Joachim Nagel: Presentation of the Deutsche Bundesbank's Annual Report 2023

Introductory statement by Dr Joachim Nagel, President of the Deutsche Bundesbank, at the press conference presenting the Annual Report 2023, Frankfurt am Main, 23 February 2024.

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Check against delivery

1 Welcome

Ladies and gentlemen,

I, would like to welcome you most warmly to this press conference.

Sabine Mauderer will explain our annual accounts to you in more detail in just a few moments. Before that, I would like to say a few words about economic and price developments as well as monetary policy in the euro area.

It won't come as a surprise that I'm about to present you with a whole host of figures – a "bird's-eye" view of the economy, so to speak. However, I believe it is important to bear in mind the specific impact of these developments on people.

That's why I would like to begin with the results of the household survey carried out as part of our Bundesbank Online Panel – Households. Looking back on 2023, respondents were asked to estimate to what extent inflation represented a financial burden for their household. Almost half of households responded that inflation presented them with a financial burden (47% in the survey categories 5-7). This figure was only slightly lower than in 2022 (when it stood at 50%). 11% reported very high financial burdens – exactly the same figure as in the previous year. For low-income households, this figure was as high as 17%.

This shows once again how important our mandate is. Inflation has economic and social costs. By achieving price stability, we make life easier for many people. It relieves them of one major worry, especially those forced to live on little money. Price stability therefore also promotes social cohesion.

2023 began with inflation rates of over 8% in the euro area. From the outset, the key monetary policy task of the year was therefore clear: to curb the high inflation.

Looking back, it is safe to say that we have embarked on the right path and have already made good progress. For instance, we have come much closer to our 2% target. But we have not yet reached it.

I would now like to outline which paths we took in 2023, where we are today and where we are headed.

2 Economic and price developments

2.1 Economic developments

2023 was a challenging year for the German economy. The period of weakness that followed the start of Russia's war of aggression against Ukraine has continued.

Headwinds initially came from the aftermath of the sharp rise in energy costs. Three other main factors slowed the economic recovery: weak external demand weighed on the industrial sector; high inflation held back private consumption; tight monetary policy led to rising financing costs, which dampened investment.

However, there were also developments that supported economic activity. Many supply bottlenecks eased over the course of the year. Moreover, the labour market proved remarkably robust. Despite the persistently weak economic environment, the number of persons in employment rose to 45.9 million, an all-time high.

On balance, economic output fell slightly on the year in 2023; it was down by 0.1% in price and calendar-adjusted terms.

The outlook for 2024 promises a little more light than shadow again. Our experts expect the German economy to gradually regain its footing during the course of the year and embark onto a growth path.

First, foreign sales markets are expected to provide tailwinds. We expect an economic recovery here. This will probably push up global demand for German goods and cause German exports to grow. Second, private consumption should benefit from an improvement in households' purchasing power. Thanks to a stable labour market, strong wage growth and falling inflation, people will effectively have more money in their pockets.

However, as things stand today, the anticipated recovery is likely to start somewhat later than we had projected in December. German economic output could once again decline slightly in the first quarter of 2024. For instance, foreign industrial demand recently trended significantly downward, too. Besides this, consumers are likely to remain cautious about spending. Because of the delay in the economic recovery, as things stand, the German economy is more likely to tread water on average in 2024.

There are clear risks to the economic outlook, if, for example, geopolitical conflicts intensify. This could lead to rising energy and commodity prices and disrupt supply chains again. This would weigh on the German economy and, at the same time, fuel inflation.

2.2 Inflation

How we see price developments last year also depends on which perspective we take.

Looking at the annual average, inflation was still exceptionally high in 2023. Germany recorded its second-highest inflation rate since reunification. The Harmonised Index of Consumer Prices (HICP) rose by 6%, compared with 8.7% the previous year. In the euro area, it went up by 5.4%. After 8.4% the previous year, this is the highest figure recorded since the launch of monetary union 25 years ago.

However, these annual averages mask the marked decline in inflation over the course of the year. In Germany, it fell from more than 9% at the start of the year to less than 4% at the end of the year, and in the euro area, from over 8% to under 3%. This was mainly due to lower energy prices. Government relief measures and lower market prices for fuels were dampening factors here. Food prices grew by double digits on average during the year. But here, too, we can see that price pressures eased significantly over the course of the year.

