DEUTSCHE
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EUROSYSTEM

ANNUAL REPORT

2009 2010 2011 2012 2013

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President of the Deutsche Bundesbank

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Professor Hans-Helmut Kotz

Dr Hans Reckers
(until 30 April 2009)

Professor Hermann Remsperger
(until 30 April 2009)

Dr Thilo Sarrazin
(since 1 May 2009)

We mourn the death
of the following members of our staff

Dirk Müller	5 January 2009
Thomas Weyring	7 January 2009
Jens Müller	12 January 2009
Arno Koch	12 March 2009
Tatjana Fix	29 March 2009
Dagmar Lindert	31 March 2009
Klaus Wohlschlegel	1 June 2009
Bernhard Erlen	10 July 2009
Reinhold Wetta	23 July 2009
Axel Schaller	27 October 2009
Ute Schulte am Hülse	20 November 2009
Henry Lederer	12 December 2009
Heinz Görgen	13 December 2009
Hubert Koch	23 December 2009

We also remember the retired staff members
of the Bank who died in 2009

We will honour their memory.

DEUTSCHE BUNDESBANK

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Annual Report
2009

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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	Figure unknown, not to be published or not meaningful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.

Foreword by the President of the Deutsche Bundesbank

Foreword

In 2009, the severe financial and economic crisis continued to loom large in the daily work of the Bundesbank and its staff. In its various business areas, the Bundesbank played a key part in overcoming the crisis while also efficiently performing its other tasks.

As the year began, the global economy was in the throes of a steep slide in real activity. After the onset of a marked recovery in the second quarter, however, fears of an unstoppable freefall were dispelled. The Asian emerging market economies, led by China, spearheaded the recovery and rapidly embarked on a dynamic expansion course. The improvement took somewhat longer in the euro area, where the economic situation brightened in the second half of the year. The financial markets, too, were able to break out of their paralysis in the second quarter of last year.

The key factor in the stabilisation of the world economy was the unparalleled intervention of monetary and fiscal policymakers in all the major economic regions. Given a difficult setting for the real economy, a clearly slower pace of monetary growth and the ensuing decline in inflation risks as well as solidly anchored inflation expectations, the Governing Council of the ECB steadily continued its policy of monetary easing in the first half of 2009. Furthermore, in mid-2009, the Eurosystem expanded its range of non-standard monetary policy measures by conducting three 12-month longer-term refinancing operations up to the end of the year and establishing a monetary policy portfolio consisting of covered bank bonds.

Fiscal policymakers made a significant contribution to stabilisation worldwide by allowing the automatic stabilisers to operate, launching additional extensive stimulus packages and implementing substantial support measures to safeguard financial stability. The government rescue packages put together in many countries comprised guarantees for bank deposits and bank debt securities, capital injections and the option of offloading problem assets onto "bad banks".

Within the EU, as worldwide, government deficit and debt ratios have risen massively in the vast majority of countries as a result of the fiscal expansion. In this situation, the fiscal framework of the EU is currently being put to its severest test since the launch of monetary union. In this connection, the European Council recently reaffirmed the responsibility of each and every country for ensuring the stability of the euro area. National policymakers must therefore now fulfil their obligations in order to steer a rapid course towards sustainable public finances and thereby preserve the institutional foundations of monetary union.

Given its extensive external trade links, the German economy was hit very hard by the global recession. On an annual average, gross domestic product shrank by 5.0% in price-adjusted terms, which was more extreme than any previous contraction experienced in the Federal Republic of Germany's 60-year history. Although aggregate output bottomed out during the year, it remained at a low level overall. This makes it all the more remarkable that the rise in unemployment has, to date, been very muted. The price climate was extremely benign in 2009. Germany's public finances worsened dramatically as a result of the sharp slump in economic activity and the extensive fiscal policy support measures, and the 3% deficit limit set by the Maastricht Treaty was exceeded. A further sharp increase is to be expected in the current year, and high deficits and a rapidly rising debt ratio are likely in the medium term, too, if no countermeasures are taken. In view of all this, consolidating public finances will be one of the most pressing policy tasks over the next few years.

The events of the past year once again posed a challenge for the Bundesbank and its staff in many areas. Besides the further expansion of the monetary policy framework in the first half of the year, the past few months were mainly concerned with providing technical and policy input for initiating a gradual exit from the non-standard monetary policy measures. In addition, the Bundesbank played an active part in developing measures to stabilise the financial markets at the national level.

The financial crisis has forcefully demonstrated the necessity of international cooperation in the monetary and economic sectors. In the informal forums of international cooperation, ie primarily at the G7, G10 and G20 levels, the Bundesbank is making its contribution to improving the foundations for a stable development in the world economy.

The turmoil of the past 18 months has made it abundantly clear that a stable international financial system is of crucial importance in this context. The Bundesbank is making intense efforts at various levels to help develop measures to enhance the resilience of the financial system. The Bundesbank took account of this in organisational terms, too, by setting up a Financial Stability Department. This leverages the Bank's resources in this field in order to optimise the performance of its tasks at the national and international levels.

