legacy burdens"). These balance sheets must be repaired before the SSM and SRM start their operations. Politicians should not leave it up to monetary policymakers to solve these problems. When dealing with legacy burdens, recourse to supranational financing mechanisms such as the ESM should, at best, be considered in the shape of a loan extended to the relevant national government.

Harmonisation of national deposit guarantee schemes

A centralised European deposit guarantee scheme is currently not on the political agenda

A European deposit guarantee scheme has been mentioned as a third component of the European banking union to stand alongside the SSM and SRM. In a press release dated 12 September 2012, the European Commission stated that a common system for deposit guarantees was also required to complete the banking union.[11] Possible concepts have been formulated merely as political declarations of intent up to now. However, these are currently not the subject of negotiations at a European level.

Third component of banking union confined to harmonising national schemes

By contrast, work on revising the EU Directive on Deposit Guarantee Schemes, intended to achieve a greater degree of harmonisation between the national deposit guarantee schemes, resumed in the second half of 2013 following a temporary impasse in negotiations. Based on the existing harmonised coverage level of €100,000 per depositor, the current revision of the Directive aims, *inter alia*, to alter the way in which guarantee schemes are financed from being solely anchored at a national level towards greater Europe-wide harmonisation, and to speed up pay-outs under the deposit- or compensation scheme. The objective is to strengthen financial stability and consumer protection while maintaining a level playing field in the countries of the EU. The negotiations on revising the EU Directive on Deposit Guarantee Schemes are close to being finalised. Once the Directive has been adopted, the EU member states will have to transpose it into national law.

11 Communication from the Commission to the European Parliament and the Council of 12 September 2012, p 6.

Outlook

SSM is first step towards a banking union

The entry into force of the SSM Regulation on 3 November 2013 constituted a key step on the road to creating a Single Supervisory Mechanism in Europe as the first component of a European banking union.

Work carried out until supervisory responsibility is transferred to the ECB in November 2014 will be dominated by the preparations for the SSM.

Preparatory work will also entail major challenges in 2014 …

Several tasks still need to be accomplished in this respect. The comprehensive assessment of banks and the accompanying stress test to be carried out by the ECB and the EBA will provide important information about the situation in the European banking sector and enable a source-based assumption of potential balance-sheet legacy burdens before the start of the SSM. The JSTs will be set up in the com-

ing months and will then gradually become involved in operational supervisory activities. Newly developed supervisory processes will be put to the test in practice and readjusted on the basis of these findings. This process poses major challenges not only to the ECB and the national supervisory authorities, but also to the banks themselves. However, progress made with the preparatory work in recent months, which was ultimately possible only through the cooperation of all the parties involved, is an encouraging sign that a smooth transition to the SSM will be achieved.

… but, all in all, preparations going according to plan

Of the various components of the banking union, most progress has been made with regard to the SSM. However, progress has also been achieved in relation to the SRM and the harmonisation of the national deposit guarantee schemes. Owing to the mutualisation of liability for bank risks which these two elements of the banking union entail, they, in particular, must be viewed in the broader context of progressive European integration. A coherent overall European concept for a lasting stabilisation of the financial markets should not be restricted to institutional supervisory and resolution structures, but rather inextricably linked to further political and fiscal integration based on the democratic principles of the European Union. Stricter regulation of the risks which banks are allowed to incur vis-à-vis governments is also extremely important in this context.

Further parallel steps towards European integration also required to complete banking union

The German economy's current account surplus

The German economy ran a current account surplus of €206 billion in 2013, which equates to 7½% of gross domestic product (GDP). Whether and to what extent persistently high surpluses represent a problem requiring economic policy action has been a topic of debate for some time now. This is the backdrop against which the European Commission's In-Depth Review aimed at assessing the existence of macroeconomic imbalances in Germany should also be viewed. The report on this In-Depth Review was presented last week. Current account deficits have been fairly rare in Germany, historically speaking. Deficits occurred briefly during the economic downturns in the late 1960s and early 1980s. The period following German reunification saw substantial domestic demand and immense capital requirements push the current account into the red for an extended period of time. Germany's current account, like its net international investment position, was close to balance at the turn of the millennium.

Current account developments over the last two decades have been affected by key events both within Germany and abroad; these notably include German reunification, the transition to European monetary union as well as the financial and sovereign debt crisis. The scale and persistence of the current account surpluses also reflect the adjustments which the German economy has achieved over the past decade – enterprises are very well positioned in global sales markets, and their balance sheets are now significantly more robust. Households have adapted their consumption and saving behaviour in response to the challenges of demographic change during a period of very muted income growth, while government has pared back its budget deficit.

Germany will in all likelihood continue to run a positive current account balance for the foreseeable future, but the surpluses are likely to diminish in size. Adjustment processes in the euro-area partner countries will continue to correct the export overhang in merchandise trade, while similar impulses for a market-driven contraction might arise in a global context from the unwinding of domestic imbalances among trading partners outside the euro area. In Germany, savings are being dampened by the fact that a rising share of the population is entering a life cycle phase which is characterised by a comparatively low propensity to save, even though old-age provision per se will continue to underpin aggregate saving. Generally speaking, however, Germany's role as a net exporter of capital is entirely appropriate, given its relatively unfavourable demographics and its high standard of living.

The current account balance is the outcome of a multiplicity of predominantly private sector decisions in Germany and the rest of the world, and it is something which cannot be meaningfully managed using macropolicy instruments. Furthermore, there are no obvious market distortions favouring a German current account surplus. Notwithstanding this, key structural policy initiatives, such as stepping up research and development efforts, upgrading and expanding transport and communication networks, engineering the policy switch to non-nuclear energy generation and further liberalising services sectors, will set the course towards new growth opportunities and encourage greater investment in Germany, and might thus indirectly shrink the current account balance.

Current account surpluses high since middle of last decade

Determinants and historical context

Current account surplus above 6% of GDP almost without exception since 2006

Germany's current account surplus widened further in 2013 to reach €206 billion, or 7½% of nominal GDP, which even slightly exceeded the previous record high seen in 2007. The German economy has consistently been running very high current account surpluses for ten years now. This has attracted criticism to the point of accusations that Germany was making it more difficult to dismantle macroeconomic imbalances both within the euro area and worldwide, or that it was placing a strain on the global economy. Germany exceeded 6% – the upper threshold defined in the European Union's Macroeconomic Imbalance Procedure (MIP) – in 2006 and has remained there almost without exception, prompting the European Commission last November to subject Germany to an In-Depth Review. The report was published last week. (See the box on pages 58 and 59 for the European Commission's policy recommendations.) Germany has been running high surpluses for such a long period of time now that they would appear to be a structural phenomenon, a view which is reinforced by the fact that even the severe recession in the latter part of 2008 and the early part of 2009 did nothing more than briefly dent Germany's current account surplus. This raises the question whether a high structural surplus poses a problem at the national or international level and whether there is any need for German policymakers to take action.

Factors explaining the current account balance must be considered, …

The current account surplus is usually shaped by foreign trade in goods and services. Given that net foreign assets have picked up again strongly over the past 15 years, consideration should now also be given to cross-border investment income. Yet looking merely at the factors underlying trends in merchandise trade and invisibles transactions, which include cross-border services and income flows as well as current transfers, would paint an incomplete picture, particularly when structural explanatory patterns are being investigated.

… as must the relation between aggregate savings and investment

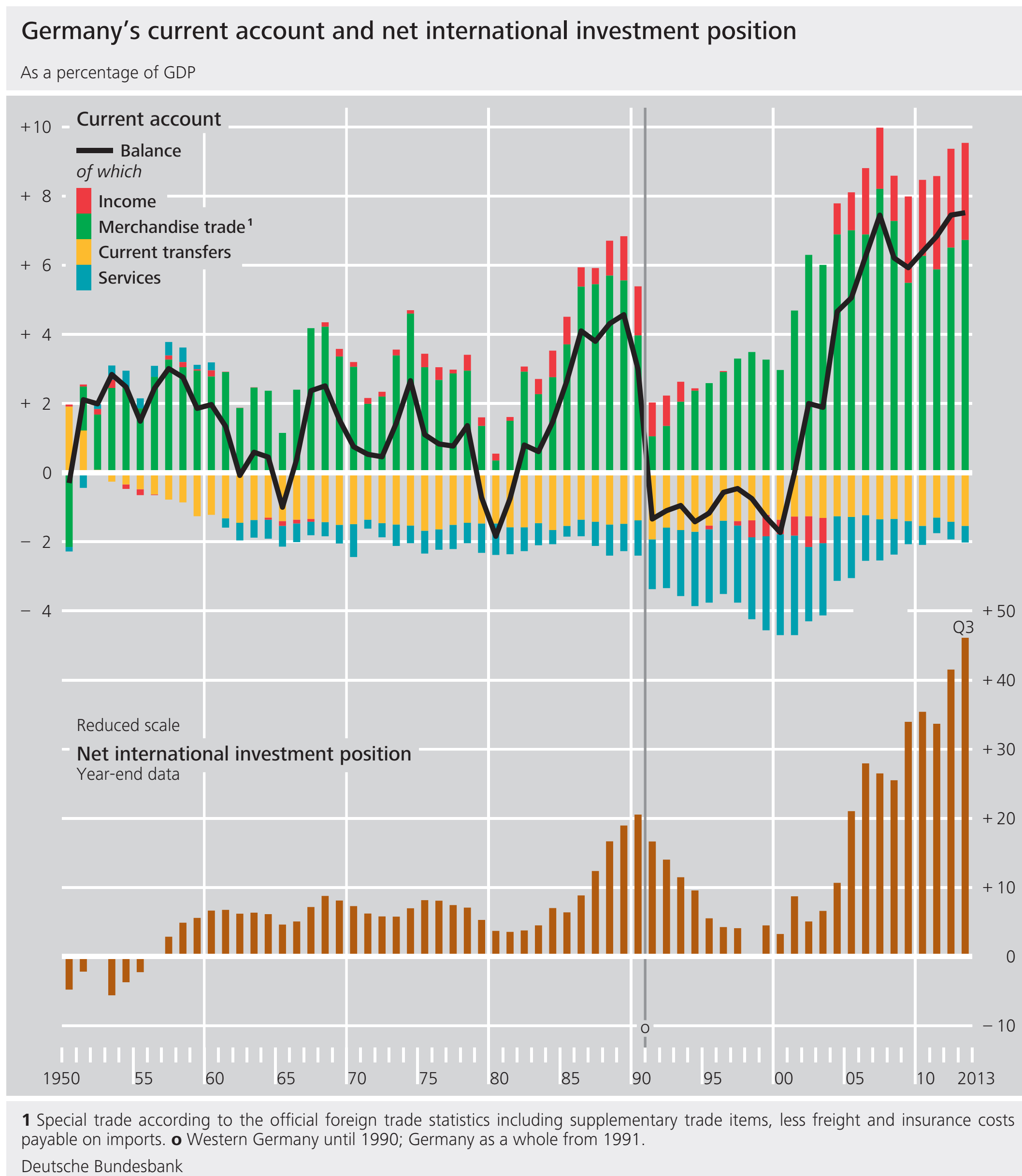
The cross-border financial account, being the mirror image of the current account, reflects saving and investment decisions in Germany and the rest of the world (see also the box on page 42). Viewed from this angle, the high surplus indicates that the German economy has, on balance, invested a relatively large percentage of its savings not in the domestic economy but abroad. Demographics, productivity and income are instrumental factors – as are price and cost relations, the institutional framework and infrastructure – for gaining an understanding of household consumption and saving patterns as well as firms' investment and financing decisions. To obtain insights into Germany's current account balance vis-à-vis the rest of the world, it is crucial to look beyond developments in Germany to ascertain where Germany stands relative to other countries.

Current account surplus is normal, historically speaking, …

Current account surpluses have been a feature of Germany's macroeconomic landscape since the end of the Second World War. Marked current account deficits occurred only sporadically between 1950 and 1990, specifically in the economic downturns in the late 1960s and the early 1980s. As a result, Germany's net external assets climbed to roughly one-fifth of GDP at the end of the 1980s. Following reunification, robust domestic demand coupled with the huge capital flows needed to reconstruct eastern Germany kept the current account in the red for a decade. Germany's current account, like its net international investment position, was close to balance at the

Germany's current account and net international investment position

As a percentage of GDP



1 Special trade according to the official foreign trade statistics including supplementary trade items, less freight and insurance costs payable on imports. **o** Western Germany until 1990; Germany as a whole from 1991.
Deutsche Bundesbank

turn of the millennium but then returned to positive territory; since the middle of the last decade the surplus, measured as a percentage of GDP, has even remained significantly above the values observed in the period preceding reunification.

… which is primarily explained by structural export surpluses

The German economy's current account surplus is primarily the outcome of cross-border merchandise trade, which reached an exceptionally high surplus averaging 6¾% of GDP over the past ten years. Recession years apart, the only time the export surplus was comparatively low was after reunification, when robust domestic demand encouraged enterprises in Germany – and further afield – to focus on the German market and accelerated goods imports from abroad. Statistically, around one-third of the overall surplus was attributable to net cross-border investment income over the past few years. This position made negative contributions, on balance, to the current account between 1997 and 2003 as a lagged response to the erosion of net foreign assets during the 1990s, while its renewed upturn can mainly be explained by the gradual reaccumulation of foreign assets. Specifically, Germany's net international investment position, which started close to balance at the end of 1998, climbed

Current account: definition, information content and relation to macroeconomic concepts

Together with the financial account and capital transfers, the current account constitutes the balance of payments, which provides a record of all economic transactions between residents and non-residents within a given period. The current account covers the corresponding flows of goods and income. Specifically, these flows comprise all transactions relating to trade in goods and services, income and current transfers. A current account surplus indicates that residents' receipts from these activities exceed their associated expenditure on them.

According to the principle of double-entry bookkeeping, each transaction generates a negative and a positive item in the balance of payments. The balances of all the sub-accounts therefore add up to zero. In practice, however, this is not the case owing to gaps in coverage and difficulties in classifying data on an accrual basis. For this reason, there is also a position for reporting errors and omissions.

Apart from capital transfers, which are quantitatively negligible, and statistical errors and omissions, a current account surplus corresponds to a net capital export, in other words an increase in claims on, or a decrease in liabilities to, the rest of the world. This encompasses any corresponding changes in the Bundesbank's foreign reserves or its other assets (eg TARGET2). Movements of assets between residents and non-residents, which are recorded in the financial account, are reflected as a transaction-related change in the net international investment position. Market price and exchange rate movements as well as other factors influencing the asset and liability positions contained in the external stock statistics (eg exceptional write-downs) are not relevant to the balance of payments.

In the national accounts, the current account balance (including the capital transfers balance) is reflected in the aggregate net lending/net borrowing position,[1] which mirrors the difference between residents' savings and domestic investment. Viewed from this perspective, a current account surplus indicates that, on balance, the total inflow of funds to residents is not being used solely for consumption (both domestically and overseas) and investment purposes at domestic locations but also to finance foreign investment projects and to accumulate claims on or to reduce liabilities to the rest of the world.

The aggregate net lending/net borrowing position is composed of the net lending/net borrowing positions of the following economic sectors: "Households and non-profit institutions serving households", "Non-financial corporations", "Financial corporations" and "General government". This breakdown makes it possible to investigate changes in the current account balance in the context of households' consumption and saving behaviour and firms' investment and financing decisions as well as of revenue and expenditure by general government.

1 Small discrepancies between the current account balance (including the capital transfers balance) and the net lending/net borrowing position are attributable to the partial use of different statistical sources, varying methods of calculation and the fact that the revision method applied to the two sets of figures is not identical.

to roughly €1,250 billion at the end of the third quarter of 2013 (46% of GDP).[1]

Travel and current transfers show deficits

Looking at the current account as a whole, structural surpluses in merchandise trade and across many parts of industry-related services such as the logistics sector contrast with the deficits posted in cross-border travel and current transfers. These components are relatively static over the short and medium term. Long-term trends in the travel sub-account nonetheless indicate that the deficit, measured as a percentage of GDP, has been tailing off appreciably since the turn of the millennium, while foreign travel expenditure by German residents in earlier decades typically outpaced economic growth.

Foreign trade and competitiveness

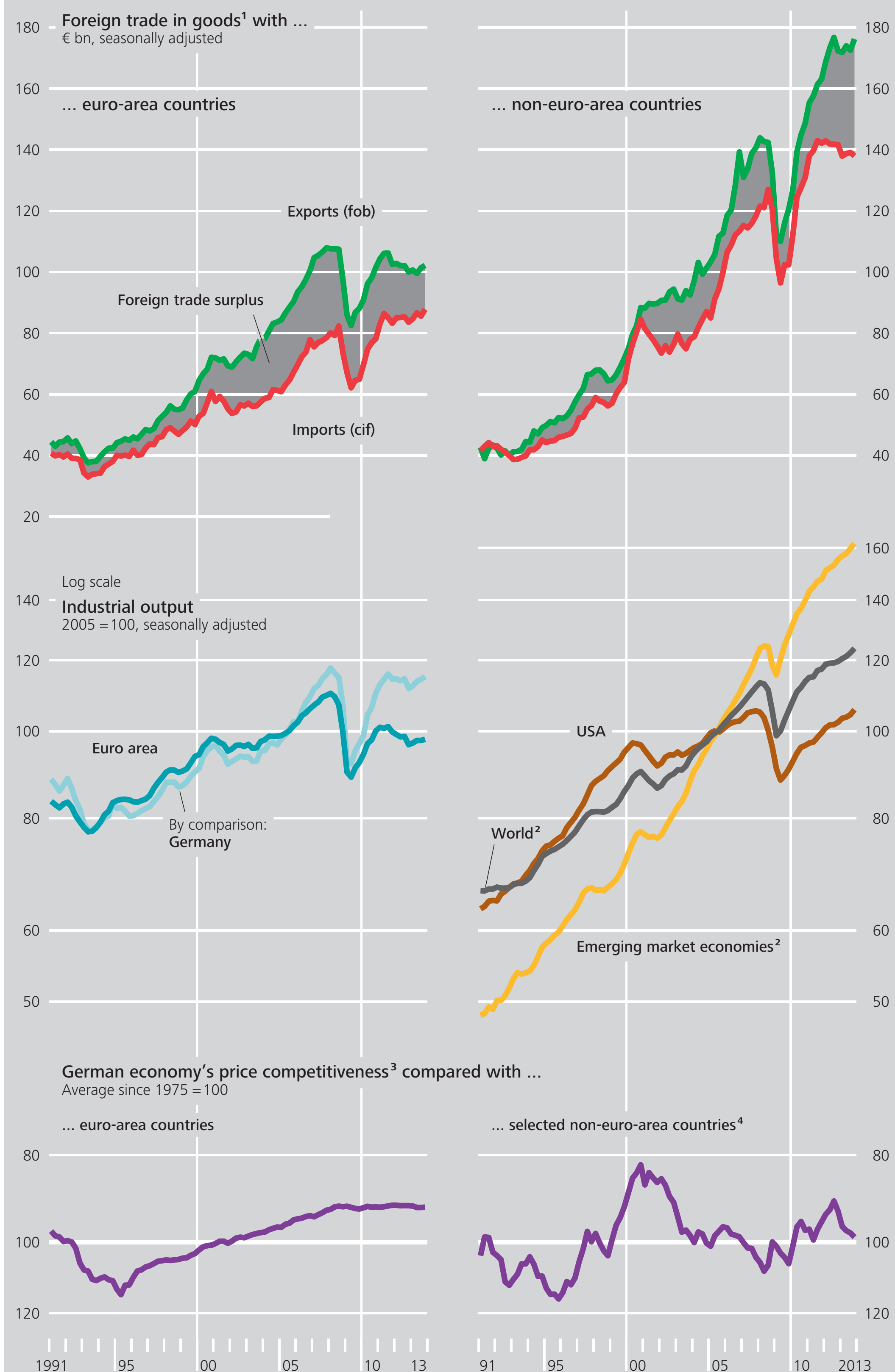
External demand has grown more important for German economy

German enterprises are well positioned in international sales markets, with foreign demand accounting for at least one-third of overall demand since 2007, the only exception being the global recession in 2009. Unlike many other countries, Germany was able to more or less defend its real world market share.[2] This can mainly be explained by the price and non-price competitiveness of German goods and services, which demonstrates enterprises' capacity to innovate as well as their more favourable cost structures. Wage policy responded to rising German unemployment by maintaining an employment-friendly stance for most of the last decade, making it easier for industry to keep and extend high-quality production stages of the value chain in Germany despite labour costs, by international standards,[3] remaining at high levels.[4] The allegation that Germany followed a "beggar thy neighbour" strategy of underbidding other countries' wages disregards the domestic structural problems that brought about wage moderation in the first place, especially considering that German manufacturers also shifted some of their production abroad during this period, albeit to a lesser degree than in the 1990s. As a result, the German economy is now even more integrated into international trade, not least in terms of intermediates suppliers and production locations.