Core inflation excluding energy and food continued to rise in 2023, at 5.1% in Germany and 4.9% in the euro area. Services prices, in particular, rose more sharply than in the previous year. At first, pent-up demand for services that were unavailable during the pandemic still played a role here. Think, for example, of travelling or eating out. This allowed some sectors to expand their profit margins. In addition, wages rose sharply in response to inflation, which also put pressure on prices.

Comparing today's situation with the situation a year ago, the nature of inflation has changed significantly. Back then, inflation was mainly being fuelled by high energy and food prices. On an annual average for 2022, headline inflation was more than twice as high as core inflation. In the meantime, the picture has changed. Of late, the core rate was significantly higher than the headline rate.

What does this mean? Energy and food prices play a key role in headline inflation. These prices typically fluctuate more strongly. By contrast, core inflation is much more stubborn and persistent. It is shaped largely by developments in wages, productivity and firms' profit margins. In January, euro area headline inflation was only around 1 percentage point higher than its pre-pandemic average. Meanwhile, at 3.3%, core inflation was still 2 percentage points higher than its average rate between 1999 and 2019.

When analysing the headline rate, we take a detailed look at core inflation. This is because, as a measure of underlying price pressures, core inflation helps us to assess future inflation developments.

It does not look as though a series of large decreases in the inflation rate, as seen in the last quarter of 2023, is to be expected any more. We will have to get used to small steps. Setbacks like those we experienced in December cannot be ruled out in this area. This was mainly due to a statistical base effect in Germany for energy. Further base effects are foreseeable. For example, Easter falls in March instead of April this year. Travel in March, for example, will therefore be particularly expensive. However, the one-off effects do not alter the trend: inflation is falling.

The latest Eurosystem staff macroeconomic projections will be published in just under two weeks. I won't jump the gun on this topic.

In Germany, our experts still expect the annual average increase in the HICP to more than halve in 2024. The high level of inflation is likely to come down in the euro area, too. Nonetheless, inflation rates – especially the "hard core" – will still remain markedly higher than 2% in the coming months.

3 Monetary policy

3.1 Path of key interest rates

Current price developments represent both a success and a challenge for the ECB Governing Council. A success because our tight monetary policy is having the desired effect and the inflation rate is falling. But also a challenge as the target has not yet been achieved and the journey towards this goal will not "walk itself".

What I find encouraging is the determination shown by the Governing Council thus far. We continued along the path of monetary policy tightening we embarked on in 2022 with verve in 2023. The four policy rate hikes in 2022 were followed by six more. Overall, key interest rates have gone up by 4½ percentage points in a space of just 14 months. This is the largest and steepest sequence of interest rate hikes in the history of the euro area.

The interest rate level we have achieved should be enough to push the inflation rate down to 2% over the medium term – provided we keep key interest rates high enough for long enough. Even though it may be very tempting, it is too early to cut interest rates. This is because the price outlook is not yet clear enough.

For me, the order is clear. First, we on the ECB Governing Council need to be convinced, based on the data, that inflation will actually and sustainably achieve our target. This largely depends on wage developments coupled with profit margins. Therefore, we will monitor these data very closely in the coming months. We will only receive a more detailed picture of how domestic price pressures are unfolding during the second quarter. First of all, we need clearer evidence that we will achieve our target – reliably and soon. Then we can contemplate a cut in interest rates.

If we reduce interest rates too early or too sharply, we run the risk of missing our target. In the worst-case scenario, we might even have to raise interest rates again. It is important to avoid such a wavering policy, as it would be costly for the economy. We should guarantee that price stability is achieved the first time around.

This is also one of the lessons which history has taught us. A team of researchers from the International Monetary Fund investigated over 100 inflation shocks since the 1970s. They warn against "premature celebrations": Four out of ten inflation shocks were yet to be overcome even after five years. And in 90% of these unresolved cases of inflation, rates initially declined, but then remained at elevated levels or picked up again.[1]

We can avoid this by giving our tight monetary policy stance sufficient time for its effects on inflation to unfold. So far, we haven't experienced any problems making decisions on a meeting-by-meeting basis, always driven by the latest data. And that is exactly what we will do again at our next meeting.

3.2 Reducing the balance sheet

The reduction of the balance sheet is supporting our monetary policy stance. We are thus gradually unwinding earlier expansionary measures. For instance, banks are paying back their loans from the targeted longer-term refinancing operations to us. What's more, we first reduced reinvestments under the largest asset purchase programme, the APP, and then discontinued them altogether in July 2023. This concerns around €25-30 billion per month that is not being reinvested.

