Sabine Mauderer: Welcome speech - 15th anniversary of the Deutsche Bundesbank's representative office

Welcome speech by Dr Sabine Mauderer, Vice-President of the Deutsche Bundesbank, at the 15th anniversary celebration of the Deutsche Bundesbank's representative office, New York City, 24 September 2024.

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1 Welcome

Ladies and Gentlemen:

For me, it is always a great pleasure to be here. Especially this year, as we celebrate the 15th anniversary of our trading office. Since its inception in April 2009, the trading office has provided the Bundesbank Executive Board with first-hand knowledge from Wall Street and beyond.

I know for sure that its success rests on a network of exceptional people, namely you! Therefore, I want to start with a big thank you to all of you, for your cooperation and trust over all these years. But before we move on to the fun part, let us look at what has happened in the markets since we last met in September 2023.

2 Economic backdrop

From an economic point of view, the world looked different a year ago. Inflation in the euro area – and in the US too – was significantly higher. Almost a year ago to the day [Sept. 2023], the Eurosystem raised its key interest rates for the last time in the tightening cycle. In September 2023, the deposit facility rate reached 4.0 percent. The tightening has done its part to cool euro area inflation. Today, the Eurosystem is well on the way to meeting its inflation target.

In the US, we also see positive developments in this regard. Inflation has decreased significantly, thanks to a series of interest rate increases. Although US inflation remains above the Fed's two percent target, things are heading in the right direction – just like in the euro area. In terms of economic growth, the US remains ahead of the euro area. While euro-area GDP grew by 0.4 percent last year[1], the US economy mustered 2.5 percent growth[2]. As it stands today, the US is poised to outperform the euro-area economy once again this year – despite recent signs of a cooling in the US labour market.

Against the backdrop of lower inflation, central banks on both sides of the Atlantic have taken steps to pare back the degree of monetary-policy restrictiveness. As expected, the Fed last week [Sept. 18] decided to lower its target range for the federal funds rate for the first time in the current cycle.

In the euro area, the ECB's Governing Council lowered the deposit facility rate twice already, in June and September, bringing it to 3.5 percent. The Eurosystem also narrowed the spread between the main refinancing rate and the deposit rate from 50 to 15 basis points. The latter step was no surprise. It had already been announced in the context of our Operational Framework Review in March. While excess liquidity will remain high over the coming years, it will gradually decline as part of our monetary policy normalisation. By reducing the spread between the main financing rate and the deposit facility rate, the Eurosystem aims to limit future swings in money market rates, while maintaining incentives for more market activity. We will continue to closely monitor developments in the money markets and other refinancing markets.

3 What else have we achieved?

The Eurosystem – and the Fed – are continuing to shrink their balance sheets. In the euro area, we stopped reinvesting bond redemptions from the asset purchase programme APP [from July 2023 on]. And the Eurosystem is phasing out the remaining reinvestments of redemptions from the Pandemic Emergency Purchase Programme [PEPP] by the end of this year. Furthermore, euro-area banks have repaid the overwhelming share of their long-term crisis loans, the TLTROs.

In the US, you are well aware that the Fed had started to reduce its securities holdings approximately a year earlier.

From a central bank perspective, there are good reasons for this withdrawal of liquidity. With the end of negative [and zero] interest rates, an important reason for large-scale bond purchases has vanished. Furthermore, large balance sheets of central banks can lead to market distortions. They may lead to collateral scarcity or a deterioration of market liquidity. Finally, yet importantly, central banks should only intervene in financial markets to the degree necessary for monetary policy purposes.

It is encouraging that, so far, the balance sheet reduction has been well received by financial markets. Investors have adapted to a market with fewer central bank purchases and hence less ample liquidity provision. Market functioning remains largely robust.

4 What challenges lie ahead?

Ladies and Gentlemen:

While central banks have made good progress in normalising their monetary policy stance, challenges remain. Let me briefly address three of them.

First, despite the wave of high inflation nearing its end, we are not there yet. We shouldn't celebrate prematurely. When it comes to interest rate cuts and their size, we are not flying on autopilot. We must remain vigilant and be wary of the risks on the path back to price stability. That's our job and that's what we are committed to delivering.

Second, recent market turbulences in early August were brief, but they serve as a warning shot. They show how sensitively markets can react to monetary policy steps –

in this case combined with crowded positions in financial markets and macroeconomic triggers.

Third, another important factor to watch is China, which faces numerous challenges, including deflationary tendencies in some parts of the economy. Let's see how the markets perceive the latest decisions of the PBOC.

5 Conclusion

To sum up, markets have coped well with the withdrawal of central bank liquidity. Greater market fluctuations – like those in early August – have so far proven to be limited and temporary. I find this very encouraging.

Nevertheless, there is still work to do. We are not completely back to price stability. And central banks will continue to reduce their balance sheets, depending on their individual reduction targets. When it comes to balance sheet size, "less may be more" – as long as liquidity conditions in money markets remain relaxed over-all.

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[1] Vgl. https://ec.europa.eu/eurostat/web/products-euro-indicators/-/2-08032024-ap#:~:text=GDP%20growth%20in%20the%20euro%20area%20and%20the%20EU,-In%20the%20fourth&text=For%20the%20year%202023%20as,the%20third%20quarter%20of%202023). (aufgerufen am 12.09.2024)

[2] Vgl. https://www.bea.gov/sites/default/files/2024-08/gdp2q24-2nd.pdf