Focus of exports shifting towards emerging markets …

Germany's industrial sector is benefiting in particular from the ongoing catch-up processes in emerging markets because it offers an attractive range of high-quality capital and consumer goods which are highly sought after in these fast-growing economies. For an indication of just how important these markets have become, the aggregate weight of goods exports to China and other South and East Asian emerging market economies in 2013, at one-twelfth, is no longer all that far behind the total share attributable to Germany's traditional non-European trading partners, the USA and Japan (together roughly one-tenth). The export success enjoyed by a number of globally active German automotive groups stands in contrast to the difficulties which their euro-area competitors are encountering in selling their vehicles, illustrating just how significant non-price factors like brand preference can be.

1 All other things being equal, Germany would have also achieved a net international investment position on this scale if it had consistently run a rather moderate current account surplus of 2% of GDP since 1991 (with the net international investment position accumulating these current account balances). This illustrates the significant contrast between the 1990s and the period thereafter. All in all, this puts the considerable accumulation of assets observed recently into perspective.
2 While it is true that Germany's nominal share of world trade in goods has shrunk from 11½% to 8% since 1991 in US dollar terms, nominal global market shares are influenced by exchange rate and price effects, which complicates their interpretation. Measured in real terms, however, Germany's position in the global marketplace has remained almost unchanged over the past two decades.
3 Eurostat reports that hourly labour costs in Germany's industrial sector averaged €35.40 in 2012, which is more than €5 higher than the euro-area average. In the euro area, this hourly rate was exceeded only by Belgium and, by a narrow margin, by France as well. Among EU member states (where the average was €24.20), hourly labour costs were also higher in Sweden and Denmark.
4 Disregarding cyclical fluctuations, the share of manufacturing in total employment has remained fairly constant since 2000 at one-fifth. The stability becomes even more apparent given the assumption that the vast majority of temporary workers are employed in industrial firms.



1 Special trade according to the official foreign trade statistics. 2 Source: Centraal Planbureau. 3 Based on deflators of total sales. Scale inverted: rising curve (declining values) indicates an increase in competitiveness. 4 Canada, Denmark, Japan, Norway, Sweden, Switzerland, United Kingdom and United States.

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… and away from the euro area

By contrast, exports to the euro area are characterised by below-average dynamics. In 2013, this group of countries accounted for just under 37% of all German goods exports, compared with almost 45½% in 2000 and 43% in 2008. The severe economic difficulties which the financial and sovereign debt crisis has inflicted on a host of euro-area countries have accelerated the region's loss of importance for German exports over the past years, adding to the gradual shifts brought about by increasing globalisation. Germany's price competitiveness relative to euro-area trading partners has remained largely constant since 2008, one contributing factor being the structural adjustments in the countries hardest hit by the crisis.

Cyclical investment lull temporarily interrupts upturn in imports

Goods imports initially made a relatively strong recovery from the severe recession in 2009. Imports were buoyed not just by the purely cyclical upward movement, but also by the fact that the burgeoning domestic demand during the current cycle, unlike the upswing observed in the last decade, is no longer being impeded by structural adjustment processes. Investment in machinery and equipment normally stimulates imports owing to its high import content, but this effect was absent over the past two years. Price factors also put a brake on nominal goods imports during this period. Prices particularly declined for imports of commodities and semi-finished products.

Reduction in the trade surplus with euro-area countries, …

The overall surplus in foreign trade in goods showed no significant decline from the high level reached at the end of the most recent upswing (7½% of GDP on average for the period from 2006 to 2008). Following the recession-related marked decline in 2009, the trade surplus went back up to 7¼% in 2012 and 2013 owing to special factors on the import side. Looking at the regional structure, the sideways movement in the aggregate is due to divergent developments. The trade surplus with the rest of the euro area, which amounted to as much as €116 billion in 2007, shrank considerably. At €59 billion last year, it stood at roughly half of that record figure. The adjustment of the trade surplus with the rest of the euro area through the export channel is, in large part, of a permanent nature, particularly as there is likely to have been a perceptible moderation in trend growth as well as in the level of demand, which was clearly excessive in a number of periphery countries prior to the crisis.[5] By contrast, demand for euro-area imports remained comparatively robust in the crisis period. A major factor in this context was German industry's demand for intermediate goods owing, not least, to its continuing successful export performance in other regions of the world. Nevertheless, international value chains are currently such that comparatively few inputs are being sourced from countries severely affected by the crisis.

… but sharp increase in the current account surplus with non-euro-area countries

In foreign trade with non-euro-area countries, the fact that the surplus doubled between 2010 and 2012 was essentially due to the extremely fast pace of growth in exports. Given a very moderate increase in exports, the further marked increase in the surplus to €139 billion last year was due, above all, to considerable gains from the terms of trade.

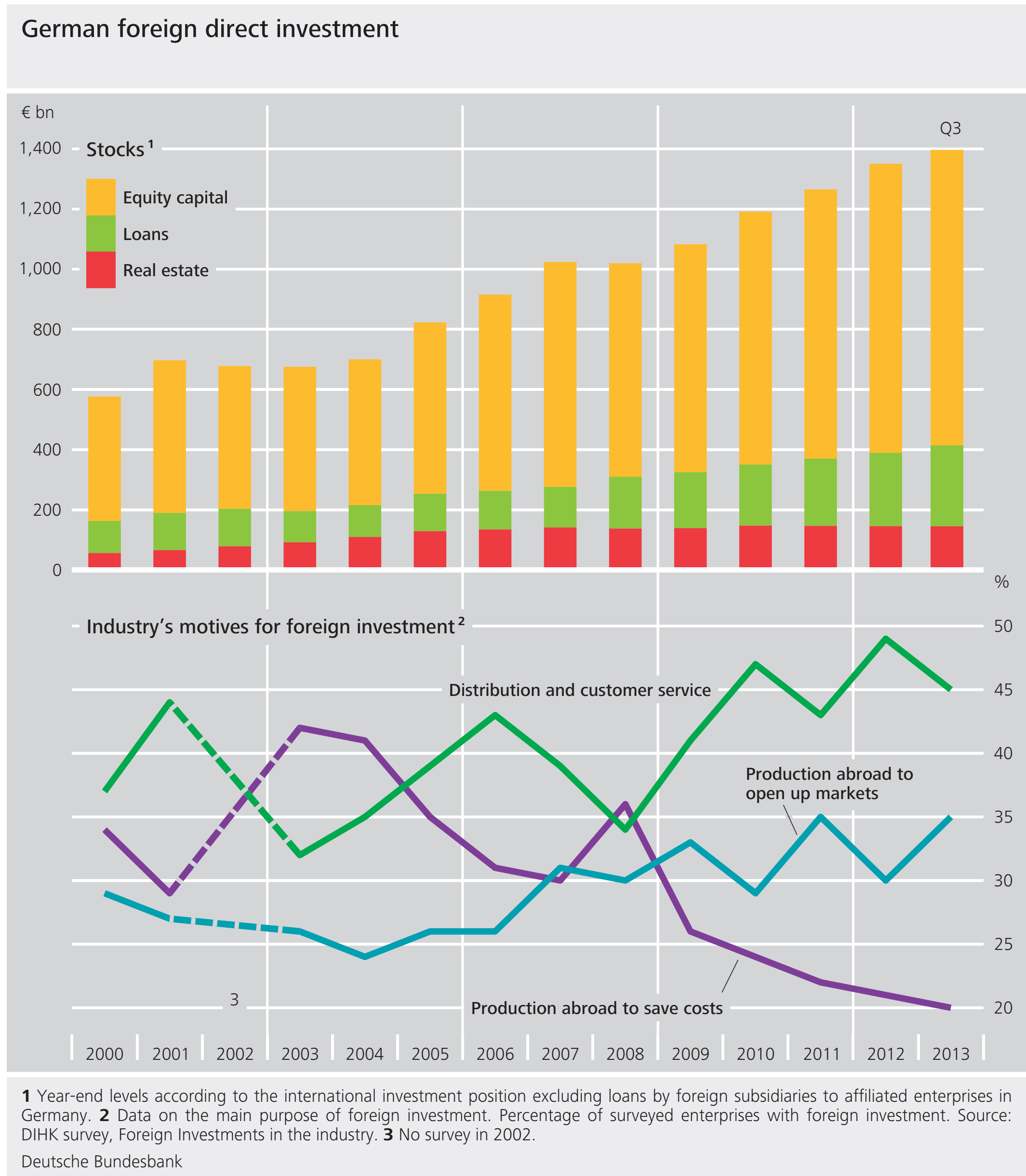
Global sales markets and international division of labour

Foreign investment safeguards presence and competitiveness on global markets

Enterprises are keen to safeguard and expand their market position and, to this end, are constantly exploring the potential for improvement in terms of process and product innovations, cost structures as well as the efficiency and customer orientation of their distribution channels. In an internationally integrated economy, these aims are achieved only if the search for the firm-specific optimal solutions encompasses foreign as well as domestic intermediates suppliers and production locations. On the production side, German industry has succeeded

5 See Deutsche Bundesbank, Adjustment processes in the member states of the economic and monetary union – Real economic adjustment processes and reform measures, Monthly Report, January 2014, pp 19-37.

German foreign direct investment



1 Year-end levels according to the international investment position excluding loans by foreign subsidiaries to affiliated enterprises in Germany. **2** Data on the main purpose of foreign investment. Percentage of surveyed enterprises with foreign investment. Source: DIHK survey, Foreign Investments in the industry. **3** No survey in 2002.

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in making use of cost advantages from the international division of labour. Especially in the case of high-value products, sophisticated marketing is also frequently required, augmented by the provision of maintenance and consulting services. Owing to the shift in demand for goods towards foreign markets, building up or expanding structures of this kind beyond national borders has been essential for a growing number of firms.

Strong expansion in equity capital abroad, …

There has been a sharp overall increase in German foreign investment over the past 20 years or more. Stocks of domestic enterprises' foreign direct investment including loans to affiliated enterprises abroad amounted to €1,400 billion (roughly 50% of GDP) at the end of the third quarter of 2013, compared with its volume of just over €250 billion (about 17% of GDP) at the end of 1991. It should be noted here that the underlying foreign direct investment statistics do not cover all forms of production transferred abroad. Not covered, for example, is "production to order" under the terms of a manufacturing licence where the licensor has no involvement in the production firm abroad.

In the 1990s, the transition countries of central and eastern Europe began to come to the at-

… with focus on transition countries in the 1990s and later increasingly on emerging markets

tention of German firms, since these countries offered attractive alternatives mainly for outsourcing industrial production stages. Over the past decade, non-European emerging markets, particularly China, became more important as destinations for investment. In the case of these rapidly growing markets, besides the motive of safeguarding low labour costs there was the added advantage of being able to service local demand directly. High tariffs, non-tariff trade barriers as well as government requirements concerning local production content for market entry in those countries play a major role.

Balance of payments effects of foreign direct investment depend on type and time horizon

Foreign direct investment represents, as a direct balance of payments effect, a capital export that arises either as a result of an outflow of domestic enterprises' funds to other countries or by the direct use of returns generated locally. The knock-on effects of foreign investments on flows of goods depend on whether production stages are relocated or whether the opening up of markets is promoted as a result. Empirical studies suggest that German direct investment tends to strengthen foreign trade rather than reduce it. Nevertheless, the impact on the trade balance is unclear.[6]

Return on foreign assets quite good overall

Foreign investment has also had an impact on the current account balance through the resulting investment income. For the period from 2005 to 2012, enterprises' foreign direct investment generated a notable total return of 7¼% per year on average, of which only just under ½ percentage point was due to valuation and exchange rate effects (which are not included in the current account).[7] The benefit of investments cannot be measured completely through their isolated returns – especially over a comparatively short period of time – since they represent individual measures within an overall business strategy. Even so, foreign direct investments performed well compared with other forms of financial investment abroad during the period under consideration. Foreign securities – amid higher volatility – brought a clearly lower return on average of 4¼% annually. The profitability of loans, which is scarcely affected by exchange rate and valuation effects, was even lower at 3¼% per year.

6 See, for example, S Krautheim (2013). Export-supporting FDI, Canadian Journal of Economics, 46 (4), pp 1571-1605.
7 The overall annual return on investment is calculated from the sum of investment income achieved during this period plus price-adjusted and exchange rate-adjusted changes as well as any value adjustments as a percentage of the stock at the beginning of the period.

German capital exports and international imbalances

Net capital exports for Germany …

Seen in terms of the balance of aggregate receipts and expenditure, a current account surplus means that domestic savings exceed, on balance, the investments made domestically by households, enterprises and government, and that financial resources are thus made available for use abroad. For the economy as a whole, the extent to which the acquisition of foreign assets is an advantage is generally measured – along the same lines as any individual investment decision – by whether a lucrative return can be expected given acceptable risks. The return expectations are mainly based on the growth prospects of the economies into which the funds flow. Individual risks are due to economic as well as political uncertainties that may compromise the value of foreign assets. With regard to the overall risk, opportunities for diversification by investing in foreign assets are also to be taken into consideration.

… rational given the demographic outlook

It is difficult to evaluate the return-risk profiles at the aggregate level. Nevertheless, even given a continuing strong capacity for innovation,

net immigration and rising labour force participation, it cannot be denied that Germany, solely on account of its demographic trends, will fall behind in terms of its potential growth compared with many other countries. With foreign assets accumulated through current account surpluses, the German economy will thus be able to participate in the potentially more dynamic economic growth elsewhere. The *per capita* income of the economy, the path of which is likely to be increasingly dampened by ageing effects, can thus be supplemented by capital gains from abroad. The average return on German foreign assets in the period from 2005 to 2012 was 4½% per year. This was somewhat more than foreign investors received on average on their investments in Germany (just over 4%). On the assets side, a comparatively large part of Germany's international position consists of investments which are characterised by volatile returns. On the liabilities side, there has been a sharp increase in the share of secure investments such as government bonds, not least as a result of safe-haven flows in the financial crisis. Given this risk structure, Germany is acting at a global level as a sort of insurer against real economic shocks and financial market turbulence.[8]

… and welcome for emerging market economies to finance their development processes

Moreover, considering the fact that capital from industrialised countries facilitates the economic catching-up processes of many emerging markets and developing countries, the German economy's current account surpluses fundamentally benefit those countries which are (net) receivers of capital, too. Such a mutual benefit nevertheless assumes that the funds are used for profitable projects in the recipient countries and that the resulting deficits do not give rise to unsustainable conditions in the long term that could lead, say, to turmoil on the financial and foreign exchange markets in connection with balance of payments crises. The exporters of capital themselves bear responsibility for prudent investment decisions, but their possibilities of exerting an influence are limited in most cases, especially with regard to the macroeconomic effects of aggregate capital flows. This is because these flows consist of a host of individual investments with risks that are difficult to assess, and macroeconomic vulnerabilities in the recipient countries have to be contained primarily by local political decision-makers.

Imbalances in the world economy with little adjustment so far, …

The correction of previous misalignments or distortions in one country triggers real economic and financial adjustments in other countries, too, via external trade links and capital flows, thus indirectly influencing the current account balances. Such a correction is under way in global imbalances, too, but has not yet been completed. In particular, there still exists a need for consolidation in some countries, both in public finances and in the corporate and household sectors. By contrast, there is no evidence that the current account balances result from obvious distortions in the German economy. The exchange rate of the euro, for example, is the outcome of market processes. Imports are not being hampered, and there is no identifiable preferential treatment that might explain an excessively positive export performance or high domestic savings. Furthermore, the wage bargaining process is market-driven and conducted by trade unions and management.

… but greater progress in the euro area

Germany's external trade relations exert a major influence on the euro area. But a distinction should be made between the internal and external dimensions. The declining current account surplus with the euro-area partner countries testifies to the fact that tensions within the monetary union are gradually abating owing to economic growth in Germany being bolstered more by domestic factors as well as initial successes in adjustment in the periphery countries. The rest of the euro area is benefiting from German enterprises' export strength in the world markets in the shape of "derived" demand impulses.

8 See G Ma and R N McCauley (2013), Global and euro imbalances: China and Germany, in M Balling and E Gnan (eds), 50 Years of Money and Finance, Lessons and Challenges, SUERF.

Savings and investment from a macroeconomic and sectoral perspective

Domestic savings and investment influenced by a variety of factors

The relationship between savings and investment in the German economy displays a number of distinctive features in the "Households and non-profit institutions serving households (NPISH)", "Non-financial corporations", "Financial corporations" and "General government" sectors. First, the net lending/net borrowing position of non-financial corporations has been distinctly positive for over a decade, which in general is somewhat untypical of industrial and commercial enterprises. Second, the positive net lending/net borrowing position of the "Households and NPISH" sector – which, in the definition used in the national accounts, includes enterprises not operated as corporations – was greater during this period than it was in the 1990s, while the fiscal deficit of the general government sector was smaller. The question as to whether this position is attributable to increased saving and/or a reduced propensity to invest needs to be addressed on a sector-by-sector basis.

Households' propensity to save and investment in housing

Household savings flowed into residential property and financial assets

In general, an economy's total savings mainly derive from households. According to the sectoral balance sheets in the national accounts for the end of 2012, four-fifths of Germany's national wealth was accounted for by the "Households and NPISH" sector.[9] These savings are invested principally in residential property and financial assets. While valuation effects have played their part in the generally continuous though at times volatile growth in financial assets – averaging 4½% a year since 1992 – the accumulation of property assets, which have grown at a slightly slower rate (around 4% a year), reflects the large fluctuations in housing investment.

Housing purchases slack over last decade …

The purchase of property – whether for owner occupation or investment purposes – has a range of effects on the saving and investment behaviour of households. Home buyers often liquidate their financial assets, but still need to finance a large proportion of the price by taking on considerable debt. These liabilities are usually repaid over an extended period according to a fixed schedule. The purchase of residential property lessens household saving indirectly in that it is usually accompanied by increased expenditure on consumer durables such as furniture and other furnishings. The adjustment process which has taken place on the German housing market over much of the last decade, correcting the boom in the aftermath of reunification, was associated with weak residential investment and more or less stagnant housing prices.[10] This largely nullified what is normally an important channel through which household savings are routed directly into fixed capital formation. Instead, the ensuing repayment effect, which is a particular form of saving, is likely to have been fairly considerable during the adjustment phase. All this contributed to a particularly high net lending position for households.

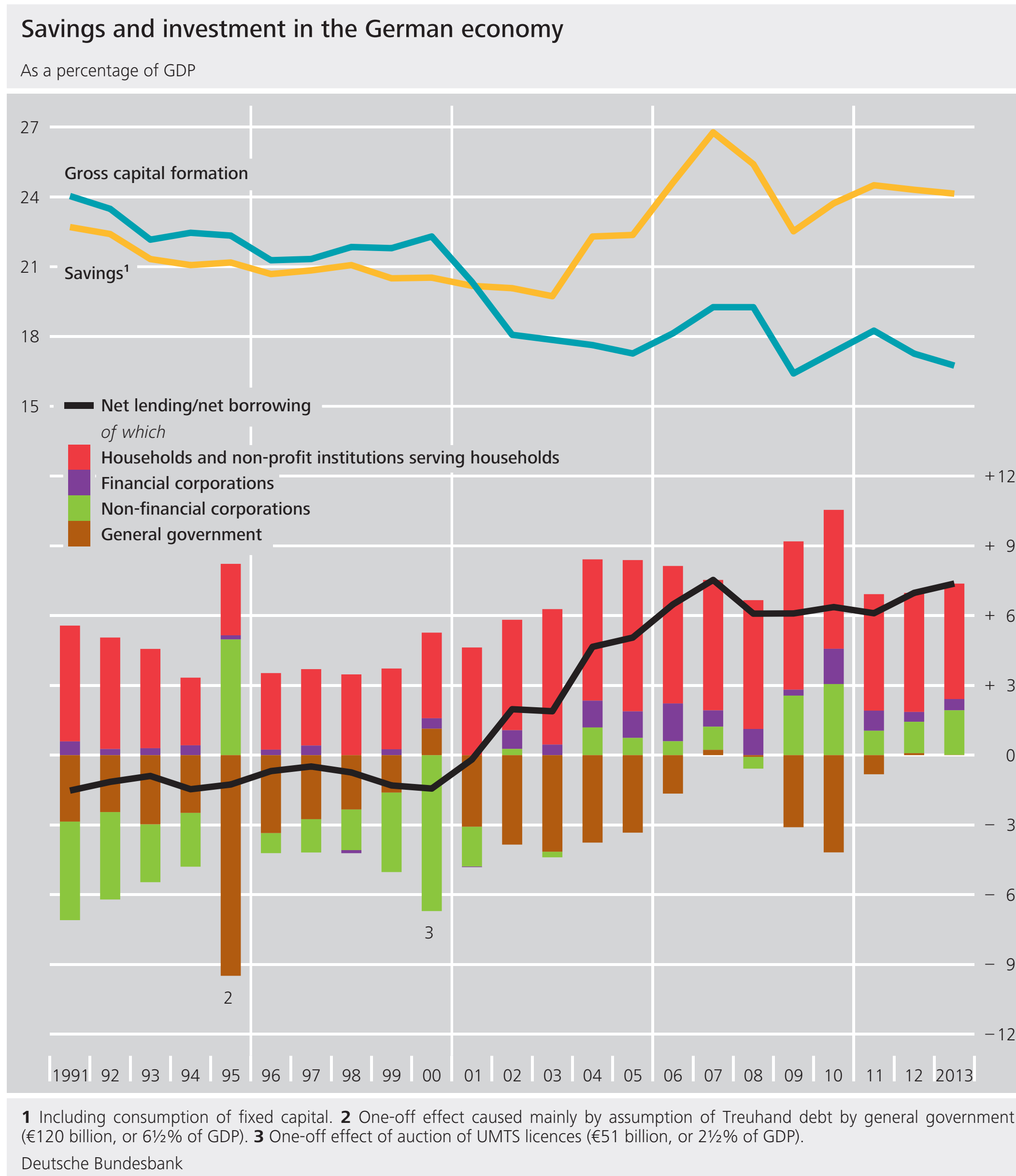
… and savings – except in the most recent period – back at a higher level

In the last decade, households' propensity to save has gradually increased. At 11½% of disposable income, the saving ratio in 2008 reached its highest level since the mid-1990s, though the ratio did not rise as high as its average for the 1980s (12½%). This increased saving occurred in a period when disposable

9 National wealth is defined as the net worth of the entire economy, comprising non-financial and financial assets minus liabilities, consolidated across all sectors of the economy. See Deutsche Bundesbank, Integrated sectoral and overall balance sheets for Germany, Monthly Report, January 2008, pp 31-45.
10 See also Deutsche Bundesbank, Extended investment cycle with stable prices: supply and demand in the German housing market from a longer-term perspective, Monthly Report, June 2010, pp 47-58.