Since the beginning of the monetary policy tightening cycle, the Eurosystem's balance sheet has shrunk by just over one-fifth. However, monetary policy bond holdings are still very high. They amount to just under €4,700 billion. Measured on this basis, the volume of reductions has so far been modest.

I therefore welcome the fact that we have also initiated the end of reinvestments under the pandemic emergency purchase programme (PEPP). As of July, repayments will only be reinvested in part, and will no longer be reinvested from the end of the year. This means that we are accelerating the reduction in bond holdings gradually and in a predictable manner.

A leaner central bank balance sheet is desirable. It creates additional space for the market mechanism to work and for resources to flow to productive uses. Monetary policymakers also regain more room for manoeuvre. This is important as it enables us to continue taking all the measures necessary to safeguard price stability in future.

3.3 Conclusion

To summarise: Monetary policy has embarked on the right path. We have made great progress towards achieving price stability. But we are not there yet.

We should not let ourselves stray away from the path we have embarked on. Now it's a question of demonstrating perseverance even if the remainder of the journey sometimes seems to be dragging on.

The effort is worth it. The road is leading us to more favourable territory. Price stability lays the foundations for a prosperous and sustainable economy.

4 Annual accounts

Ladies and gentlemen,

The monetary policy stance of recent years is also reflected in the Bundesbank's annual accounts. Monetary policy developments from over a decade are having a combined effect in this context: the Eurosystem's highly accommodative monetary policy following the financial and sovereign debt crisis up until the pandemic, along with the interest rate reversal since 2022.

The former led to large holdings of securities for the central banks and large deposits from commercial banks. Central banks are now paying higher interest rates on these deposits owing to the policy rate hikes. At the same time, income from the extensive bond portfolios will initially remain virtually unchanged at a low level. Overall, the Eurosystem central banks are recording lower net interest income.

This also applies to the Bundesbank especially, as it has Bunds in its portfolio that have a particularly high credit rating and are therefore remunerated at a correspondingly low interest rate.

In the 2016 annual accounts, the Bundesbank had already started to make provisions to account for interest rate risk on its balance sheet. Risk provisioning was the main reason why the Bundesbank did not distribute any profit for 2020 and 2021.

We have our provisions for general risks and reserves to absorb financial burdens. Withdrawals from the provisions for general risks were already made in 2022. However, as the rise in key interest rates did not begin until mid-2022, the withdrawal of €1 billion was still comparatively limited.

In 2023, the key interest rate hikes took full effect. The remaining €19.2 billion in provisions for general risks will now be released in full. In addition, €2.4 billion will be withdrawn from the reserves. On balance, the Bundesbank is once again reporting a distributable profit of zero for financial year 2023. Just under €0.7 billion now remain in reserves.

The financial burdens are likely to persist for several years and their scale is highly uncertain. We do, however, expect them to be considerable again for the current year. They are likely to exceed the small volume of reserves remaining, in which case the Bundesbank will report a loss carryforward. Future profits would have to be used to reduce the loss carryforward. We therefore do not expect to be able to distribute any profit for a longer period of time.

However, our annual accounts show that the Bundesbank's balance sheet is sound. The Bundesbank can bear the financial burdens. It has considerable assets, which are significantly in excess of its obligations. Our revaluation reserves, for instance, amount to almost €200 billion. For this reason, the Bundesbank will remain able to fully discharge its tasks even in the event of a loss carryforward, not least in the area of monetary policy.

We need to keep in mind that the Bundesbank is a central bank. Central banks differ from enterprises and commercial banks. They always remain able to pay in their own currency. And we have been assigned a clear legal mandate: The primary objective of the Eurosystem is to safeguard price stability. The Bundesbank will continue to firmly advocate for price stability, even if this results in financial losses.

To sum up, figuratively speaking: It is right that monetary policy is taking us on a path towards price stability. The financial burdens do not change our ability, nor our determination to continue on the path towards our goal. That is something people can rely on.

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1 Ari, A., C. Mulas-Granados, V. Mylonas, L. Ratnovski, and W. Zhao (2023), One Hundred Inflation Shocks: Seven Stylized Facts, IMF Working Paper WP/23/190.