Savings and investment in the German economy

As a percentage of GDP



1 Including consumption of fixed capital. 2 One-off effect caused mainly by assumption of Treuhand debt by general government (€120 billion, or 6½% of GDP). 3 One-off effect of auction of UMTS licences (€51 billion, or 2½% of GDP).
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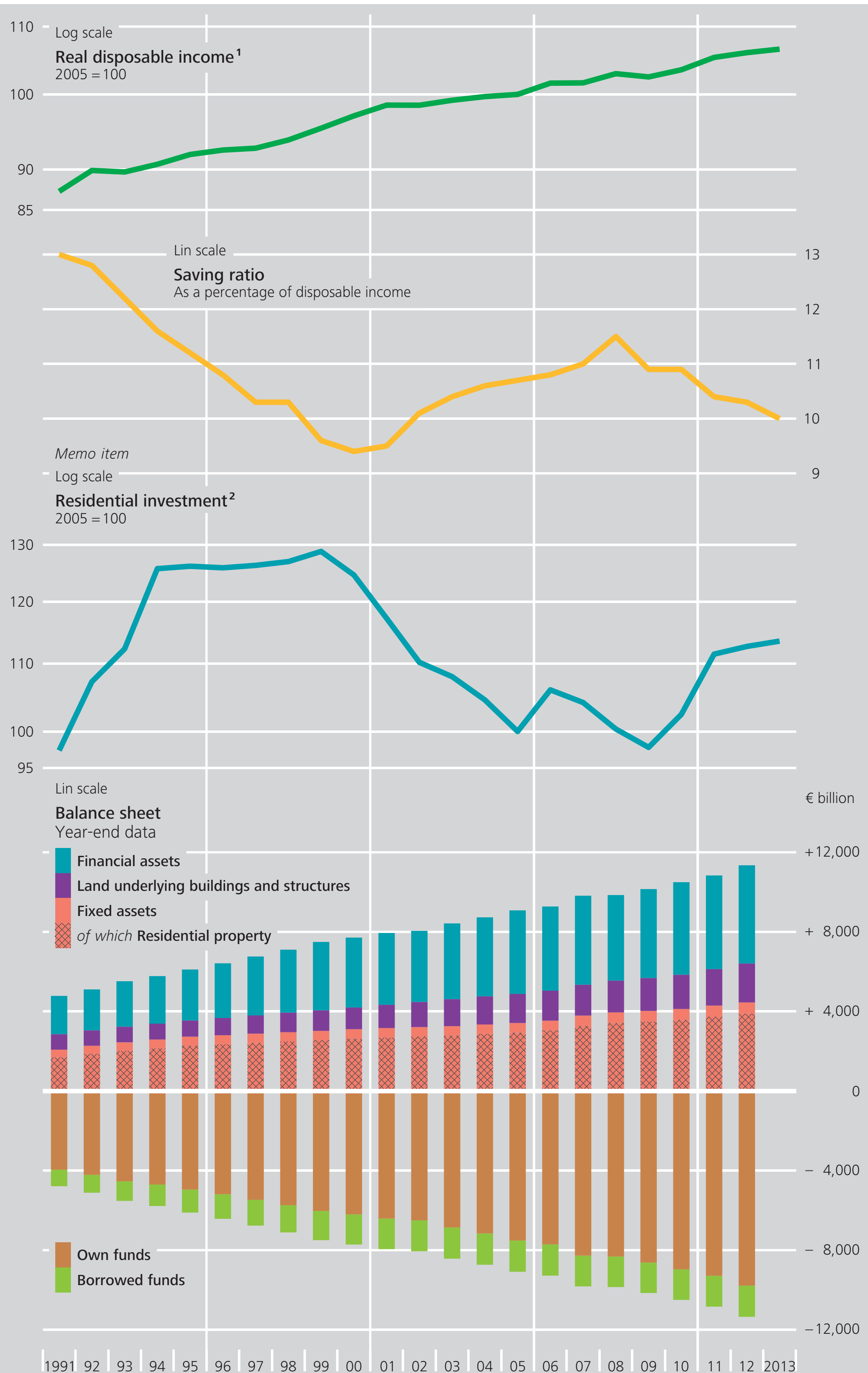
income rose only modestly owing, in particular, to marked wage moderation. This trend is likely to have been motivated by a recognition that more funds would have to be devoted to supplementary private old-age provision. This is to be seen in connection with the discussion about the long-term sustainability of state pension schemes which had begun in the mid-1980s. Benefits from statutory retirement pension schemes were reduced, and private pension provision was made more attractive by grants and favourable tax treatment. However, in the last five years, the saving ratio has decreased appreciably, falling to 10% by 2013. This fall was driven by a high propensity to consume and rising demand for residential property, which are based on confidence about future income and reduced employment risks.

Demographic outlook favours saving and places a drag on residential investment

In view of the demographic outlook, which is particularly unfavourable in Germany, supplementary private retirement pension provision is likely to continue to influence saving decisions in many households in the medium to long term. By contrast, Germany's demographics point to a rising share of the total population with a comparatively low propensity to save for life cycle reasons, resulting in a dampening effect on the aggregate saving ratio. With regard to investment, the demographic outlook very

Household income and asset accumulation



1 Deflated by the deflator of household final consumption expenditure. **2** Price-adjusted; households and corporations.
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much limits the potential for increased construction of new housing, notwithstanding the current buoyancy of the property market. This will remain true even if the resident population is stabilised by net immigration. Additional investment requirements will thus in future be focused increasingly on improving the quality of the housing stock. This includes renovation work to improve energy efficiency and installations allowing households to generate their own energy. Expenditure of this nature will be offset by future savings through lower energy costs.

Commercial investment and its financing

Upturn in fixed investment halted over the last two years by the crisis

Investment by enterprises in structures, machinery and equipment has been conspicuously low in the last two years. The upturn in fixed investment which followed the severe recession and rapidly gathered pace in 2010 and 2011 has come to a halt. In view of the ongoing prospect of depressed sales in the euro area and the uncertainty associated with the occasional flare-ups in the debt crisis, many firms probably judged it best to take a wait-and-see approach to future developments and to postpone the procurement of capital goods. Industrial enterprises, in particular, had no immediate need to invest in capacity expansion in the context of declining capacity utilisation. Although there are indications at present of a gradual unblocking of fixed investment, a strong recovery is not to be expected in the near future.

Structural "investment gap" seems limited

From a longer-term perspective, fixed capital formation is largely determined by the production-function foundations of economic growth. However, the potential labour force is unlikely to be greater at the end of this decade than it is now, even if immigration increases.[11] Nonetheless, advances in technology and knowledge offer growth opportunities. Making full use of the potential in these areas is a prerequisite for a substantial increase in fixed investment by business relative to value added. However, the increasing importance of producing close to the sales markets points instead towards stronger growth in foreign investment. Projects to expand domestic capacity for export purposes would reduce the current account surplus in the short term at best but would engender rising surpluses in the medium and long term.

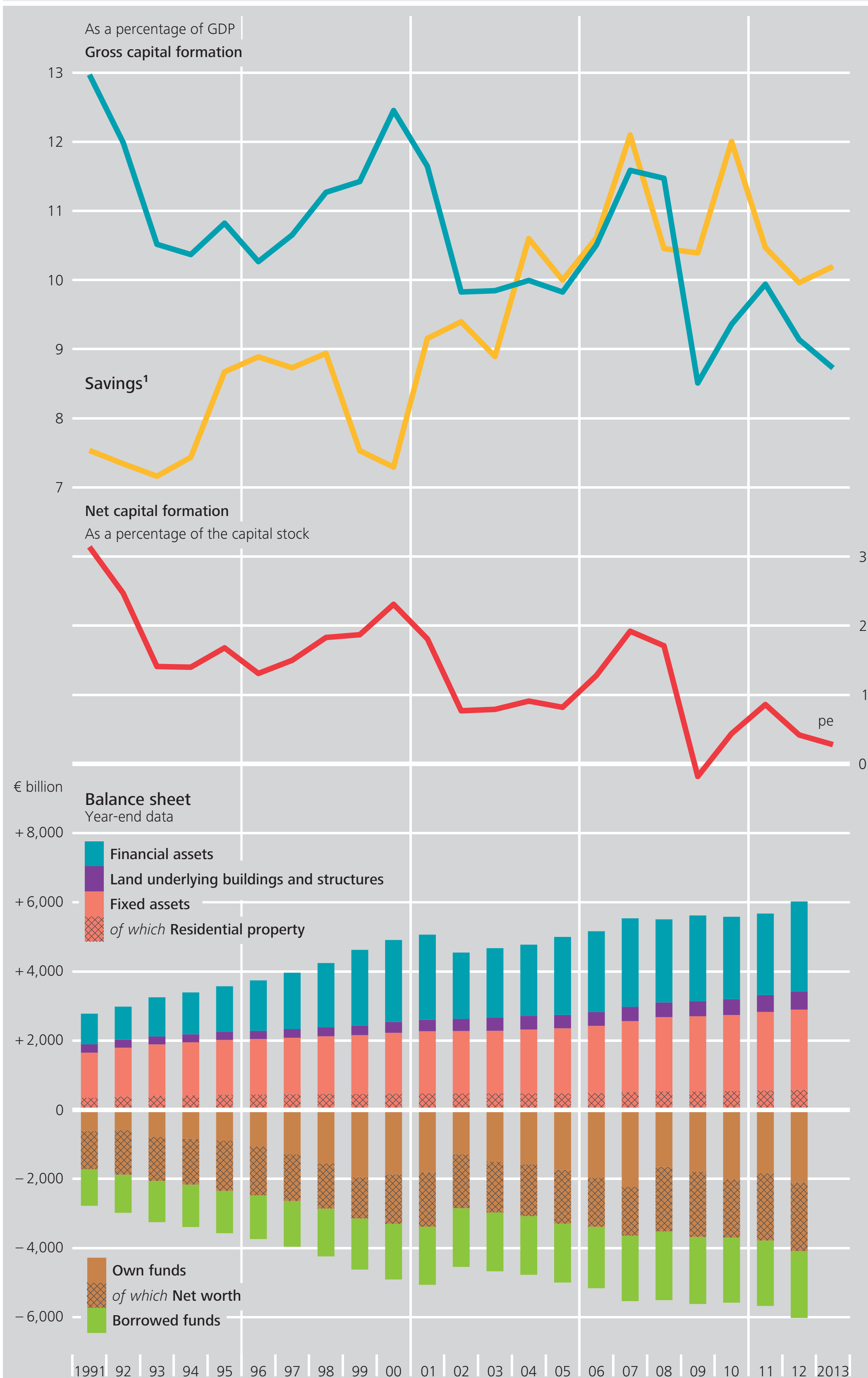
Strengthened equity base over the last decade due to one-off effects

The investment path in a long-term balanced growth scenario, with an equilibrated distribution of corporate earnings between employees and shareholders, requires a broad financing mix in general. Therefore, it is unlikely that the unusual circumstances of the last decade will persist – whereby retained earnings in the non-financial corporate sector were so high that investments were in large part funded internally. At the turn of the millennium, German enterprises had a very weak capital base by international standards.[12] Firms were also eager to reduce their dependency on bank borrowing, because the banks were obliged by the Basel II rules to make a more stringent assessment of their customers' creditworthiness. Furthermore, business tax reform in 2001 made self-financing of firms' investment appreciably more attractive for tax reasons, and inheritance tax tends to favour the formation of business assets. Over the last decade, firms used their earnings, which rose sharply thanks to favourable business conditions and continued wage moderation, in order to drive forward the accumulation of equity capital and the reduction of loan capital. This process substantially enhanced their financial resilience to economic risks, which helped the export-oriented sectors, in particular, to cope with the collapse in global demand in the latter part of 2008 and the early part of 2009 without significantly increasing insolvency risks. In view of the progress already

11 See Deutsche Bundesbank, Potential growth of the German economy – medium-term outlook against the backdrop of demographic strains, Monthly Report, April 2012, pp 13-28.

12 See Deutsche Bundesbank, Capital base of non-financial enterprises in Germany sustainably strengthened, Monthly Report, December 2013, pp 44-46, and Deutsche Bundesbank, Long-term developments in corporate financing in Germany – evidence based on the financial accounts, Monthly Report, January 2012, pp 13-27.

Investment and financing of non-financial corporations



1 Including consumption of fixed capital.
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achieved, it seems probable that earnings retained by non-financial corporations will be lower in the years ahead.

Consolidation of public finances and government investment

Consolidation of public finances

General government fiscal balances have improved since the end of the millennium. In particular, the deficit, from a starting position in the order of 1½% to 2% of GDP, and despite significantly higher figures being recorded at times, has now been fully eliminated – with the process of deficit reduction being supported in recent times mainly by a favourable macroeconomic and financial setting. The general government debt ratio has nonetheless risen significantly and has for a number of years been considerably in excess of the Maastricht ceiling of 60% of GDP. The national budget rules were reformed in 2009 with the objective of reversing the trend of a rising debt ratio which had spanned several decades, and thereby, not least, making provision for the demands which demographic change will impose. Furthermore, sound public finances are an important prerequisite for sustainable growth, they provide the government with room for manoeuvre even in times of crisis, and they ensure that Germany can act as an anchor of stability for the monetary union. In the years ahead, a largely neutral fiscal stance can be expected as things stand, and the general government fiscal balance is likely to remain more or less as it is.

Government investment has shown moderate trend for a long time

Gross investment by general government, more than half of which is devoted to transport and communications as well as education and science, has been on a downward path since the beginning of the 1970s – measured in relation to GDP – but has recently stabilised at a lower level. In terms of the current account balance, the decrease in the government investment ratio from just under 2% at the turn of the millennium to a little over 1½% of GDP most recently is less dramatic, and Germany's infrastructure is generally deemed to be relatively good by international standards. It is nonetheless the case that in the last ten years, according to the national accounts, gross government investment has failed to make good the depreciation of the public capital stock, and it is also relatively low compared to that in other countries. In interpreting such metrics, however, it needs to be borne in mind that some municipal activities in Germany, such as water supply and treatment and waste disposal, have been hived off from the government sector, and that a large share of investment in healthcare does not appear in government sector accounts, which means that it is especially important to consider the relevant sectoral allocation of investment when making international or historical comparisons.

Efficient infrastructure and energy policy switch require investment

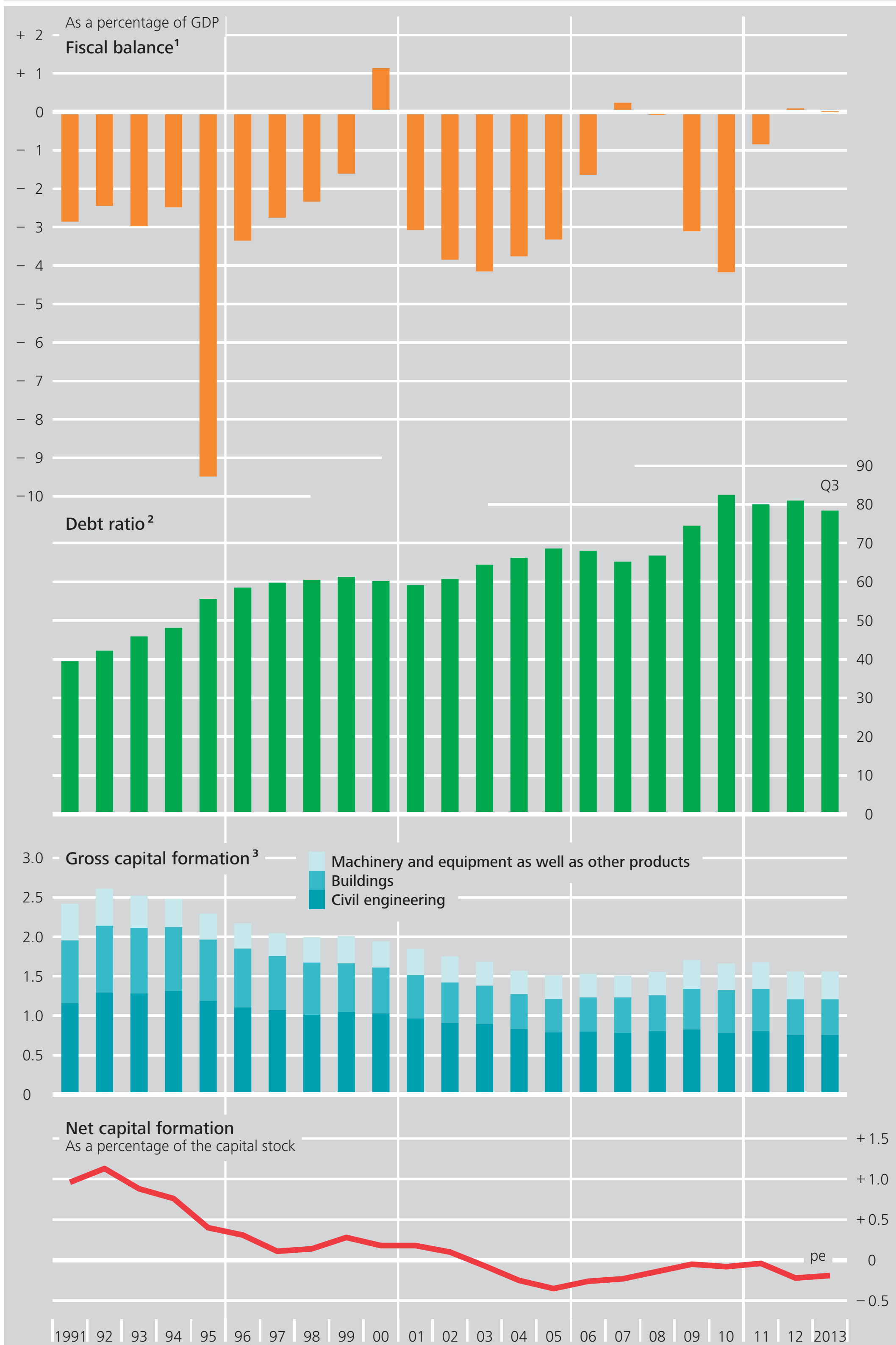
Nonetheless, a range of studies suggest that a certain amount of catch-up may be needed with a view to maintaining and extending public infrastructure. The additional investment needed in structural terms for upkeep in the core area of transport, for instance, is often put at ¼% of GDP per year.[13] In addition, the policy switch to non-nuclear energy generation and other projects of the new Federal Government, such as the "digital agenda for Germany", are associated with an increased need for investment, although by far the largest part of this investment will have to come from the private sector.

Successful investment policy calls for case-by-case investigation

A good infrastructure is important for economic growth. To ensure that this is achieved, the focus of activity must not be on simply expanding investment spending and its share of nominal GDP across the board. Particularly in view of the highly developed infrastructure which is already in place, and of the likelihood of demand falling in some areas of infrastructure

13 This is the magnitude calculated, for instance, in a report by the Bundesrat "Nachhaltige Verkehrsinfrastrukturfinanzierung" ("Sustainable financing of transport infrastructure") commission dated 30 September 2013, and in U Kunert and H Link, Verkehrsinfrastruktur: Substanzerhaltung erfordert deutlich höhere Investitionen, German Institute for Economic Research Wochenbericht No 26.2013, pp 32-38.

General government fiscal balance and investment



1 As defined in the Maastricht Treaty, ie including interest payments from swap transactions and forward rate agreements. Excluding adjustment for the balance of notional capital transfers between general government and the corporate sector principally occurring in connection with the dissolution of the Treuhand agency in 1995 (adjusted balance: −3.0% of GDP). Including the proceeds from the auction of UMTS licences in 2000 (adjusted balance: −1.3% of GDP). **2** As defined in the Maastricht Treaty. **3** Excluding residential investment by government and the balance of purchases and sales of land between general government and enterprises.

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and some regions for demographic reasons, case-by-case investigation is required to ascertain whether there is a need for replacement or whether a bottleneck needs to be eliminated. It also makes sense to devote greater attention to achieving value for money in the implementation of projects. In this context, the use of funds for investment purposes also has to be weighed against alternatives (other expenditure or lower taxes). Such calculations must factor in both the initial additional expenditure and follow-on costs.

Outlook and policy options

Current account surplus likely to shrink

The German economy's current account surplus is likely to shrink given the upward trend in domestic economic activity, solid growth forecasts worldwide – to which the euro area will gradually also be able to contribute once again – and lessening uncertainty in connection with the financial and debt crisis. The anticipated cyclical upturn in investment will stimulate imports. Due to the growth differential between Germany and the rest of the euro area, which will probably persist for some time, the trade surpluses with this region are also likely to continue their downward trend. It would be desirable in this context if the euro-area countries worst affected by the crisis were to make further discernible progress in their adjustment efforts, as this would improve their competitiveness and lead to imbalances being increasingly redressed through higher exports to Germany rather than low imports from Germany, as has been the case in recent years. If, moreover, global deleveraging processes continue at a rapid pace, the reduction in the German current account surplus is likely to be more pronounced than most forecasts currently expect.

Countervailing macroeconomic policy action in Germany inappropriate

If the high current account balances were due to market distortions or misaligned incentives in Germany, that would generally require economic policy action. However, there is no evidence of any pressing need for action of this kind.[14] Germany's considerable total savings overhang observed during the last decade was largely the result of the adjustments made by households, enterprises and policymakers in order to sustainably overcome the structural problems which became pressing after the turn of the millennium. This phase of economic weakness reflected both the indirect consequences of German reunification and the new conditions of European economic and monetary union. Now that this period of adjustment has almost run its course, it is likely that the specific set of circumstances which led to an increased propensity to save among households and high retained earnings among corporations on the one hand, and low domestic investment on the other, will largely become a thing of the past. Countervailing macroeconomic policy action would be equally inappropriate. At both a global and a domestic level, the situation is increasingly returning to normal of its own accord. Moreover, there are serious fundamental concerns regarding the feasibility and effectiveness of countermeasures. The current account balance cannot be managed through macropolicy, as it is the result of a multiplicity of decisions made primarily in the private sector.

Market-driven higher wage increases in Germany part of normal adjustment processes within monetary union

For around two years, negotiated wage increases in Germany have remained within a range which avoids placing excessive strain on operational cost structures, while also giving employees a significant increase in income. In view of the interests of wage bargainers, particularly those in industries facing stiff interna-

14 There were, however, major imbalances in other countries. The development of the German current account balance is partly a response to this. See the chapter entitled "German capital exports and international imbalances" (pp 47-60).

tional competition, marked growth in wage increases is unlikely. Nonetheless, given the current employment situation, including the increasing shortage of skilled workers, the relatively positive macroeconomic outlook and the robust structural situation of German enterprises, wage increases will probably be more pronounced in Germany in the coming years than in the euro-area countries which are worst affected by the crisis and which are facing major problems in the labour market. A market-driven development of this kind would be part of the usual adjustment processes within a monetary union and would be unlikely to jeopardise the significant job creation of the past or undermine the competitiveness of German products in markets outside Europe, meaning that it would not need to be corrected by economic policy either. Government intervention in the wage-setting process with the aim of actively boosting or supressing wage growth is not appropriate.

Fiscal stimulus also inadvisable

The notion of applying a fiscal stimulus through measures which are not funded by increasing revenue or cutting other expenditure should likewise be rejected, especially in light of the normal utilisation of aggregate production capacities,[15] high government debt, the burdens arising from demographic change, and national budgetary rules. Furthermore, given the low import content of the measures typically used to stimulate growth, ie consumption expenditure and public construction investment, the short-term effect of a fiscal stimulus on the trade balance would probably be minimal. This would still apply even if an increasing number of construction contracts were to be awarded to foreign enterprises because of the currently very high level of equipment utilisation in the German construction sector.[16]

Saving ratio of households could decrease on aggregate in long term

The effects of the comparatively unfavourable demographic outlook on saving decisions and investment will be extremely important for the medium to long-term development of the current account balance. With life expectancy set to rise further and the expected benefits from statutory pension insurance declining because of the shrinking proportion of young people in the total population, retirement saving is expected to rise. However, the saving ratio could still fall on aggregate, as age groups which are less likely to save will account for an increasingly large share of the total population. Demographics also limit the accumulation of fixed capital, which is closely linked to the resident population. This will affect both housing construction, unless the demand for space *per capita* increases or improvements are made in the quality of the housing stock, and the government institutions responsible for meeting personal needs (eg public administration, educational institutions).

Improving the conditions for investment and growth through more research and development …

Business fixed investment, in conjunction with technological advances and an efficient infrastructure, generates growth opportunities. In 2012, private and public spending on research and development amounted to just under €80 billion, two-thirds of which came from private sources. This means that the policy target of investing 3% of GDP in research and development, which was enshrined in the coalition agreement of the new Federal Government, had practically already been achieved two years ago. For the future, it is important to ensure favourable conditions for research and development.

… and rapid network expansion

Beyond the promotion of technological progress, the structural policy agenda in Germany also includes upgrading and expanding transport and communication networks, as well as a policy switch in energy supply. This is a focal

15 Based on the Bundesbank's estimates, the output gap is currently closed (see Deutsche Bundesbank, Outlook for the German economy – macroeconomic projections for 2014 and 2015, Monthly Report, December 2013, pp 13-26). By contrast, the European Commission's calculations suggest underutilisation of production capacities of around 1% (see European Commission, Macroeconomic Imbalances – Germany 2014, European Economy, Occasional Papers 174, March 2014).
16 Revenue generated by foreign enterprises from construction projects in Germany has more than doubled since 2006. Less expenses for German subcontactors, however, income only amounted to around €1¼ billion in 2013, or less than 1% of the current account surplus.

Policy recommendations following the European Commission's In-Depth Review of Germany under the Macroeconomic Imbalance Procedure

On 5 March 2014 the European Commission presented its report on the In-Depth Review on the existence of macroeconomic imbalances in the German economy.[1] This comprehensive investigation focuses on identifying what caused the high current account surpluses observed in the past years. The topics it covers and its specific policy recommendations are broadly consistent with the essence of this Bundesbank article. Some sections of the Commission's report go beyond the scope of this article.

Unlike the Bundesbank, the Commission assesses Germany's persistent current account surpluses as an indication of macroeconomic imbalances in the German economy which require monitoring and policy action. Nonetheless, the report does acknowledge that the international competitiveness of German exporters is not only buoying the domestic economy but also benefiting Germany's European trading partners owing to the high degree of integration in production processes. Germany's past fiscal consolidation is considered appropriate overall. The thrust of the Commission's policy recommendations is based on the diagnosis that domestic growth drivers have been relatively subdued for years. In the Commission's view, policy action is thus needed to spur domestic demand and stimulate the German economy's growth potential. Against this background, the report mainly puts forward proposals designed to raise private and public investment.

The Commission welcomes the Federal Government's plans to boost public investment. However, on the basis of the assessment that the backlog in public infrastructure investment is relatively large, the Commission concludes that the additional funds that have so far been earmarked for modernisation and expansion are insufficient. According to the report, the biggest investment needs are at the municipal level, which strengthens the case for quickly reforming the fiscal relations between the different layers of government so as to increase local government's fiscal space and ensure policy clarity. The report adds that central and state government should prioritise efforts to improve conditions in the fields both of education and training and of research and development. Additional spending should not, however, result in a dilution of the fiscal policy course, which the Commission considers appropriate.

To unleash growth potential, the Commission recommends that policy action be taken to boost labour force participation, and makes a case for further easing the immigration of skilled workers from abroad. This would positively impact on corporate investment. The Federal Government's plan to reduce the retirement age for certain groups of workers is viewed critically in the report – this would shrink the labour supply of older persons and, in conjunction with other planned benefit increases, squander the scope for easing non-wage labour costs. Cost increases could be curbed by making full use of efficiency reserves in the healthcare sector. The report generally recommends that the direct tax and social security burden should be shifted away from labour

1 See European Commission, Macroeconomic Imbalances – Germany 2014, European Economy, Occasional Papers 174, March 2014.

income to more growth-friendly sources. The Commission criticises the existence of disincentives which tend to prevent second earners and low-skilled workers from taking up employment or working more hours. The report adds that the level and scope of the minimum wage should take into account the potential impact on employment. Moreover, appropriate conditions should be secured in order to enable wage growth to further contribute to domestic demand.

The Commission also points out that more efficient corporate taxation might support private investment. Amongst other things, it would be useful for Germany to work towards a tax system which reduced the tax bias towards debt financing and did not unduly favour the accumulation of retained earnings and discourage companies from paying out dividends. The Commission also believes that greater efforts to cut bureaucracy, while promoting deregulation and measures designed to facilitate business start-ups, could provide fresh impetus for economic growth, particularly in a number of services sectors. The report states that successfully engineering the policy switch to non-nuclear energy generation was, on the one hand, crucial to the German economy given the importance of safeguarding an efficient supply of energy; on the other hand, it would necessitate substantial investment, for example in the expansion of energy grids.

The Commission's analysis of financial intermediation is another topic highlighted by the report: the main challenges facing the German banking system were to ensure that it had sufficient loss absorption capacity to withstand economic and financial shocks and to address any impediments to further consolidation.

area of the policy recommendations presented by the European Commission within the context of its In-Depth Review of possible macroeconomic imbalances (for details of the individual proposals, see also the box on pages 58 and 59). Viewed in isolation, such large-scale projects require significant investment, although – with the exception of transport infrastructure – the majority of the funding is provided by private investors rather than the government. A particularly important task for the government is to put in place the framework conditions for the fast and efficient implementation of development proposals and to bring about a broad public consensus on specific projects.

No debt financing of additional public spending

Additional public spending needs must be funded not via debt incurrence but by consolidating finances elsewhere. The financial position of local government is likely to improve due to planned additional grants from central government. State governments must identify sustainable prospects for the future for highly indebted local governments and initiate countermeasures to prevent over-indebtedness in future. It is generally worth considering the option of funding investments by levying use-related fees or charges. Public-private partnerships or private-sector provision also make sense, provided these options also offer cost savings over the long term and the economic risks are distributed appropriately between the public sector and private lenders.

High current account surplus not an indication of severe market distortions and misaligned incentives

Taken in isolation, higher productivity-enhancing private and public investment not only leads to a reduction in the current account balance first and foremost, but also generates higher *per capita* income in the medium to long term. Germany would remain an attractive destination for immigrants, which would bolster the potential labour force and boost housing demand. Productivity potential is also leveraged by making efficient use of infrastructure. To achieve this, it is necessary to bring market forces to bear to a greater extent in sectors

such as logistics, healthcare, telecommunications and energy. Other possible measures include deregulation in the craft trades and in some services sectors. The main reason why structural product market reforms of this kind make sense is that domestic growth opportunities would otherwise be squandered. While the current account balance is likely to diminish as a knock-on effect, this effect should not be overestimated. Ultimately, this also shows that the high current account surplus of recent years is not an indication of major market distortions and misaligned incentives in the German economy.

Need for growth policy and structural policy initiatives

The German economy's current account surplus has undoubtedly been especially high in recent years. However, this is due to a number of special factors, which will probably fade into the background while endogenous economic adjustment processes will come to the fore. In Germany's case, attempts to directly control macroeconomic developments through economic policy are not necessary, are unlikely to succeed and could even be counterproductive under certain circumstances. German economic policy must, however, strengthen domestic growth in Germany and thus counteract the decline in potential output growth caused by demographic change. The efficient provision of energy, public infrastructure, education, research and development as well as the regulation of the services sector offer ample points of departure for such a growth policy, and the resulting impetus could eventually filter through to the current account balance. Given Germany's relatively unfavourable demographics and its high standard of living, however, current account surpluses appear to be entirely appropriate for the German economy for the foreseeable future.

Chronology of economic and monetary policy measures

1 January 2013

The European Fiscal Compact enters into force. The legal requirements are to be fulfilled by the signatory countries within the year.

The contribution rate to the statutory pension insurance scheme is cut from 19.6% to 18.9%, while the public long-term care insurance scheme contribution rate is raised from 1.95% to 2.05% (plus 0.25 percentage point for childless persons). At the same time, nursing benefits are increased, particularly for individuals suffering from dementia.

Central government transfers to the health insurance fund and to the statutory pension insurance scheme are lowered by €2.5 billion and €1 billion, respectively. In addition, the surgery visit charge applying to out-patient treatment is abolished.

With retroactive effect, the basic income tax allowance is raised by €126 to €8,130. The background to this is the constitutionally enshrined tax exemption up to the minimum subsistence level.

Under the Third Financial Market Stabilisation Act (*Drittes Finanzmarktstabilisierungsgesetz*), the raft of measures drawn up to stabilise the financial sector in 2012 are extended until the end of 2014. To help cover any losses arising from stabilisation-related intervention, in future use may also be made of money held in the restructuring fund in order to ease the burden on the taxpayer.

16 January 2013

In its Annual Economic Report, central government expects a rebound in growth in 2013. The increase in real GDP is, however, forecast to be limited to 0.4% on account of the weak fourth quarter of 2012 and first quarter of 2013. Growth is expected to be driven primarily by the domestic economy, with exports probably rising only moderately and imports seeing more dynamic growth. It is anticipated that this will result in a slightly negative growth contribution from foreign trade. Private consumption and housing investment are forecast to increase perceptibly, whereas investment in machinery and equipment is again expected to see noticeable cuts.

30 January 2013

Banks are for the first time allowed to fully or partially repay central bank money which they obtained through the first three-year refinancing operation. 278 counterparties take advantage of this opportunity and redeem a total of €137 billion in borrowed funds. From this date on, banks are entitled to repay any unneeded liquidity from the first three-year tender on a weekly basis. Of the original tender amount of €489 billion, €260 billion in funds are redeemed by the end of 2013.

7 February 2013

The ECB Governing Council "unanimously took note" of the liquidation of IBRC, the state-owned Irish Bank Resolution Corporation, and its effects on the Irish central bank's balance sheet. IBRC had received large-scale emergency liquidity assistance (ELA) from the Irish central bank, primarily on the basis of short-term government promissory notes. In exchange for liquidating this collateral, the Irish government presented the Irish central bank with long-term government bonds with lower coupons.

21 February 2013

The ECB Governing Council publishes details of the Eurosystem's holdings of securities acquired under the Securities Markets Programme (SMP). As at this date, the nominal value of these holdings stands at €218 billion, with Italian, Spanish, Greek, Portuguese and Irish bonds accounting for €103 billion (47%), €44 billion (20%), €34 billion (16%), €23 billion (11%) and €14 billion (7%) of this total, respectively. The

average remaining maturity of all outstanding bonds is 4.3 years.

27 February 2013

Under the second three-year tender, banks can now likewise repay liquidity they no longer need to the Eurosystem. At the earliest possible juncture, 356 counterparties take advantage of this opportunity by redeeming a total of €61 billion. By the end of 2013, these redemption payments reach a total of €187 billion. The original volume allotted under the second three-year tender was €529 billion.

12 March 2013

The Bundesbank presents its annual accounts for the 2012 financial year. The profit of €664 million is transferred to central government.

13 March 2013

The Federal Government sets out benchmark figures for the 2014 central government budget and the fiscal plan up to 2017. With net borrowing of €6½ billion, a structurally balanced budget is envisaged for 2014. From 2015 onwards, the plan is to halt net borrowing and to instead aim for growing surpluses, reaching a target of €9½ billion by 2017.

21 March 2013

The ECB Governing Council decides that it will only consider maintaining the current level of emergency liquidity assistance (ELA) requested by the Central Bank of Cyprus beyond Monday, 25 March 2013 if an EU/IMF adjustment programme is in place by this date that would ensure the solvency of the banks concerned.

22 March 2013

To ensure that monetary policy counterparties are treated equally and to simplify the existing legal situation, the ECB Governing Council adopts a decision which prevents, as of 1 March 2015, the use as collateral in Eurosystem monetary policy operations of uncovered government-guaranteed bank bonds and covered bonds that have been issued by the counterparty itself or an entity closely linked to it, and, in the case of covered bonds, contain uncovered bank bonds originating from the same pool.

17 April 2013

The Federal Cabinet presents an updated stability programme for Germany. This assumes real GDP growth of 0.4% in 2013, 1.6% in 2014 and 1½% annually in the years thereafter up to 2017. Plans for the general government budget envisage a return to a deficit of ½% in 2013 after a surplus of 0.2% of GDP one year previously. The stability programme foresees a balanced budget for 2014 and 2015 followed by a surplus of ½% of GDP in both 2016 and 2017. In structural terms, a surplus of ½% of GDP is projected for 2014 and beyond. The debt ratio is expected to diminish significantly from 81.9% in 2012 to 69% in 2017.

22 April 2013

The general government deficit and debt figures reported by the EU member states in their spring notifications by the end of March are published under the European budgetary surveillance procedure, after validation by Eurostat. According to these data, in 2012 Germany recorded a general government surplus of 0.2% of GDP coupled with a year-end debt ratio of 81.9%. For 2013, central government announced a planned deficit ratio of 0.3% and a fall in the debt ratio to 80.4%.

2 May 2013

The ECB Governing Council decides to lower the interest rate on the Eurosystem's main refinancing operations by 25 basis points to 0.50%, commencing with the operation to be conducted on 8 May 2013. In addition, it leaves the interest rate on the deposit facility

unchanged at 0.00% and reduces the interest rate on the marginal lending facility by 50 basis points to 1.00%. The ECB Governing Council also decides to conduct refinancing operations with maturities of one week, one maintenance period and three months as fixed-rate tenders with full allotment until 8 July 2014.

7 May 2013

According to a ruling of the Federal Constitutional Court, the unequal treatment of (same-sex) registered civil partnerships and marriages with regard to the splitting of income taxation between couples is incompatible with the general principle of equality and is unconstitutional. The relevant provisions are amended with retroactive effect.

15 May 2013

After submitting an application for financial assistance on 25 June 2012, Cyprus eventually sees a corresponding macroeconomic adjustment programme approved by the euro-area member states on 24 April, then endorsed by the International Monetary Fund (IMF) on 15 May. The total amount of financial assistance envisaged comes to €10 billion, of which €9 billion is to be provided by the European Stability Mechanism (ESM) and €1 billion by the IMF.

28 May 2013

The Stability Council establishes that in 2012 the federal states of Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein once again adhered to the deficit ceilings set out in Article 143d of the German Basic Law as a condition for granting consolidation assistance and thus agrees to release the relevant funding.

29 May 2013

The European Commission presents the Council with a number of recommendations relating to decisions under the excessive deficit procedure (EDP): it is argued that the procedure initiated against Italy in 2009 should be abrogated as its general government deficit ratio dropped below the reference value in 2012 and it is forecast that the country will keep to this course in future.

It is further recommended that an excessive deficit procedure be initiated against Malta on account of its 2012 deficit ratio of 3.3% and its insufficient progress in reducing the debt ratio, even though the last such procedure was only terminated in December 2012. In this context, Malta is called upon to correct its excessive deficit by 2014.

The Netherlands, France, Portugal, Slovenia and Spain are found to have taken effective measures to correct their excessive deficits in a timely manner. In the light of some unexpected economic developments which considerably compromised these countries' public finances, the national deadlines for correcting excessive deficits were extended by two years in the case of France, Slovenia and Spain and by one year for the Netherlands and Portugal. Hence, the Netherlands is required to correct its excessive deficit by 2014 while France, Portugal and Slovenia must achieve this target by 2015; the deadline for Spain is 2016. The European Commission issued its judgement, stating that effective measures had been implemented, on the basis of a complex, opaque process of examination which was not uniform from one country to the next. Had it not taken this stance, the aforementioned deadline extensions would only have been permitted conditional on a stepped-up EDP and financial sanctions might have been incurred.

Belgium failed to achieve its target of a deficit ratio of 3% or less on time in 2012 and the European Commission concluded that Belgium did not take sufficient effective action in order to meet the recommendations of the EDP. The Commission urges the Council to step up the EDP and to give notice to Belgium but refrains from imposing financial sanctions, as funda-

mentally provided for under the Six-Pack. Belgium is called upon to correct its excessive deficit in the course of 2013.

The Ecofin Council endorses the European Commission's recommendations on 21 June 2013.

30 May 2013

Entry into force of two new EU regulations, known as the Two-Pack, aimed at strengthening the surveillance of national fiscal policies.

7 June 2013

The Bundesbank expects the economy to grow by 0.3% (0.4% in calendar-adjusted terms) in 2013, probably increasing to 1.5% in 2014. Consumer price inflation, as measured by the Harmonised Index of Consumer Prices (HICP), is forecast to decrease, to 1.6% in 2013 and 1.5% in 2014, owing to the effect of declining crude oil and commodity prices. Despite waning negative external factors, the accelerated increase in wages, is, however, likely to push up the rate excluding energy to 1.8% in 2014, compared with 1.6% in 2013.

11 and 12 June 2013

The Second Senate of the Federal Constitutional Court opens its oral proceedings as part of the main action concerning the ESM/ECB. Bundesbank President Jens Weidmann and Jörg Asmussen, member of the ECB's Executive Board, are among those to contribute to these oral proceedings, providing expert assessments of the ECB's outright monetary transactions (OMT) programme, which greenlights where necessary the purchase of government bonds issued by euro-area countries undergoing certain ESM or EFSF programmes, as announced by the ECB Governing Council in the summer of 2012.

24 June 2013

The Federal Government approves a draft supplementary budget for 2013 for the solitary purpose of facilitating advance loan payments amounting to €8 billion to a national flood assistance fund. Departing from standard practice, no adjustments are made to take account of the results of the latest official tax estimate or the Bundesbank's much lower-than-expected profit distribution, for example, nor does the government lend its approval to the extraordinary financial transfer to Greece decided in autumn 2012.

Moreover, the Federal Cabinet gives its assent *inter alia* to draft legislation to create a flood assistance fund.

26 June 2013

The Federal Government comprising the CDU/CSU and FDP approves a draft of the 2014 central government budget along with a fiscal plan up to 2017. Under the draft budget, the core budget is expected to run a structural surplus of €2 billion. On balance, the improvement vis-à-vis the benchmark figures adopted in March is mainly the result of lower projected interest expenditure. The fiscal plan contains only marginal adjustments to the benchmark figures. Following the general election on 22 September 2013, the new government will be required to present a new draft budget for 2014.

28 June 2013

In light of the debt restructuring arrangement for Cyprus and the corresponding rating downgrades, the ECB Governing Council decides to temporarily suspend the eligibility of marketable debt instruments issued or fully guaranteed by the Republic of Cyprus for use as collateral in Eurosystem monetary policy operations. This step is then reversed on 5 July once the aforementioned restructuring programme has come to a close.

1 July 2013

Croatia becomes the 28th country to join the European Union, from which point on the Hrvatska narodna banka is part of the European System of Central Banks (ESCB).

18 July 2013

In a biennial review of its risk control framework, the ECB Governing Council adjusts the eligibility criteria concerning the collateral accepted for monetary policy operations. In this context, the haircuts applied to asset-backed securities (ABS) are reduced and the rating requirements for ABS subject to loan-level reporting requirements are lowered from two "triple A" ratings to two "single A" ratings.

19 July 2013

The Act concerning the implementation of the Fiscal Compact within Germany (*Gesetz zur innerstaatlichen Umsetzung des Fiskalvertrages*) enters into force. With reference to the European Stability and Growth Pact and the Fiscal Compact, the Budget Principles Act (*Haushaltsgrundsätzegesetz*) stipulates a ceiling for the general government deficit, thus fundamentally limiting the structural deficit ratio to a maximum level of 0.5%. In addition, the Stability Council is charged with monitoring compliance with this ceiling and with proposing appropriate measures to help avoid any breaches, should the need arise. To fulfil this additional task, the Council will receive support from a newly formed committee. The nine-member committee will also include a Bundesbank representative. In a further modification affecting the national debt brake on the central government budget, the balance accumulated on the control account for the fiscal years up to and including 2015 will be cancelled with effect from 31 December 2015.

12 September 2013

The ECB welcomes the European Parliament vote in favour of establishing a Single Supervisory Mechanism (SSM).

10 October 2013

The ECB Governing Council concludes its first-ever currency swap agreement with the People's Bank of China (PBC). The arrangement, which will initially be valid for three years, will have a maximum size of 350 billion yuan when yuan are provided to the ECB and of €45 billion when euro are provided to the PBC. Furthermore, on 31 October the temporary swap lines set up between the ECB and the Bank of Canada, the Bank of England, the Bank of Japan and the Federal Reserve System will be converted into permanent facilities.

15 October 2013

For the very first time, the Federal Government submits a draft budgetary plan under the reformed programme for budgetary surveillance at the European level (Two-Pack). The draft budgetary plan expects the 2013 budget to develop slightly more favourably than envisaged in April's updated stability programme. On this basis, it is deemed possible to achieve a practically balanced budget and a structural surplus of ½% as early as 2013. As previously set out, the position attained is expected to be maintained in principle in 2014. After standing at 81.0% in 2012, the debt ratio is projected to fall to 79½% in 2013 and 77% in 2014.

17 October 2013

The ECB Governing Council publishes details about the emergency liquidity assistance (ELA) programme on a first-time basis. Pursuant to Article 14.4 of the Statute of the ESCB and of the ECB, this assistance falls within the remit of the national central banks. Nevertheless, the ECB Governing Council has the power to restrict the granting of ELA if it finds, by a majori-

ty of two-thirds of votes cast, that the provision of ELA is inconsistent with the objectives and tasks of the ESCB. To this end, the Governing Council has defined and published specific disclosure requirements and thresholds.

21 October 2013

The general government deficit and debt figures reported by the EU member states in their autumn notifications by the end of September are published under the European budgetary surveillance procedure, after validation by Eurostat. For Germany, the revised figures for 2012 vis-à-vis the spring notification reveal a surplus of 0.1% of GDP and a debt ratio of 81.0%. For 2013, central government announced a planned deficit ratio of 0.2% and a fall in the debt ratio to 79.6%.

23 October 2013

The ECB publishes details of its comprehensive assessment of large banks, which it is scheduled to conduct prior to commencement of banking supervision activities under the SSM. The assessment will subject each of about 130 credit institutions to a supervisory risk assessment, an asset quality review and a stress test.

7 November 2013

The ECB Governing Council cuts its key policy rate again: as of 13 November 2013, the interest rate on the main refinancing operations will be set at 0.25%, putting it 25 basis points below its previous level. Parallel to this, it lowers the interest rate on the marginal lending facility by the same margin to 0.75%, while once again leaving the interest rate on the deposit facility untouched at 0.00%. The Governing Council announces its intention to conduct its refinancing operations as fixed-rate tenders with full allotment not just until mid-2014 as per its announcement in May but up to 7 July 2015.

8 November 2013

The ECB publishes its opinion on the Single Resolution Mechanism (SRM) in which it states the need, among other things, for a clear-cut distinction to be made between the responsibilities of the resolution and supervisory authorities.

13 November 2013

In its 2013-14 Annual Report, the German Council of Economic Experts forecasts a further brightening of the economic picture in the course of 2014. Driven by domestic demand, real GDP is expected to increase by 1.6%. Exports are projected to rise on account of the resurgent global economy. However, imports are set to expand at a faster pace owing to domestic investment activity and stable private consumption, resulting in a slightly negative net trade figure of -0.2 percentage point. After falling in 2013, investment in machinery and equipment is expected to go up by an impressive 6.2%, bolstered by the pick-up in demand and the continually improving internal funding options. Construction investment is forecast to increase substantially by 4.1%. Private consumption is set to grow by 1.4% and government consumption by 1.1%. It is anticipated that disposable income will increase by 3.4%. Under these conditions, employment is projected to rise on a similar scale to 2013, while the unemployment rate should remain virtually unchanged at 6.8%.

15 November 2013

In accordance with one of the EU regulations contained in the Two-Pack, the European Commission assessed the 2014 draft budgetary plans that had to be put forward by 15 October 2013. It criticised the plans of most of the countries to varying degrees, and five countries were instructed to take additional action to meet the EDP recommendations. However, the Commission found none of the countries culpable of a serious failure to comply with the rules set out in the Stability and Growth Pact,

so it refrained from demanding a new budgetary plan.

In accordance with the EDP, the European Commission investigates whether the countries concerned took effective action in line with the expressed recommendations during 2013. Belgium, Spain, France, Malta, the Netherlands and Slovenia are all found to have complied, rendering any further steps under the EDP unnecessary at this juncture.

The European Commission states its opinion on the economic partnership programmes. In line with the provisions contained in the Two-Pack, these were required for the euro-area countries Spain, France, Malta, the Netherlands and Slovenia and had to be presented by 1 October 2013.

4 December 2013

Upon confirmation of the successful implementation of the adjustment measures prescribed for Ireland, the latter was allotted the final tranche of its financial assistance. Funds from the European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Facility (EFSF), the IMF and bilateral loans totalled €67.5 billion. Even after completion of the programme, Ireland remains subject to regular monitoring until 75% of the European assistance loans has been repaid. The IMF will also continue its surveillance of the country.

5 December 2013

In the course of monitoring the structural general government deficit ratio pursuant to section 51(2) of the Budget Principles Act, the Stability Council finds that the regular ceiling of 0.5% of GDP is being adhered to. At the same time, the Council criticises the restructuring programme to ward off impending budgetary hardship presented by the federal state of Bremen in particular, but also that of Saarland.

6 December 2013

Given estimated potential growth of 1.4%, the Bundesbank forecasts real GDP growth of 1.7% for 2014 and of 2.0% for 2015 (1.8% in calendar-adjusted terms). These developments are driven by domestic demand. The sustained improvement in the labour market is expected to lead to higher wage increases than in the past. Consumer price inflation, as measured by HICP, could initially dip to 1.3% in 2014, but then go up again to 1.5% in 2015. If energy is excluded, the rate is likely to increase to 1.5% in 2015 in the wake of the accelerated rise in wages.

16 December 2013

Ms Danièle Nouy, previously Secretary General of the French Prudential Supervision and Resolution Authority (*l'Autorité de contrôle prudentiel et de résolution*), is appointed as Chair of the Supervisory Board of the new SSM operating under the auspices of the ECB.

17 December 2013

Subsequent to the German general election on 22 September 2013, a coalition government is formed comprising the CDU/CSU and the SPD; the Federal Chancellor and her cabinet are duly sworn into office. The coalition agreement concluded between the three political parties contains numerous fiscal policy measures. While these evidently envisage higher levels of new borrowing on the part of both central and general government compared with the parameters set by the previous government, it seems that larger structural deficits are not likely to be on the cards. The parties agree on additional unfunded expenditure totalling €23 billion in the central government budget for the 2014 to 2017 period. Most of this money is to be spent on education, research, childcare and transport infrastructure, but part of it will be used to ease the financial burden on state and local government. These measures are complemented *inter alia* by plans to increase social security

payments – in particular measures concerning the statutory pension insurance scheme, but also, for example, the benefits provided under the public long-term care insurance scheme. By necessity, the additional spending on social security funds will entail higher contribution rates and a faster depletion of reserves than would have been the case without the new measures.

1 January 2014

Latvia becomes the 18th EU member state to adopt the euro as its currency; the Latvijas Banka becomes a member of the Eurosystem.

The basic income tax allowance is raised by €224 to €8,354.

15 January 2014

According to the provisional figures, the 2013 central government budget recorded a deficit of €22½ billion, representing a marginal year-on-year decline of €½ billion despite the €8 billion worth of advance payments channelled to the flood assistance fund. However, transfers to the social security funds were also cut on a discretionary basis by a net €6 billion. Applying the simplified central government procedure, the cyclical burden comes to €4 billion (as opposed to the procedure used by the Bundesbank, which again generates a much smaller figure), while net burdens from financial transactions (especially owing to ESM contributions) are found to amount to €3½ billion. Taking into account the surpluses of the off-budget entities (not least that of the flood assistance fund), the Federal Ministry of Finance records a figure for structural net borrowing of 0.23% of GDP, which is thus below the upper limit of 0.35% of GDP to be observed as of 2016.

23 January 2014

The assistance programme for the Spanish banking sector, which was not tied to a macroeconomic adjustment programme, is officially ended. The ESM granted loans totalling €41.3 billion to the FROB restructuring fund, which passed the money on to the banks. The overall volume of funds made available under the assistance programme (€100 billion) was therefore far from fully exhausted.

24 January 2014

The ECB Governing Council announces that it will cease to conduct US dollar liquidity-providing operations with a maturity of three months as of April 2014 on account of the greatly improved market conditions. These operations had met with very little demand of late.

27 January 2014

Ms Sabine Lautenschläger, formerly Deputy President of the Bundesbank, is appointed to the Executive Board of the ECB where she assumes responsibility for banking supervision and the position of Vice-Chair of the Supervisory Board of the SSM. In this capacity, she succeeds Jörg Asmussen who takes up the post of State Secretary at the Federal Ministry of Labour and Social Affairs.

7 February 2014

The Federal Constitutional Court announces its intention to split the proceedings in the main action relating to the ESM/ECB that was initiated in June 2013. While its verdict concerning the ESM and the Fiscal Compact will be announced on 18 March 2014, the proceedings surrounding the ECB Governing Council's decision on OMT will be separated and suspended, as the Federal Constitutional Court will present the European Court of Justice with a range of questions on which it will give a preliminary ruling. In the context of this decision, the Federal Constitutional Court takes a critical look at the OMT programme.

12 February 2014

According to its Annual Economic Report, central government anticipates a broad-based up-

turn in 2014. The increase in real GDP would then come to 1.8%. Growth is expected to be driven primarily by the domestic economy. Exports are projected to rise moderately, with imports experiencing more dynamic growth. In real terms, this is expected to result in a broadly balanced growth contribution. Private consumption and housing investment are forecast to increase perceptibly and investment in machinery and equipment is expected to expand sharply. Employment is forecast to increase by 0.6% and the unemployment rate is expected to remain virtually unchanged at 6.8%.

25 February 2014

The Federal Statistical Office reports a balanced general government budget (pursuant to the Maastricht criteria) for 2013.

5 March 2014

The European Commission presents its in-depth review, which assesses whether there are any macroeconomic imbalances in Germany. The review focuses on the causes of the persistently large current account surpluses of recent years, which the Commission interprets as an indication of macroeconomic imbalances. However, it acknowledges that the high level of competitiveness of German exporters is not only buoying domestic economic activity but also benefiting Germany's European trading partners owing to the high degree of integration in production processes. The Commission recommends measures to spur domestic demand and stimulate the German economy's growth potential.

13 March 2014

The Bundesbank presents its annual accounts for the 2013 financial year. The profit of €4,591 million is transferred to central government.

Annual accounts of the Deutsche Bundesbank for 2013

Balance sheet of the Deutsche Bundesbank as at 31 December 2013

Assets

			31.12.2012
		€ million	€ million
1 Gold and gold receivables		94,876	137,513
of which: gold receivables €325,635.90			*(0)*
2 Claims on non-euro-area residents denominated in foreign currency			
2.1 Receivables from the IMF	20,798		(22,344)
2.2 Balances with banks, portfolio investment, external loans and other external assets	28,080		(28,774)
		48,878	51,118
3 Claims on euro-area residents denominated in foreign currency		125	3,341
4 Claims on non-euro-area residents denominated in euro		–	–
5 Lending to euro-area credit institutions related to monetary policy operations denominated in euro			
5.1 Main refinancing operations	38,162		(2,855)
5.2 Longer-term refinancing operations	13,771		(69,651)
5.3 Fine-tuning reverse operations	–		(–)
5.4 Structural reverse operations	–		(–)
5.5 Marginal lending facility	122		(587)
		52,054	73,093
6 Other claims on euro-area credit institutions denominated in euro		4,691	1,442
7 Securities of euro-area residents denominated in euro			
7.1 Securities held for monetary policy purposes	55,844		(67,487)
7.2 Other securities	–		(–)
		55,844	67,487
8 Claims on the Federal Government		4,440	4,440
9 Intra-Eurosystem claims			
9.1 Participating interest in the ECB	2,031		(2,038)
9.2 Claims arising from the transfer of foreign reserves to the ECB	10,872		(10,909)
9.3 Claims related to the allocation of euro banknotes within the Eurosystem (net)	–		(–)
9.4 Other claims within the Eurosystem (net)	510,467		(654,948)
		523,369	667,895
10 Items in course of settlement		3	2
11 Other assets			
11.1 Coins	879		(838)
11.2 Tangible and intangible fixed assets	844		(909)
11.3 Other financial assets	11,777		(12,125)
11.4 Off-balance-sheet instruments revaluation differences	3		(46)
11.5 Accruals and prepaid expenses	1,747		(2,840)
11.6 Sundry items	1,503		(2,219)
		16,753	18,977
		801,033	1,025,306

Liabilities

			31.12.2012
		€ million	€ million
1 Banknotes in circulation		237,258	227,231
2 Liabilities to euro-area credit institutions related to monetary policy operations denominated in euro			
2.1 Current accounts	83,877		(129,607)
2.2 Deposit facility	10,712		(40,470)
2.3 Fixed-term deposits	46,870		(129,885)
2.4 Fine-tuning reverse operations	–		(–)
		141,459	299,962
3 Other liabilities to euro-area credit institutions denominated in euro		–	–
4 Liabilities to other euro-area residents denominated in euro			
4.1 General government deposits	2,013		(11,870)
4.2 Other liabilities	8,453		(28,059)
		10,466	39,929
5 Liabilities to non-euro-area residents denominated in euro		52,047	83,284
6 Liabilities to euro-area residents denominated in foreign currency		1,830	3
7 Liabilities to non-euro-area residents denominated in foreign currency		37	76
8 Counterpart of special drawing rights allocated by the IMF		13,486	14,058
9 Intra-Eurosystem liabilities			
9.1 Liabilities related to the issuance of ECB debt certificates	–		(–)
9.2 Liabilities related to the allocation of euro banknotes within the Eurosystem (net)	224,251		(200,308)
9.3 Other liabilities within the Eurosystem (net)	–		(–)
		224,251	200,308
10 Items in course of settlement		2	1
11 Other liabilities			
11.1 Off-balance-sheet instruments revaluation differences	–		(–)
11.2 Accruals and income collected in advance	226		(397)
11.3 Sundry items	3,079		(2,919)
		3,305	3,317
12 Provisions		19,221	18,898
13 Revaluation accounts		88,080	132,577
14 Capital and reserves			
14.1 Capital	2,500		(2,500)
14.2 Statutory reserves	2,500		(2,500)
		5,000	5,000
15 Profit for the year		4,591	664
		801,033	1,025,306

Profit and loss account of the Deutsche Bundesbank for the year 2013

				2012
			€ million	€ million
	1.1 Interest income	7,281		(11,001)
	1.2 Interest expense	– 1,715		(– 2,742)
1	Net interest income		5,566	8,259
	2.1 Realised gains/losses arising from financial operations	379		(832)
	2.2 Write-downs on financial assets and positions	– 733		(– 52)
	2.3 Transfers to/from provisions for general risks, foreign exchange risks and price risks	–		(– 6,671)
2	Net result of financial operations, write-downs and risk provisions		– 353	– 5,891
	3.1 Income from fees and commissions	60		(63)
	3.2 Expenses relating to fees and commissions	– 21		(– 21)
3	Net income from fees and commissions		39	42
4	Income from participating interests		526	195
5	Net result arising from allocation of monetary income		– 11	– 689
6	Other income		268	185
	Total net income		6,035	2,100
7	Staff costs		745	706
8	Other administrative expenses		330	324
9	Depreciation of tangible and intangible fixed assets		105	113
10	Banknote printing		36	91
11	Other expenses		228	203
	Profit for the year		4,591	664

Frankfurt am Main, 11 February 2014

DEUTSCHE BUNDESBANK
Executive Board

Dr Jens Weidmann

Dr hc Rudolf Böhmler   Dr Andreas Dombret   Dr Joachim Nagel   Carl-Ludwig Thiele

Unqualified auditor's report for statutory audits of annual financial statements

We have audited the annual financial statements – consisting of the balance sheet and the profit and loss account – together with the bookkeeping system of the Deutsche Bundesbank for the business year from 1 January 2013 to 31 December 2013. The maintenance of the books and records and the preparation of the annual financial statements in accordance with generally accepted accounting principles and the principles for the accounting of the Deutsche Bundesbank approved by the Executive Board pursuant to section 26 (2) of the Bundesbank Act are the responsibility of the Executive Board of the Deutsche Bundesbank. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, based on our audit.

We conducted our audit of the annual financial statements in accordance with section 317 HGB ["Handelsgesetzbuch": "German Commercial Code"] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [*Institute of Public Auditors in Germany*] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with [German] principles of proper accounting are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Deutsche Bundesbank and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records as well as the annual financial statements are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of the annual financial statements. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and the additional provisions of the principles for the accounting of the Deutsche Bundesbank and give a true and fair view of the net assets, financial position and results of operations of the Deutsche Bundesbank in accordance with [German] principles of proper accounting.

Eschborn/Frankfurt am Main,
25 February 2014

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Müller-Tronnier	Kuhlmann
Wirtschaftsprüfer	Wirtschaftsprüferin

Overview of the principles for the accounting of the Deutsche Bundesbank

General accounting principles

Record of economic reality, thus reflecting the Bundesbank's assets and liabilities, financial position and profitability; prudence; account to be taken of post-balance-sheet events that affect the balance sheet; materiality; going-concern principle; accruals principle (income and expense to be recognised in the accounting period in which they are earned or incurred); consistency and comparability.

Recording of spot transactions

Spot transactions in gold and foreign currencies shall be taken into account as from the trade date for ascertaining the average acquisition costs and the realised gains and losses. The balance sheet recording of these spot transactions and of spot transactions in securities shall be based on the date of payment (settlement date).

Balance sheet valuation rules

Gold, foreign currency instruments, securities and financial instruments shall be valued at mid-market rates and prices on the balance sheet date. Securities held to maturity and non-marketable securities are valued at amortised cost.

No distinction shall be made between price and currency revaluation differences for gold, but a single gold revaluation difference shall be accounted for on the basis of the euro price per defined unit of weight of gold derived from the euro-US dollar exchange rate on the balance sheet date.

Revaluation shall take place on a currency-by-currency basis for foreign exchange (including off-balance-sheet transactions).

In the case of securities, each revaluation shall be on a code-by-code basis (same ISIN number/type).

Repurchase agreements

A repurchase agreement (repo) shall be recorded as a collateralised inward deposit on the liabilities side of the balance sheet while the item that has been given as collateral remains on the assets side of the balance sheet. A reverse repurchase agreement (reverse repo) shall be recorded as a collateralised outward loan on the assets side of the balance sheet for the amount of the loan.

In the case of security lending transactions, the assets shall remain on the balance sheet of the transferor.

Income recognition

Realised gains and realised losses can arise only in the case of transactions leading to a reduction in securities items or currency positions. They are derived from a comparison of the transaction value with the acquisition value as calculated using the average method; they shall be taken into the profit and loss account.

Unrealised gains and unrealised losses arise as a result of the revaluation through a comparison of the market value with the acquisition value as calculated using the average method. Unrealised gains shall not be recognised as income but shall be transferred directly to a revaluation account.

Unrealised losses shall be taken into the profit and loss account if they exceed previous unrealised gains registered in the corresponding revaluation account. Unrealised losses recorded in the profit and loss account in previous years shall not be reversed in subsequent years in the event of new unrealised gains. There shall be no netting of unrealised losses in any one security, in any currency or in gold holdings against unrealised gains in other securities, currency or gold.

The average cost method shall be used on a daily basis for calculating the acquisition cost in the case of assets that are subject to exchange rate and/or price movements. The average cost price or rate of the assets shall be reduced by unrealised losses taken into the profit and loss account at the end of the year.

Premiums or discounts arising on purchased securities shall be treated as part of interest income and shall be amortised using the internal rate of return method.

Accrual and deferral items covering foreign currency holdings shall be converted at the mid-market rate on each business day and change the respective foreign currency position.

Accounting rules for off-balance-sheet instruments

Foreign exchange forward transactions, the forward legs of foreign exchange swaps and other currency instruments involving an exchange of one currency for another at a future date shall be included in the foreign currency position as from the trade date.

Interest rate swaps, futures, forward rate agreements and other interest rate instruments shall be accounted for and valued on an item-by-item basis.

Gains and losses arising from off-balance-sheet instruments shall be treated in a similar manner to those from spot transactions.

Tangible and intangible fixed assets

Tangible and intangible fixed assets shall be valued at cost less depreciation, which shall be calculated on a straight-line basis and applied over the expected economic life of the asset. A distinction shall be made as follows:

– Computers, related hardware and software, and motor vehicles: four years
– Equipment, furniture and installed equipment: ten years
– Building and capitalised refurbishment expenditure: 25 years
– Depreciation shall not apply to land

Tangible and intangible fixed assets, the acquisition value of which, after deduction of value added tax, is less than €10,000 shall be fully amortised in the year in which they were acquired.

Provisions

With the exception of the provisions for Eurosystem monetary policy operations, the regulations set forth in the Commercial Code *(Handelsgesetzbuch)* continue to apply to the reporting of provisions in the balance sheet. Pursuant to section 26 (2) of the Bundesbank Act *(Bundesbankgesetz)*, the creation of liability items for general risks associated with domestic and foreign business is possible.

Transitional arrangements

The assets and liabilities shown in the closing Deutsche Mark balance sheet of 31 December 1998 shall be revalued on 1 January 1999. Unrealised gains arising on or before 1 January 1999 are to be recorded separately from the unrealised gains which arise after 1 January 1999. The market rates/prices applied by the Bundesbank in the euro-denominated opening balance sheet of 1 January 1999 shall be deemed to be the average acquisition rates/prices as at 1 January 1999. The revaluation items for unrealised gains accruing on or before 1 January 1999 shall be dissolved only in connection with decreases in value and in the event of disposals after 1 January 1999.

General information on annual accounts

Legal basis

Sections 26 and 27 of the Bundesbank Act (*Gesetz über die Deutsche Bundesbank)* form the legal basis for the annual accounts and the distribution of profit. In accordance with the provisions on accounting laid down in the second sentence of section 26 (2), the Bundesbank may apply the accounting principles governing the annual accounts of the ECB.

Accounting principles of the Deutsche Bundesbank

The Governing Council of the ECB adopted the principles it applies to its annual accounts in accordance with Article 26.2 of the ESCB Statute. The Deutsche Bundesbank decided to adopt those principles as the "accounting principles of the Deutsche Bundesbank"[1]. An overview of the principles for the accounting of the Deutsche Bundesbank is given above.

Balance sheet entry of euro banknotes and …

The ECB and the national central banks of the euro-area countries, which together comprise the Eurosystem, issue banknotes denominated in euro. The following allocation procedure was approved for recording the euro banknotes in circulation in the financial statements of the individual central banks in the Eurosystem[2]. The respective share of the total value of euro banknotes in circulation due to each central bank in the Eurosystem is calculated on the last business day of each month in accordance with the banknote allocation key. The ECB is allocated an 8% share of the total value of the euro banknotes in circulation, whereas the remaining 92% is allocated to the national central banks in proportion to their respective paid-up shares in the capital of the ECB. As at 31 December 2013, the Bundesbank had a 27.0% share in the fully paid-up capital of the ECB and therefore a 24.8% share of the euro banknotes in circulation in accordance with the banknote allocation key. The value of the Bundesbank's share in the total amount of euro banknotes issued by the Eurosystem is shown in item 1 "Banknotes in circulation" on the liabilities side of the balance sheet.

… of intra-Eurosystem balances arising from the allocation of euro banknotes

The difference between the value of the euro banknotes allocated to each central bank of the Eurosystem in accordance with the banknote allocation key and the value of the euro banknotes that the central bank actually puts into circulation gives rise to remunerated intra-Eurosystem balances[3]. If the value of the euro banknotes actually issued is greater than the value according to the banknote allocation key, the difference is recorded in the balance sheet in liability sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)". If the value of the euro banknotes actually issued is less than the value according to the banknote allocation key, the difference is recorded in asset sub-item 9.3 "Claims related to the allocation of euro banknotes within the Eurosystem (net)". These balances are remunerated at the respective rate of the main refinancing operations.

In the year of the cash changeover and in the following five years, the intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are adjusted in order to avoid significant changes to the national central banks' relative income positions from those in previous years. The adjustments are made by taking into account the differences between the average value of the banknotes that each national central bank had in circulation in the reference period and the average value of the banknotes that would have been allocated to them during that period in ac-

1 Published as a revised edition in Bundesbank Notice No 10002/2013 of 21 February 2013.
2 Decision of the European Central Bank of 13 December 2010 on the issue of euro banknotes (ECB/2010/29), as last amended by the decision of the European Central Bank of 29 August 2013 (ECB/2013/27).
3 Decision of the European Central Bank of 25 November 2010 on the allocation of monetary income of the national central banks of member states whose currency is the euro (ECB/2010/23), as amended by the decision of the European Central Bank of 3 November 2011 (ECB/2011/18).

cordance with the ECB's capital key. The adjustments are reduced in annual stages until the first day of the sixth year after the year of the cash changeover. Thereafter, income from euro banknotes is allocated fully in proportion to the national central banks' paid-up shares in the ECB's capital. In the year under review, the adjustments resulted from the accession of the Maltese and the Cypriot central banks in 2008, the Slovakian central bank in 2009 and the Estonian central bank in 2011. The adjustment relating to the accession of the Maltese and the Cypriot central banks ended on 31 December 2013; the other adjustments will be phased out accordingly by 31 December 2014 and 2016. The interest income and interest expense arising from the remuneration of the intra-Eurosystem balances are cleared through the accounts of the ECB and are shown in the profit and loss account of the Bundesbank in item 1 "Net interest income".

The ECB's interim profit distribution

The ECB's income from the transfer of 8% of the euro banknotes in circulation to the ECB as well as from securities purchased by the ECB as part of the "Securities Markets Programme" is allocated to the national central banks of the Eurosystem in the form of an interim distribution of profit in the financial year in which the income arose, unless the ECB's net profit for the year is less than this income or the Governing Council of the ECB decides that the amount is to be retained for allocation to the ECB risk provision[4]. For the financial year 2013, €1,370 million of the aforementioned ECB income (2012: €575 million) was distributed among the national central banks as interim profit in January 2014. The Bundesbank's share of €369 million (2012: €156 million) is shown under item 4 "Income from participating interests" in its profit and loss account.

Change to the ECB's capital key on 1 July 2013 and 1 January 2014

In connection with the accession of Croatia to the EU, the ECB's capital key was adjusted with effect from 1 July 2013. As, in accordance with Article 48.3 of the ESCB Statute, the ECB's subscribed capital grows proportionately when new member states join the EU, the ECB's capital was increased to €10,825 million on 1 July 2013. The Bundesbank's share of the ECB's subscribed capital dropped from 18.9% to 18.8%, while its participating interest in the ECB declined from €2,038 million to €2,031 million and its share of the ECB's fully paid-up capital fell from 27.1% to 27.0%. In the Eurosystem, a compensatory payment is made if a national central bank's share of the accumulated net equity of the ECB falls because of a reduction of its participating interest. The resulting income for the Bundesbank amounting to €24 million is included in item 4 "Income from participating interests" in its profit and loss account. In accordance with the provisions laid down in Article 29.3 of the ESCB Statute, the ECB's capital key is adjusted every five years. Accordingly, a further adjustment was made to the ECB's capital key with effect from 1 January 2014. The Bundesbank's share of the ECB's subscribed capital decreased to 18.0% with its participating interest in the ECB falling to €1,948 million. Furthermore, the Latvian central bank joined the Eurosystem on 1 January 2014 and paid up its capital share in the ECB in full. As a result, the Bundesbank's share of the fully paid-up capital of the ECB declined from 27.0% to 25.7% as at 1 January 2014.

Preparation and auditing of financial statements

The Executive Board drew up the Bundesbank's financial statements for the financial year 2013 on 11 February 2014. The financial statements were audited by Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Eschborn/Frankfurt am Main. The Executive Board had appointed the firm as external auditors on 25 November 2008 in accordance with section 26 (3) of the Bundesbank Act. The auditors confirmed without qualification on 25 February 2014 that the Bundesbank's financial statements for 2013 – consisting of the balance sheet and the profit and loss account – comply

4 Decision of the European Central Bank of 25 November 2010 on the interim distribution of the income of the European Central Bank derived from euro banknotes in circulation and securities purchased under the Securities Markets Programme (ECB/2010/24), as amended by the decision of the European Central Bank of 19 December 2012 (ECB/2012/33).

with the statutory provisions and the additional provisions of the principles for the accounting of the Deutsche Bundesbank and give a true and fair view of the net assets, financial position and results of operations of the Deutsche Bundesbank. After studying the external auditors' report, the Executive Board decided to publish the financial statements and transfer the Bundesbank's profit to the Federal Government on 13 March 2014.

Notes on the individual balance sheet items

Assets

1 Gold and gold receivables

As at 31 December 2013, the Bundesbank's physical holdings (bars) of fine gold (ozf) amounted to 3,387,158 kg or 109 million ounces. These are supplemented by an additional 12 kg of gold receivables that were generated by the settlement of margins in the context of gold transactions. The gold was valued at market prices at the end of the year (1 kg = €28,010.37 or 1 ozf = €871.220). Compared with the previous year's price of 1 kg = €40,547.85 or 1 ozf = 1,261.179, this represents a decline of 30.9%. By contrast, the gold holdings declined by just 0.1% in the year under review (by 4,204 kg or 0.1 million ounces). This was due to the sale of gold to the Federal Government at market prices for the purpose of minting gold coins. The resulting income in the amount of €123 million is shown in sub-item 2.1 "Realised gains/losses arising from financial operations" in the profit and loss account.

2 Claims on non-euro-area residents denominated in foreign currency

This item comprises the claims on the International Monetary Fund (IMF) as well as balances with banks, portfolio investment, loans and other foreign currency claims on non-euro-area residents.

2.1 Receivables from the IMF

Sub-item 2.1 contains the claims on the IMF which are financed and held by the Bundesbank and which arise from Germany's membership in the IMF. The claims, which total SDR 18,597 million (€20,798 million), are made up of the drawing rights within the reserve tranche, special drawing rights and loans under the New Arrangements to Borrow (NAB).

Gold reserves by storage location

Storage location	31.12.2013 tonnes	31.12.2013 € million	31.12.2012 tonnes	31.12.2012 € million	Year-on-year change tonnes	Year-on-year change tonnes %	Year-on-year change € million	Year-on-year change € million %
Deutsche Bundesbank, Frankfurt	1,073	30,048	1,036	42,013	37	3.5	– 11,965	– 28.5
Federal Reserve Bank, New York	1,531	42,896	1,536	62,298	– 5	– 0.3	– 19,402	– 31.1
Bank of England, London	441	12,349	445	18,047	– 4	– 0.9	– 5,698	– 31.6
Banque de France, Paris	342	9,583	374	15,154	– 32	– 8.5	– 5,571	– 36.8
Total	3,387	94,876	3,391	137,513	– 4	– 0.1	– 42,637	– 31.0

Deutsche Bundesbank

Receivables from the IMF

Item	31.12.2013		31.12.2012		Year-on-year change			
					SDR million		€ million	
	SDR million	€ million	SDR million	€ million		%		%
German quota	14,566	16,289	14,566	16,980	–	–	– 691	– 4.1
less euro balances	10,752	12,024	10,085	11,757	667	6.6	268	2.3
Drawing rights within the reserve tranche	3,813	4,265	4,480	5,223	– 667	– 14.9	– 958	– 18.3
Special drawing rights	11,479	12,837	11,652	13,583	– 173	– 1.5	– 746	– 5.5
New Arrangements to Borrow	3,305	3,696	3,034	3,537	271	8.9	159	4.5
Total	18,597	20,798	19,167	22,344	– 569	– 3.0	– 1,546	– 6.9

Deutsche Bundesbank

The drawing rights within the reserve tranche correspond to the amounts actually paid to the IMF in gold, special drawing rights, foreign exchange and national currency under the German quota. The drawing rights held represent the difference between the German quota of SDR 14,566 million (€16,289 million) and the euro balances amounting to €12,024 million (SDR 10,752 million) at the disposal of the IMF at the end of the year. In 2013, there was a net decline of SDR 667 million to SDR 3,813 million (€4,265 million) in the holdings of drawing rights within the reserve tranche.

Special drawing rights, by means of which convertible currencies can be obtained at any time, amounting to SDR 12,059 million were allocated free of charge. A corresponding counterpart is shown as liability item 8, "Counterpart of special drawing rights allocated by the IMF". In 2013, the holdings of special drawing rights declined by SDR 173 million to SDR 11,479 million (€12,837 million).

NABs are multilateral credit lines with the Fund which serve as a backstop for use in the event of a systemic crisis and have been activated since 1 April 2011. The Bundesbank's NAB credit line amounts to SDR 25.4 billion. At the end of the reporting year, this resulted in receivables from the IMF of SDR 3,305 million (€3,696 million).

The additional bilateral credit line of €41,500 million pledged by the Bundesbank to the IMF in October 2012 was not drawn upon as adequate IMF liquidity was available. There were therefore no receivables arising from bilateral loans at the end of the year.

If all items on the assets side and the liabilities side of the balance sheet are taken into account, the net special drawing rights item amounted to SDR 6,539 million, compared with SDR 7,108 million in 2012. The valuation is based on the reference rate of SDR 1 = €1.1183 (2012: SDR 1 = €1.1657) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem.

2.2 Balances with banks, portfolio investment, external loans and other external assets

The balances with banks, portfolio investment, loans and other foreign currency claims which are shown in sub-item 2.2 amounted to €28,080 million at the end of 2013, compared with €28,774 million on 31 December 2012. These include, in particular, US dollar holdings in the amount of US$35,482 million (€25,728 million), representing an increase of US$1,384 million on the year. The sub-item also contains holdings in yen (¥201,676 million equivalent to €1,394 million) and in Australian dollars (A$1,470 equivalent to €953 million) as well as a very small amount in other currencies. The holdings are interest-bearing.

Balances with banks, portfolio investment, external loans and other external assets

Item	31.12.2013	31.12.2012	Year-on-year change	
	€ million	€ million	€ million	%
Current account holdings and overnight deposits	2,595	626	1,968	314.2
Claims arising from reverse repurchase agreements	1,211	3,377	– 2,166	– 64.1
Fixed-term deposits and deposits at notice	–	385	– 385	– 100.0
Marketable securities				
Government bonds	22,496	23,655	– 1,158	– 4.9
Supranational institutions	1,667	620	1,047	168.9
Other	110	110	0	0.1
Total	28,080	28,774	– 694	– 2.4

Deutsche Bundesbank

If all items on the assets side and the liabilities side of the balance sheet are taken into account, the net US dollar item valued at market prices amounted to US$33,017 million (2012: US$34,109 million), the net yen item to ¥201,868 million (2012: ¥201,957 million) and the net Australian dollar item to A$1,483 million (2012: A$1,455 million). The foreign currency items were valued at the respective end-of-year market rate; in the case of the US dollar item, this amounted to €1 = US$1.3791 (2012: €1 = US$1.3194), for the yen item €1 = ¥144.72 (2012: €1 = ¥113.61) and for the Australian dollar item €1 = A$1.5423 (2012: €1 = A$1.2712).

3 Claims on euro-area residents denominated in foreign currency

This item contains €125 million in US dollar claims on credit institutions resulting from refinancing operations in the context of the temporary swap agreement with the Federal Reserve (2012: €3,341 million). In order to carry out these operations, the ECB receives US dollars from the Federal Reserve in return for euro based on the swap agreement; the ECB then makes these available to the national central banks, which pass them on to euro-area credit institutions. The TARGET2 liability resulting from swap transactions between the ECB and the Bundesbank lower the TARGET2 claim on the ECB shown in asset sub-item 9.4 "Other claims within the Eurosystem (net)".

5 Lending to euro-area credit institutions related to monetary policy operations denominated in euro

The volume and structure of liquidity-providing monetary policy operations carried out by the Bundesbank as part of the Eurosystem are shown in this item (main and longer-term refinancing operations and the marginal lending facility). At the end of the reporting year, the Eurosystem's corresponding outstanding monetary policy operations amounted to €752,288 million (2012: €1,126,019 million), of which the Bundesbank held €52,054 million (2012: €73,093 million). Pursuant to Article 32.4 of the ESCB Statute, risks from these operations, provided they materialise, are shared among the Eurosystem national central banks in proportion to the prevailing ECB capital key shares. Losses only arise if the counterparty involved in a monetary policy operation defaults and the collateral provided by the latter proves insufficient upon realisation. However, the Governing Council of the ECB has ruled out risk-sharing for certain types of collateral, which the national central banks may nevertheless accept as collateral on their own responsibility. The Bundesbank does not accept such collateral.

Main refinancing operations are regular weekly transactions with a normal one-week maturity, the purpose of which is to provide liquidity. In the reporting year, main refinancing operations were conducted as fixed-rate tenders with full allotment. At the end of the year, the main refi-

nancing operations amounted to €38,162 million, which was €35,307 million more than on 31 December 2012. On a daily average, the outstanding volume of main refinancing operations amounted to €1,250 million (2012: €2,126 million).

Longer-term refinancing operations with maturities of between one maintenance period and three months were carried out in the year under review with the purpose of providing longer-term liquidity. The operations were conducted as fixed-rate tenders with full allotment at the main refinancing rate. The volume of these transactions amounted to €13,771 million at the end of 2013 and was therefore €55,880 million lower than in the previous year. This decline was due, in particular, to the early repayment of the liquidity allotted in the three-year tenders at the end of 2011/beginning of 2012, which has been possible since the end of January 2013. At the end of the reporting year, the volume of outstanding three-year refinancing operations amounted to €7,964 million (2012: €66,785 million). On a daily average, the volume of longer-term refinancing operations came to €20,010 million (2012: €69,488 million).

The marginal lending facility is a standing facility which counterparties may use to obtain overnight liquidity at a predetermined interest rate. At the end of 2013, recourse to this facility amounted to €122 million (previous year-end: €587 million). The extent to which it was being used on a daily average amounted to €24 million (2012: €126 million).

6 Other claims on euro-area credit institutions denominated in euro

This item, amounting to €4,691 million (2012: €1,442 million), consists, in particular, of fixed-term deposits which are held at credit institutions and which arise from funds received in connection with central bank services (see liability item 5 "Liabilities to non-euro-area residents denominated in euro").

7 Securities of euro-area residents denominated in euro

This item contains covered bonds denominated in euro as well as bonds of euro-area sovereign issuers which are held to maturity and valued at amortised cost. The holdings resulting from purchases made within the framework of the Eurosystem's Covered Bond Purchase Programme (CBPP), Securities Markets Programme (SMP) and Second Covered Bond Purchase Programme (CBPP2), which the ECB Governing Council approved on 7 May 2009, 9 May 2010 and 6 October 2011, respectively, are shown under sub-item 7.1 "Securities held for monetary policy purposes".

The Bundesbank's securities holdings under the CBPP amounted to €9,508 million at the end of 2013 (2012: €12,591 million). The balance sheet value of CBPP2 holdings totalled €3,936 million at the end of 2013 (2012: €4,325 million).

At the end of 2013, the Eurosystem national central banks' SMP holdings amounted to €165,846 million (2012: €192,608 million), of which the Bundesbank held €42,400 million (2012: €50,570 million). Pursuant to Article 32.4 of the ESCB Statute, all risks from these operations, provided they materialise, are shared among the Eurosystem national central banks in proportion to the prevailing ECB capital key shares. The Governing Council of the ECB decided that no write-downs were required for bonds contained in the SMP holdings as at 31 December 2013 as it is expected that all payment obligations relating to the bonds contained in Eurosystem central banks' SMP holdings will continue to be met as agreed.

8 Claims on the Federal Government

This item shows the equalisation claims on the Federal Government and the non-interest-bearing debt register claim in respect of Berlin, both of which date back to the currency reform of 1948. They form the balance sheet counterpart of the amounts paid out at that time in cash *per capita* and per enterprise and of the initial provision of credit institutions and public corporations with central bank money. Equalisation claims yield interest at the rate of 1% *per annum*. In conjunction with Article 123 of the Treaty on the Functioning of the European Un-

ion (Lisbon Treaty), it has been stipulated that equalisation claims and the debt register claim are to be redeemed in ten annual instalments, starting in the year 2024.

9 Intra-Eurosystem claims

The Bundesbank's claims on the ECB and on the national central banks participating in the Eurosystem are combined in this item.

Sub-item 9.1 shows the Bundesbank's participating interest in the ECB. Pursuant to Article 28 of the ESCB Statute, the ESCB national central banks are the sole subscribers to the capital of the ECB. In the reporting year, the key for subscribing to the ECB's capital was adjusted with effect from 1 July 2013 in connection with the accession of Croatia to the EU (see General information on annual accounts). On 31 December 2013, the Bundesbank's participating interest in the ECB stood at €2,031 million.

Sub-item 9.2 contains the Bundesbank's euro-denominated claims arising from the transfer of foreign reserves to the ECB. At the beginning of 1999, the central banks participating in the Eurosystem transferred foreign reserves (15% in gold and 85% in foreign currency) to the ECB in accordance with Article 30 of the ESCB Statute. Adjustments to the key for subscribing to the ECB's capital also result in adjustments to the Bundesbank's claims arising from the transfer of foreign reserves to the ECB. On 31 December 2013, these claims amounted to €10,872 million (2012: €10,909 million). As the transferred gold does not earn any interest, the claims are remunerated at 85% of the respective interest rate for the main refinancing operations.

Sub-item 9.3 "Claims related to the allocation of euro banknotes within the Eurosystem (net)" shows the claims which arise from applying the banknote allocation key. As at the end of 2012, the Bundesbank had no claims at the end of 2013 and instead recorded liabilities, which are shown in liability sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)".

A daily net balance vis-à-vis the ECB is derived from settlement balances between the central banks of the ESCB which result from cross-border payments as part of the TARGET2 large-value payment system. Unlike in 2012, when the German banking system received central bank money via TARGET2 in the net amount of €192,536 million, there was a partial return flow of funds in the reporting year. At the end of the year, the Bundesbank's net claim on the ECB had thus declined by €145,469 million to €510,201 million, which is shown under sub-item 9.4 "Other claims within the Eurosystem (net)". The net balance (with the exception of unremunerated intra-Eurosystem balances resulting from the swap transactions between the ECB and the Bundesbank, see asset item 3 "Claims on euro-area residents denominated in foreign currency") is remunerated at the respective interest rate for main refinancing operations. On a daily average, the interest-bearing net claim amounted to €590,575 million (2012: €675,765 million). This item also contains the liabilities of €104 million arising from the allocation of monetary income to the national central banks (see profit and loss item 5 "Net result arising from allocation of monetary income") and the €369 million claim on the ECB arising from the interim distribution of profit (see General information on annual accounts).

10 Items in course of settlement

This item contains the asset items arising from payments still being processed within the Bundesbank.

11 Other assets

The Bundesbank's holdings of euro coins are shown in sub-item 11.1 "Coins". New coins are received from the federal mints at their nominal value for the account of the Federal Government, which holds the coin prerogative.

Sub-item 11.2 "Tangible and intangible fixed assets" amounted to €844 million compared with €909 million in 2012. It comprises land and buildings, furniture and equipment and computer software.

Tangible and intangible fixed assets

€ million

Item	Purchase/ production costs 31.12.2012	Additions	Disposals	Accumulated depreciation	Book value 31.12.2013	Book value 31.12.2012	Depreciation in 2013
Land and buildings	2,356	5	– 92	– 1,576	693	745	– 50
Furniture and equipment	744	38	– 24	– 611	147	159	– 48
Computer software	131	7	– 0	– 133	5	5	– 7
Total	3,231	49	– 116	– 2,320	844	909	– 105

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Sub-item 11.3 "Other financial assets" amounted to €11,777 million, compared with €12,125 million in 2012. It contains fixed-interest euro assets of €11,688 million as a counterpart to the capital, statutory reserves, provisions for general risks and provisions for pensions and healthcare assistance. Euro assets are invested in covered bonds, mostly German Pfandbriefe, then held to maturity and valued at amortised cost. This item also includes €89 million in participating interests held by the Bundesbank. The latter's participating interest in the BIS, Basel, was unchanged at €50 million at the end of 2013. It holds 50,100 shares. As in the previous year, the balance sheet value of its participating interest in Liquiditäts-Konsortialbank GmbH, Frankfurt am Main, amounted to €38 million. This 30% interest continues to entail a maximum additional commitment of €300 million for the Bundesbank. As in 2012, the participating interest in the cooperative society SWIFT, La Hulpe (Belgium) amounted to €1 million.

Sub-item 11.4 "Off-balance-sheet instruments revaluation differences" essentially comprises €3 million (2012: €46 million) for the valuation of the US dollar forward liabilities to the ECB arising from the euro/US dollar swap agreement with the ECB (see asset item 3 "Claims on euro-area residents denominated in foreign currency").

Sub-item 11.5 "Accruals and prepaid expenses" contains the accrued and prepaid expenditure calculated as at 31 December 2013. This chiefly consists of interest income due in 2014 from securities, refinancing operations for credit institutions and the interest-bearing TARGET2 claim on the ECB which were acquired or transacted in 2013.

As at 31 December 2013, sub-item 11.6 "Sundry items" mainly contained, as in 2012, the nominal value of claims against one counterparty that defaulted from monetary policy operations undertaken by the Eurosystem.

Liabilities

1 Banknotes in circulation

The total value of euro banknotes issued by the central banks in the Eurosystem is distributed among these banks on the last business day of each month in accordance with the key for allocating euro banknotes (see General information on annual accounts). According to the banknote allocation key applied on 31 December 2013, the Bundesbank has a 24.8% share of the value of all euro banknotes in circulation. During the year under review, the total value of banknotes in circulation within the Eurosystem rose from €912,592 million to €956,185 million, or by 4.8%. According to the allocation

key, the Bundesbank had euro banknotes in circulation worth €237,258 million at the end of the year, compared with €227,231 million at the end of 2012. The value of the euro banknotes actually issued by the Bundesbank in 2013 increased by 7.9% from €427,538 million to €461,509 million. As this was more than the allocated amount, the difference of €224,251 million (2012: €200,308 million) is shown in liability sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)".

2 Liabilities to euro-area credit institutions related to monetary policy operations denominated in euro

Sub-item 2.1 "Current accounts" contains the deposits of credit institutions, amounting to €83,877 million (2012: €129,607 million), which are also used to meet the minimum reserve requirement and to settle payments. The main criterion for including these deposits in this sub-item is that the respective business partners appear in the list of institutions which are subject to the Eurosystem's minimum reserve regulations. The balances held to fulfil the minimum reserve requirement amounted to €27,576 million on an annual average. Minimum reserve balances are remunerated at the average interest rate for main refinancing operations in the respective maintenance period. Any deposits exceeding this amount are not remunerated. On a daily average, the current account deposits decreased from €105,286 million in 2012 to €98,686 million in 2013.

Sub-item 2.2 "Deposit facility", amounting to €10,712 million (2012: €40,470 million), contains overnight deposits at the deposit facility rate. On a daily average, the deposit facility amounted to €23,856 million, compared with €161,951 million in 2012.

Sub-item 2.3 "Fixed-term deposits" contains liquidity-absorbing fine-tuning operations of €46,870 million (2012: €129,885 million). In 2013, they were conducted as variable-rate tenders with a maximum bid rate to neutralise the liquidity-providing effects of the Securities Markets Programme. On a daily average, the fixed-term deposits amounted to €82,401 million (2012: €136,835 million).

4 Liabilities to other euro-area residents denominated in euro

Sub-item 4.1 "General government deposits" encompasses the balances of the Federal Government, its special funds, the state governments and other public depositors. The deposits of other public depositors constitute balances held by social security funds and local authorities. On 31 December 2013, general government deposits amounted to €2,013 million in total (2012: €11,870 million). This decrease results, in particular, from lower deposits of the health insurance fund of the statutory health insurance scheme.

Sub-item 4.2 "Other liabilities" amounted to €8,453 million, compared with €28,059 million on 31 December 2012. It mainly comprises deposits of financial intermediaries and individuals, which includes deposits in the European Stability Mechanism (ESM), in particular. The decrease is due primarily to a decline in deposits in the European Financial Stability Facility (EFSF).

5 Liabilities to non-euro-area residents denominated in euro

This balance sheet item, amounting to €52,047 million (2012: €83,284 million), contains the balances of non-euro-area central banks, monetary authorities, international organisations and commercial banks held to settle, *inter alia*, payments. These include fixed-term deposits of central banks accepted as part of the Bundesbank's central bank services which are then invested in the money market (see asset item 6 "Other claims on euro-area credit institutions denominated in euro").

6 Liabilities to euro-area residents denominated in foreign currency

This item, amounting to €1,830 million (2012: €3 million), contains US dollar deposits of banks domiciled in the euro area and of the Federal Government.

7 Liabilities to non-euro-area residents denominated in foreign currency

The foreign-currency-denominated liabilities vis-à-vis banks outside the euro area are recorded in this item. These are liabilities in US dollars, amounting to €37 million (2012: €76 million),

which have arisen from securities repurchase agreements (repos).

8 Counterpart of special drawing rights allocated by the IMF

The counterpart of the special drawing rights allocated by the IMF free of charge corresponds to the allocations of SDRs to the Federal Republic of Germany from 1970 to 1972, from 1979 to 1981 and in 2009, which together totalled SDR 12,059 million (see assets sub-item 2.1 "Receivables from the IMF").

9 Intra-Eurosystem liabilities

The Bundesbank's liabilities to the ECB and to the other central banks participating in the Eurosystem are combined in this item.

Sub-item 9.1 contains "Liabilities related to the issuance of ECB debt certificates". The ECB did not issue any such paper during 2013.

Sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)" contains the liabilities arising from the application of the euro banknote allocation key (see liability item 1 "Banknotes in circulation"). At the end of the year, these liabilities amounted to €224,251 million (2012: €200,308 million).

The net liabilities arising from other assets and liabilities within the Eurosystem would be shown in sub-item 9.3 "Other liabilities within the Eurosystem (net)". At the end of 2013, the Bundesbank had a net claim, which is shown on the asset side under sub-item 9.4 "Other claims within the Eurosystem (net)" and outlined in the explanatory notes above.

10 Items in course of settlement

This item contains the liabilities items arising from payments still being processed within the Bundesbank.

11 Other liabilities

Sub-item 11.2 "Accruals and income collected in advance" contains the accrued income calculated as at 31 December 2013. This consists mainly of interest expenditure which is due in 2014 but was incurred in 2013 and which arose in connection with the allocation of banknotes within the Eurosystem.

Sub-item 11.3 "Sundry items" mainly comprises the liabilities arising from the Deutsche Mark banknotes still in circulation. Although Deutsche Mark banknotes are no longer legal tender, the Bundesbank has publicly undertaken to redeem Deutsche Mark banknotes that are still in circulation for an indefinite period. The Deutsche Mark banknotes still in circulation belong to the series BBk I/Ia and BBk III/IIIa and at the end of 2013 totalled €3,171 million. The banknote series BBk I/Ia accounted for €1,232 million of this sum and the banknote series BBk III/IIIa for €1,938 million. Total deposits of Deutsche Mark banknotes amounted to €45 million, with the banknote series BBk I/Ia accounting for €9 million of this amount (2012: €10 million) and the banknote series BBk III/IIIa for €36 million (2012: €43 million). In 2004, part of the liabilities arising from Deutsche Mark BBk I/Ia series banknotes still in circulation and amounting to €1,237 million was taken off the books and reported as income. Taking account of this partial write-off and the deposits that have been made in the meantime, the liabilities arising from the Deutsche Mark banknotes still in circulation on 31 December 2013, which comprised only notes of the series BBk III/IIIa, amounted to €1,938 million.

12 Provisions

The provisions for general risks are created pursuant to the regulations governing the Bundesbank's annual accounts contained in section 26 (2) of the Bundesbank Act *(Bundesbankgesetz)*. They are established to hedge against general risks associated with domestic and foreign business. The level of funds to be allocated to risk provisions is reviewed annually using value-at-risk and expected shortfall calculations amongst others. In doing so, the holdings of risk-weighted assets, their risk content, the financial situation expected for the coming year and the statutory reserves (€2.5 billion) are taken into account. In the reporting year 2013, the Bundesbank's risks have decreased mainly on account of the decline in its holdings of risk-weighted assets. At the same time, however, the cuts in key interest rates in May and

Provisions

Provisions for	31.12.2013	31.12.2012	Year-on-year change	
	€ million	€ million	€ million	%
General risks	14,380	14,380	–	–
Monetary policy operations	–	91	– 91	– 100.0
Direct pension commitments	3,373	3,080	293	9.5
Indirect pension commitments (supplementary pension funds)	401	417	– 16	– 3.8
Healthcare subsidy commitments to civil servants	778	597	181	30.3
Partial retirement scheme	76	91	– 15	– 16.6
Staff restructuring schemes	169	194	– 25	– 13.1
Other	45	47	– 2	– 4.6
Total	19,221	18,898	323	1.71

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November 2013 have led to a decline in the anticipated annual result for 2014 and thus in the Bundesbank's available financial resources. Taking all of the aforementioned factors into consideration, there was no need to adjust the existing risk provisions as at 31 December 2013. The Bundesbank's risks, which are determined using a model, relate, in particular, to exchange rate risks, default risks of the Securities Markets Programme and credit risks arising from refinancing loans. This risk analysis does not take account of the Bundesbank's TARGET2 claim on the ECB. The Bundesbank, as an ECB shareholder, could hypothetically be indirectly affected by risks to which the ECB is exposed from TARGET2 claims if a state with a TARGET2 liability were to leave the single currency area without the central bank of this state settling its liability vis-à-vis the ECB. The Bundesbank considers this scenario to be unlikely, however, which means that the risks arising from Eurosystem operations to provide liquidity are ultimately the decisive factor.

A provision for monetary policy operations has been built up since 2008 following a decision by the ECB Governing Council regarding concrete risks arising from the default of six Eurosystem counterparties. In accordance with Article 32.4 of the ESCB Statute, this provision is funded by all Eurosystem national central banks in proportion to their subscribed capital key shares in the ECB applicable in the year in which the counterparty defaults. In accordance with the Eurosystem accounting principles and in consideration of the general principle of prudence, the Governing Council of the ECB reviewed the appropriateness of this provision and decided to dissolve the provisions in the total amount of €310 million on 31 December 2013. This yielded a proportionate income of €91 million for the Bundesbank in 2013 (see profit and loss item 5 "Net result arising from allocation of monetary income").

Provisions for direct pension commitments, for indirect pension commitments as a result of the Bundesbank's obligation to act as guarantor for pension payments out of the supplementary pension funds for public sector employees and for healthcare subsidy commitments to civil servants are valued on the basis of an actuarial expert opinion pursuant to the entry age normal method *(Teilwertverfahren)*, with a discount rate of 4.74% used in the reporting year (2012: 4.9%). For the reporting year 2013, as in the previous year, it is estimated that there was also a wage trend of 1.75%, a career trend of 0.5%, a pension trend of 1.75% for civil servants and of 1% for public sector employees. The cost trend for healthcare subsidy commitments amounted to 2.5%, compared

with 2.25% in the previous year. Provisions for the partial retirement scheme and for payment commitments arising from staff restructuring schemes that had already been carried out by the balance sheet date are calculated using a discount rate of 3.53% (2012: 3.85%) based on an actuarial expert opinion pursuant to the present value method *(Barwertverfahren)*. As in 2012, a wage trend of 1.75% is taken into consideration. Expenses in the amount of €318 million from marking up the aforementioned staff provisions (including effects of changing the discount rate) are contained in profit and loss sub-item 1.2 "Interest expense". Transfers of €190 million due to changing over to the provisions of the Act to Modernise Accounting Law are booked to profit and loss item 11 "Other expenses". Other changes to provisions on balance result in a dissolution-related income of €47 million in profit and loss item 6 "Other income" and in a usage-related relief of €42 million in profit and loss item 11 "Other expenses" as well as €3 million in profit and loss item 7 "Staff costs".

Other provisions have been created for remaining holiday entitlement, overtime and positive balances of flexible working hours as well as for other uncertain liabilities.

13 Revaluation accounts

This item contains the disclosed hidden reserves from the initial valuation at the time of the changeover to market valuation on 1 January 1999 (revaluation items "old") and the unrealised profits arising from market valuation on 31 December 2013 (revaluation items "new").

Revaluation items "old"

A revaluation item "old" now remains only for the item gold. It represents the difference between the market value of gold on 1 January 1999 and the lower value of gold up to that date. In the balance sheet on 31 December 1998, the value for gold was 1 ozf = DM143.8065 (€73.5271) while the market value on 1 January 1999 was 1 ozf = €246.368. Although the valuation gains arising from the initial valuation of the gold holdings are not eligible for distribution, they will be dissolved under certain circumstances. Besides a dissolution in the case of valuation losses on the gold item, a proportionate dissolution also takes place in the event of net reductions if the end-of-year gold holdings are below their lowest end-of-year level since 1999.

The reduction of 4,204 kg or 0.1 million ozf in the gold holdings resulted in a dissolution amount of €23 million in the year under review. The dissolution amount is included in profit and

Revaluation accounts

	Revaluation items "old"	Revaluation items "new"	Total 31.12.2013	Total 31.12.2012	Year-on-year change	
Item	€ million	€ million	€ million	€ million	€ million	%
Gold	18,822	68,046	86,869	129,496	– 42,627	– 32.9
US dollars	–	1,113	1,113	2,303	– 1,190	– 51.7
SDRs	–	–	–	195	– 195	– 100.0
Yen	–	–	–	109	– 109	– 100.0
Securities	–	99	99	475	– 376	– 79.2
Total	18,822	69,258	88,080	132,577	– 44,497	– 33.6

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loss sub-item 2.1 "Realised gains/losses arising from financial operations".

Revaluation items "new"

In the case of gold holdings, the net positions in each foreign currency and the securities portfolios, the positive difference between their market value on 31 December 2013 and their value in terms of the average acquisition cost carried forward from 1 January 1999 is shown in the revaluation items "new".

As regards gold, the acquisition cost is 1 ozf = €246.370. At the end of 2013, the market value of the gold position exceeded its acquisition value, leading to a revaluation item of €68,046 million (2012: €110,650 million). The market value of the US dollar position at the end of 2013 was also above its acquisition value (€1 = US$1.4466), with the result that there was a revaluation item. In the case of the yen and the Australian dollar items, as well as the SDR item, the market values at year-end were below the respective acquisition values (€1 = SDR 0.8779, €1 = ¥121.32 and €1 = A$1.2756), giving rise to valuation losses (see profit and loss sub-item 2.2 "Write-downs on financial assets and positions").

The valuation gains from securities shown in the balance sheet result almost exclusively from US dollar investments. The euro securities are held to maturity and valued at amortised cost.

14 Capital and reserves

In accordance with section 2 of the Bundesbank Act, liable capital amounted to €2.5 billion and is attributable to the Federal Government. The statutory reserves are in line with the fixed upper limit which is laid down in section 27 number 1 of the Bundesbank Act and which is likewise €2.5 billion.

15 Profit for the year

The profit and loss account for the year 2013 closed with an annual surplus of €4,591 million. Pursuant to section 27 of the Bundesbank Act, it will be transferred in full to the Federal Government as the statutory reserves were at their maximum level of €2.5 billion at the end of 2013.

Notes on the profit and loss account

1 Net interest income

This item shows interest income less interest expense. Net interest income was lower than in the previous year, falling by €2,692 million to €5,566 million. This was attributable in particular to key interest rates being around one-third lower in annual average terms, but also to the decline in Eurosystem-relevant balance sheet items. On the asset side, monetary policy refinancing operations decreased by 70%, the interest-bearing TARGET2 claim on the ECB by 13% and SMP securities by 10%; on the liabilities side, liabilities related to monetary policy operations went down by 49% on an annual average.

1.1 Interest income

Interest income in foreign currency in 2013 fell year on year by €117 million to €258 million. This was due to the lower annual average rate of interest on US dollar assets. Interest income in euro declined on the year by €3,603 million to €7,023 million. Interest income from monetary policy refinancing operations declined by €504 million, given that the annual average volume of refinancing operations was down by around €50 billion compared with the previous year; in addition, the lowered key interest rates resulted in considerably reduced average interest rates of 0.64% compared with 0.89% in the previous year. Income arising from the TARGET2 claim on the ECB fell by €2,624 million. Besides the decrease in the TARGET2 claim by around €85 billion on an annual average, this was mainly due to the lower average rate of interest (0.57% compared with 0.89% in the previous year). Income from securities (SMP portfolio, CBPP portfolios and financial assets)

Net interest income

Item	2013	2012	Year-on-year change	
	€ million	€ million	€ million	%
Interest income in foreign currency				
IMF	17	24	– 7	– 28.7
Reverse repo transactions	3	7	– 4	– 55.3
Securities	226	295	– 69	– 23.5
Claims arising from the provision of foreign exchange liquidity	8	41	– 32	– 79.6
Other	4	8	– 4	– 52.8
Total	258	375	– 117	– 31.2
Interest income in euro				
Main refinancing operations	4	19	– 15	– 77.1
Longer-term refinancing operations	131	618	– 487	– 78.8
Other refinancing operations	0	2	– 2	– 87.1
TARGET2 claim on the ECB	3,357	5,981	– 2,624	– 43.9
Government bonds (SMP portfolio)	2,611	2,874	– 263	– 9.2
Covered bonds (CBPP and CBPP2 portfolio)	427	484	– 57	– 11.8
Claims arising from the transfer of foreign reserves to the ECB	52	83	– 31	– 37.4
Claims arising from central bank services	3	17	– 14	– 82.8
Covered bonds (financial assets)	380	483	– 103	– 21.4
Other	58	66	– 8	– 11.4
Total	7,023	10,626	– 3,603	– 33.9
Interest income	7,281	11,001	– 3,720	– 33.8
Interest expense in foreign currency				
IMF	11	15	– 4	– 27.7
Liabilities arising from the provision of foreign exchange liquidity	8	41	– 32	– 79.6
Other	0	0	0	.
Total	19	56	– 36	– 65.2
Interest expense in euro				
Minimum reserves	153	263	– 110	– 42.0
Deposit facility	–	305	– 305	– 100.0
Fixed-term deposits	59	210	– 151	– 72.0
Liabilities related to the allocation of euro banknotes	1,162	1,616	– 454	– 28.1
Liabilities arising from central bank services	2	10	– 8	– 82.8
Marking up of staff provisions	318	275	44	16.0
Other	2	8	– 6	– 73.7
Total	1,695	2,687	– 991	– 36.9
Interest expense	1,715	2,742	– 1,028	– 37.5
Grand total interest income	5,566	8,259	– 2,692	– 32.6

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fell by €423 million owing to the decrease in securities holdings by €10 billion on an annual average.

1.2 Interest expense

Interest expenditure decreased by €1,028 million to €1,715 million year on year. In the case of the euro, there was a year-on-year decline by €991 million to €1,695 million. Owing to the lower average rate of interest (0.56% compared with 0.90% in the previous year), the interest expenditure on the remuneration of intra-Eurosystem balances arising from the allocation of euro banknotes fell by €454 million despite the rise by around €29 billion in the annual average of liabilities (see General information on annual accounts). Furthermore, interest expenditure on liabilities related to monetary policy operations (minimum reserves, deposit facility and fixed-term deposits) declined by €566 million due to a reduction in liabilities of around €199 billion on an annual average and lower average interest rates (0.10% compared with 0.19% in the previous year).

2 Net result of financial operations, write-downs and risk provisions

The net income shown in sub-item 2.1 "Realised gains/losses arising from financial operations" amounted to €379 million compared with €832 million in 2012.

The write-downs in the sub-item 2.2 arise primarily from currency holdings in yen, Australian dollar and special drawing rights; in addition, valuation losses on securities occurred, above all, in US Treasury notes in connection with the rise in US capital market rates.

Sub-item 2.3 "Transfers to/from provisions for general risks, foreign exchange risks and price risks" contained in the previous year an increase of €6,671 million in the provision for general risks, which represented the final step in a three-year expansion (2010–2012).

3 Net income from fees and commissions

Net income from fees and commissions came to €39 million compared with €42 million in the previous year.

4 Income from participating interests

This item contains the Bundesbank's income from its participating interests in the ECB, the BIS and Liquiditäts-Konsortialbank GmbH. The total income of €526 million (2012: €195 million) includes, in particular, the Bundesbank's share of the ECB's profit distribution for the financial years 2012 and 2013. The share of the ECB's interim distribution of profit for the 2013 financial year is €369 million; a further €115 million was due to the (remaining) profit distribution for the 2012 financial year, which took place in February 2013. Moreover, the item contains a compensatory payment of €24 million for the smaller share of the accumulated net assets of the ECB in the context

Net result of financial operations, write-downs and risk provisions

Item	2013	2012	Year-on-year change	
	€ million	€ million	€ million	%
Realised gains/losses				
Gold	123	204	– 80	– 39.4
Foreign currency	100	299	– 200	– 66.7
Securities	156	329	– 172	– 52.4
Total	379	832	– 452	– 54.4
Write-downs				
Foreign currency	– 606	– 46	– 560	.
Securities	– 127	– 6	– 121	.
Total	– 733	– 52	– 681	.
Transfers to/from provisions for general risks, foreign exchange risks and price risks	–	– 6,671	6,671	100.0
Grand total	– 353	– 5,891	5,538	94.0

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Net income from fees and commissions

Item	2013	2012	Year-on-year change	
	€ million	€ million	€ million	%
Income				
Cashless payments	25	25	− 0	− 1.0
Cash payments	10	12	− 2	− 15.4
Securities business and security deposit business	9	9	− 0	− 3.4
Other	16	17	− 1	− 3.7
Total	60	63	− 3	− 4.8
Expense				
Securities business and security deposit business	15	16	− 1	− 5.4
Other	6	5	1	13.3
Total	21	21	− 0	− 0.9
Grand total	39	42	− 3	− 6.8

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of the reduction of the participating interest in the ECB (see General information on annual accounts).

5 Net result arising from allocation of monetary income

This item comprises expenditure of €11 million overall in 2013 (2012: €689 million). Risk provisioning for Eurosystem monetary policy operations (see liability item 12 "Provisions") resulted in income of €93 million (2012: €188 million); expenditure from the allocation of monetary income amounted on balance to €104 million compared with €877 million in 2012.

The monetary income of the Eurosystem national central banks is allocated in accordance with a decision taken by the Governing Council of the ECB.[5] Since 2003, the amount of monetary income allocated to each national central bank has been measured on the basis of the actual income which arises from the earmarked assets that each holds as a counterpart to its liability base.

The liability base contains, in particular, the following items: liability item 1 "Banknotes in circulation", liability item 2 "Liabilities to euro-area credit institutions related to monetary policy operations denominated in euro", liability sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)" and the TARGET2 net liability contained in liability sub-item 9.3 "Other liabilities within the Eurosystem (net)". All interest expense which a national central bank has paid on the aforementioned liability base items reduces the amount of the monetary income to be transferred by the national central bank concerned.

A national central bank's earmarked assets consist of the following items: asset item 5 "Lending to euro-area credit institutions related to monetary policy operations denominated in euro", asset sub-item 7.1 "Securities held for monetary policy purposes", asset sub-item 9.2 "Claims arising from the transfer of foreign reserves to the ECB", asset sub-item 9.3 "Claims related to the allocation of euro banknotes within the Eurosystem (net)", the net asset arising from TARGET2 accounts contained in asset sub-item 9.4 "Other claims within the Eurosystem (net)" and a limited amount of the national central banks' gold holdings corresponding to their share in the fully paid-up capital of the ECB. Gold is considered to generate no income, and securities purchased as part of both the CBPP and the CBPP2 generate income ac-

5 Decision of the European Central Bank of 25 November 2010 on the allocation of monetary income of the national central banks of member states whose currency is the euro (ECB/2010/23), as amended by the Decision of the European Central Bank of 3 November 2011 (ECB/2011/18).

cording to the respective interest rate for the main refinancing instrument.

If the value of a national central bank's earmarked assets is above or below the value of its liability base, the difference is offset by applying to the value of the difference the applicable interest rate for the main refinancing instrument. At the end of each financial year, the total monetary income transferred by all national central banks is distributed among the national central banks in proportion to their respective shares in the fully paid-up capital of the ECB. The allocation can cause redistribution effects among the national central banks under two conditions in practice. First, earmarked assets and liabilities as part of the liability base must have an interest rate that is different to the interest rate of the main refinancing instrument; second, the respective national central bank's share of earmarked assets and in the liability base must deviate from the central bank's share in the ECB's capital.

The allocation of monetary income resulted in a net expense of €104 million for the Bundesbank. This net expense represents the difference between the €4,614 million in monetary income paid by the Bundesbank into the common pool and the Bundesbank's claim of €4,511 million – corresponding to the Bundesbank's share of the ECB's paid-up capital – on the common pool.

As in 2012, the redistribution effect is the result primarily of the SMP portfolio, the yield on which was higher than the interest rate on the main refinancing instrument, and of the balance sheet counterpart, ie the (lower-yielding) fixed-term deposits from the SMP liquidity-absorbing tenders. The net interest income arising from these two balance sheet items is recognised at year-end in the allocation of monetary income among the national central banks in line with the capital key. For the Bundesbank, this resulted in a reallocation effect arising from the high 42% share (on an annual average; 2012: 64%) in the fixed-term deposits of the Eurosystem compared with a 27% share in the fully paid-up capital of the ECB. However, owing to the Bundesbank's smaller share in fixed-term deposits compared with the previous year in particular, there was lower proportional net interest income and, in connection with this, lower net expenditure from the allocation of monetary income.

6 Other income

Other income amounted to €268 million compared with €185 million in 2012. In the 2013 financial year, €121 million (2012: €51 million) was collected from the quota share distributed to Germany from the IMF's windfall gold sales profits (this amount was retransferred in the reporting year from the Federal budget to the IMF for loans to developing countries). A further €50 million was attributable to the release of provisions, in particular in the area of Human resources (see liability item 12 "Provisions"), €27 million to rental income and €26 million to the reimbursement of costs by the central banks of the ESCB, in particular for the development and operation of TARGET2.

7 Staff costs

Staff costs rose from €706 million to €745 million year on year. Expenditure for transfers to staff provisions (see liability item 12 "Provisions") in particular rose by €82 million net on the year; of this, €65 million was for retirement pensions due to higher cost rates for provisions for healthcare assistance. The number of staff was virtually unchanged on the year.

The remuneration received by each member of the Executive Board is published in the Annual Report in accordance with item 8 of the "Code of Conduct for the members of the Executive Board of the Deutsche Bundesbank". For the year 2013, the President of the Bundesbank received a pensionable salary of €336,339.98, a special non-pensionable remuneration of €76,693.78 and a standard expenses allowance of €5,112.96, amounting to a total of €418,146.72. The Deputy President of the Bundesbank received a pensionable salary of €269,071.97, a special non-pensionable remuneration of €61,355.03 and a standard

Staff costs

Item	2013	2012	Year-on-year change	
	€ million	€ million	€ million	%
Salaries and wages	482	515	– 34	– 6.5
Social security contributions	85	84	1	1.0
Expenditure on retirement pensions	179	107	72	67.4
Grand total	745	706	39	5.6

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expenses allowance of €3,067.80, amounting to a total of €333,494.80 for 2013. The other members of the Executive Board each received a pensionable salary of €201,804.08, a special non-pensionable remuneration of €46,016.27 and a standard expenses allowance of €2,556.48, amounting to a total of €250,376.83 for the year 2013.

Total payments to serving and former members of the Executive Board, former members of the Bundesbank's Directorate and of the Executive Boards of the Land Central Banks, including their surviving dependants, amounted to €11,610,668.19 in 2013.

8 Other administrative expenses

The other (non-staff) operating expenditure is almost unchanged on the year and stands at €330 million. This item shows not only operating expenditure but also, in particular, expenditure on computer hardware and software (€89 million) and buildings (€87 million).

9 Depreciation on tangible and intangible fixed assets

The depreciation of land and buildings, of furniture and equipment and of computer software amounted to €105 million compared with €113 million in 2012 (see asset sub-item 11.2 "Tangible and intangible fixed assets").

10 Banknote printing

Expenditure on banknote printing declined year on year by €55 million to €36 million due to a lower procurement volume in the reporting year.

11 Other expenses

Other expenses amounted to €228 million compared with €203 million in 2012, and contained in particular the final transfer (spread across the annual accounts from 2010 to 2013) to staff provisions due to the transition to the provisions of the Act to Modernise Accounting Law totalling €190 million as well as expenditure on staff restructuring schemes of €17 million and on residential buildings of €12 million.

Annex

The Deutsche Bundesbank: key figures

Staff[1]	2012	2013
Core staff (full-time equivalents)	9,543	9,547
– contraction since 31 December 2001[2]	5,257 (= 35.5%)	5,253 (= 35.5%)

Locations/core staff (full-time equivalents)[1]	2012	2013
Central Office	1 / 4,025	1 / 4,215
Regional Offices	9 / 2,624	9 / 2,584
Branches	41 / 2,894	41 / 2,748

Annual accounts[1]		2012	2013
Profit for the year		€664 million	€4,591 million
Net interest income		€8,259 million	€5,566 million
Balance sheet total		€1,025,306 million	€801,033 million
Foreign reserve assets (total)		€188.6 billion	€143.8 billion
– foreign currency		€28.8 billion	€28.1 billion
– receivables from the IMF		€22.3 billion	€20.8 billion
– gold		(3,391 t) €137.5 billion	(3,387 t) €94.9 billion
Allocation across the various storage locations			
	Frankfurt	(1,036 t) €42.0 billion	(1,073 t) €30.0 billion
	New York	(1,536 t) €62.3 billion	(1,531 t) €42.9 billion
	London	(455 t) €18.0 billion	(441 t) €12.3 billion
	Paris	(374 t) €15.2 billion	(342 t) €9.6 billion

ECB capital key[3]	2012	2013
Share of subscribed capital	18.9373%	18.7603%
Share of paid-up capital	27.0647%	26.9707%
Amount of the participating interest in the ECB[4]	€2.04 billion	€2.03 billion
Foreign reserve assets transferred to the ECB	€10.91 billion	€10.87 billion

Money market transactions[5]	2012	2013
Open market operations		
– Main refinancing operations in the euro area	€98.16 billion	€107.14 billion
– Longer-term refinancing operations in the euro area	€1,006.64 billion	€739.33 billion
of which counterparties of the Bundesbank	€71.61 billion	€21.26 billion
– Banks participating in the main refinancing operations in the Eurosystem (average)	85	62
of which via the Bundesbank	14	8
Standing facilities		
– Marginal lending facility in the euro area	€1.94 billion	€0.47 billion
– Deposit facility in the euro area	– €493.66 billion	– €100.21 billion

1 On 31 December. **2** Core staff (full-time equivalents) on 31 December 2001 (year before the structural reform began): 14,800. **3** Since 1 January 2011. **4** Since 27 December 2012. **5** Daily average of the individual amounts outstanding.

Cash payments	2012	2013
Volume of euro banknotes in circulation (Eurosystem), on 31 December	€912.6 billion	€956.2 billion
Volume of coins in circulation (Eurosystem), on 31 December	€23.7 billion	€24.2 billion
Value of DM/euro exchange transactions	DM97.5 million	DM85.7 million
Unreturned DM banknotes and coins	DM13.16 billion	DM13.04 billion

Incidence of counterfeit money in Germany	2012	2013
Euro banknotes (number)	41,500	38,800
Euro coins (number)	52,000	52,000

Cashless payments	2012	2013
Payments via the Bundesbank (number of transactions)	2,866.4 million	3,165.5 million
– *of which* via RPS	2,817.1 million	3,115.5 million
– *of which* via TARGET2-BBk	45.0 million	45.8 million
Payments via the Bundesbank (value)	€200.7 trillion	€155.4 trillion
– *of which* via RPS	€2.5 trillion	€2.7 trillion
– *of which* via TARGET2-BBk	€195.6 trillion	€151.6 trillion
Share of TARGET2-BBk transactions in EU-wide TARGET system	~ 50%	~ 50%

Banking supervision	2012	2013
Number of institutions to be supervised	3,582	3,548
On-site inspections	212	239
Inspection reports processed	5,723	5,601
Meetings with senior management	2,977	3,174

Cooperation with foreign central banks	2012	2013
Training and advisory events	308	270
– number of participants (total)	3,764	3,119
– number of participating countries (total)	87	96

Selected economic publications (editions/circulation)	2012	2013
Annual Report	1 / 16,000	1 / 10,000
Financial Stability Review	1 / 9,500	1 / 9,000
Monthly Report	12 / 8,600	12 / 8,000
Statistical Supplements	52 / 1,500	52 / 1,300
Research Centre Discussion Papers	36 / 300	57 / 300
Publications in academic journals/books	47 / –	33 / –

External communication/public relations	2012	2013
Visitors to the Money Museum	37,914	40,731
Written answers to queries	16,061	17,941
Press releases	341	339
Visits to the website (www.bundesbank.de)	4,716,951	6,860,723
Training sessions on counterfeit prevention	2,200	2,500
– number of participants	44,000	52,000

Branches of the Deutsche Bundesbank on 1 April 2014

Locality number	Bank location	Locality number	Bank location
720	Augsburg	660	Karlsruhe
		210	Kiel[1]
773	Bayreuth[1]		
100	Berlin	860	Leipzig
480	Bielefeld	545	Ludwigshafen
430	Bochum	230	Lübeck[2]
290	Bremen[1]		
		810	Magdeburg
870	Chemnitz	550	Mainz
570	Coblenz	700	Munich
370	Cologne		
		150	Neubrandenburg
440	Dortmund	760	Nuremberg
850	Dresden[2]		
300	Düsseldorf	280	Oldenburg
		265	Osnabrück
820	Erfurt		
360	Essen	750	Regensburg
		640	Reutlingen
500	Frankfurt/M	130	Rostock
680	Freiburg		
		590	Saarbrücken
513	Giessen[2]	600	Stuttgart
260	Göttingen		
		630	Ulm
450	Hagen		
200	Hamburg	694	Villingen-Schwenningen
250	Hanover		
		790	Würzburg

1 Closure date 30 September 2015. **2** Closure date 31 March 2015.

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Staff of the Deutsche Bundesbank on 31 December 2013[1]

Item	Staff numbers[2]				Year-on-year changes			
	Total	Regional Offices	Branches	Central Office	Total	Regional Offices	Branches	Central Office
Civil servants	5,446	1,530	1,284	2,632	29	− 18	− 86	133
Salaried staff	5,376	1,409	1,696	2,271	− 32	− 42	− 73	83
Total	10,822	2,939	2,980	4,903	− 3	− 60	− 159	216
of which Trainees	524	124	0	400	− 13	− 19	0	6
Remainder Core staff	10,298	2,815	2,980	4,503	10	− 41	− 159	210
Memo item Core staff *pro rata* (full-time equivalents)	9,547.4	2,584.1	2,748.1	4,215.2	4.2	− 40.0	− 145.7	189.9

	End-2013	End-2012
1 Not included:		
Members of staff on secondment	134	153
Members of staff on unpaid leave	326	335
Members of staff in the second phase of the partial retirement scheme	573	502
2 Of which part-time employees	2,140	2,068
Of which staff with temporary contracts	126	117

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Offices held by members of the Executive Board of the Deutsche Bundesbank

Pursuant to the Code of Conduct for members of the Executive Board of the Deutsche Bundesbank, the Annual Report shall disclose, *inter alia*, details of offices held by Board members on supervisory boards or similar inspection bodies of business enterprises.

The Board members hold the offices indicated below.

- Dr Jens Weidmann, President:
  Member of the Board of Directors, BIS;[1]
  Member of the Financial Stability Board (FSB)[1]

- Ms Sabine Lautenschläger, Deputy President:
  Member of the Administrative Council, LIKO-Bank;[2]
  Member of the German Financial Stability Committee;
  Member of the Basel Committee on Banking Supervision[1]

- Dr hc Rudolf Böhmler:
  Member of the Supervisory Board of ARADEX AG, Lorch;
  Alternate, Administrative Council, LIKO-Bank;[2]
  Member of the Board of Trustees, Monetary Stability Foundation

- Dr Andreas Dombret:
  Member of the Board of Directors, BIS;
  Member of the German Financial Stability Committee;
  Member of the Stock Exchange Expert Commission of the Federal Ministry of Finance;
  Alternate, Board of Trustees, Monetary Stability Foundation

- Dr Joachim Nagel:
  Alternate, Board of Directors, BIS;[1]
  Senior Vice-Chairman of the Administrative Council, LIKO-Bank;[2]
  Vice-Chairman of the Credit Committee, LIKO-Bank;[2]
  Standing guest on the Central Capital Market Committee

- Mr Carl-Ludwig Thiele:
  Alternate, Administrative Council, LIKO-Bank;[2]
  Member of the Board of Trustees, Monetary Stability Foundation

1 Ex officio. 2 Partnership agreement.