Above and beyond that, the Bundesbank is playing a very active role, both at the European level and in a wider international context, in adjusting the regulatory framework and is represented not only on the Financial Stability Board (FSB) but also, *inter alia*, on the Basel Committee on Banking Supervision (BCBS) and the Committee of European Banking Supervisors (CEBS). Improving the quality of regulatory capital, strengthening risk cover and drawing up quantitative liquidity standards are key objectives in the work of the Basel Committee. Moreover, at the European level, the establishment of prudential authorities for banking, insurance and securities supervision, which is scheduled for 2011, represents an integral component of the future European financial market architecture for regulation and oversight. Cooperation was concurrently stepped up in respect of monitoring EU cross-border banking groups through supervisory colleges. At the national level, the first lessons were drawn from the financial crisis by extending supervisors' powers of intervention and amending the Minimum Requirements for Risk Management.

The Bundesbank did not restrict its activities to areas directly connected with overcoming and analysing the financial crisis, however. For example, in the field of cash management, an in-depth study on payment behaviour in Germany was published in 2009. This study confirmed that cash is likely to continue to play a dominant role in payment transactions in the future. While lodgement volumes at the Bundesbank's branches fell slightly for the first time in 2009, this may be due to a gradual increase in banknote recycling by private cash handlers, which currently takes place mainly via customer-operated cash deposit and cash recycling machines. In the light of this and based on evaluations of economic efficiency, the Bundesbank decided last year to further consolidate its branch network from 47 to 35 locations. In addition, it is reviewing whether other locations in the Rhine-Ruhr area should be consolidated into a new "superbranch" by 2015. Despite the smaller number of branches in future, the Bundesbank will continue to perform its statutory mandate and take an active part in the cash cycle.

With the new TARGET2-Securities (T2S), the Eurosystem will take on an active role in future in securities settlement and offer the settlement of securities transactions in central bank money on a single integrated platform. It is to be based on the Single Shared Platform (SSP) developed for the TARGET2 payment settlement system. The joint operation of TARGET2 and T2S will achieve considerable savings as well as improvements in banks' liquidity and risk management. Overall, the implementation of T2S represents a further major contribution to the integration of European securities markets. It will also make settlement in Europe more secure and more stable. There continues to be a high level of support for the project. One major milestone was the Memorandum of Understanding signed by the Eurosystem central banks and central securities depositories in July 2009. After the Bundesbank, Banque de France, Banca d'Italia and Banco de España had been commissioned by the Governing Council of the ECB in July 2008 with the development and subsequent operation of T2S, the project began to assume concrete shape last year. The general functional specifications have very largely been finalised, which means that a start can now be made on the development of T2S.

The introduction of the SEPA direct debit on 2 November 2009 was a further important step on the road to the Single Euro Payments Area. The use of a single direct debit procedure across national borders is now possible for the first time. The Bundesbank is playing an active role in both a national and European context in ensuring the success of the SEPA direct debt and, therefore, the SEPA project as a whole. The aim of SEPA is to secure the advantages of a single European market in payment transactions for the benefit of consumers and enterprises.

Overall, with regard to the Bank's core business areas and other activities, the Bundesbank's regular strategy review conducted in the reporting year showed that the positive start made in implementing the 2008-2012 strategic cycle with the stated objective of "raising the Bank's profile, continuing the consolidation process" was successfully carried forward in 2009.

As always, qualified and highly motivated employees are essential to the continued successful performance of our tasks and to the achievement of our objectives. Recruiting and keeping highly qualified staff is a permanent challenge for all areas of the Bank. In this regard, the Bundesbank will continue to offer an attractive employment framework with interesting and challenging tasks.

I am joined by the other members of the Executive Board in thanking all our staff for their work in 2009 and for their high level of dedication. My thanks also go to the staff representation committees for their invariably dedicated and constructive contribution.

Frankfurt am Main, March 2010

Professor Axel A Weber
President of the Deutsche Bundesbank

Monetary policy and economic developments

The global economy has rallied somewhat following a sharp downturn in the final quarter of 2008/first quarter of 2009. Global output has picked up significantly since the second quarter. The Asian emerging market economies (EMEs), led by China, spearheaded this development: they came out of recession relatively rapidly to embark on a dynamic growth path.

In the euro area, the economy was still deep in recession in the first half of 2009. Given considerable downward pressure on the overall economy, clearly muted monetary expansion and the resulting decline in inflationary risks as well as solidly anchored inflation expectations, the Governing Council of the ECB continued its monetary easing policy in the first half of 2009. By May, the Eurosystem's top decision-making body had lowered the interest rate for main refinancing operations to 1% in four steps. The combined effect of interest rate cuts, non-standard monetary policy measures and massive fiscal support programmes ultimately led to a considerable brightening of the economic situation and a stabilisation of the financial markets in the second half of the year.

The German economy was very hard hit by the global recession due to its many external trade links. On an annual average, gross domestic product fell by 5.0% in price-adjusted terms, more sharply than ever before in the history of the Federal Republic of Germany. Although economic output bottomed out during the year, it remained at an exceptionally low level overall. This makes the, to date, very muted labour market response all the more remarkable. The price climate was extremely benign in 2009. The sharp economic downturn, which was accompanied by a correction of the previous exceptional positive development of profit-related taxes, and the extensive fiscal support measures led to a dramatic deterioration in public finances. If no remedial action is taken, this is likely to cause high deficits and a rapid increase in the debt ratio in the medium term, too. In view of all this, consolidating public finances will be the most pressing policy task over the next few years.

I International setting

1 Global economic recovery following sharp downturn

Global economic turnaround ...

The global economy has rallied somewhat following a sharp downturn in the final quarter of 2008/first quarter of 2009. Since the spring, global output has picked up significantly. The Asian emerging market economies (EMEs) – led by China – spearheaded this development: they came out of recession relatively rapidly to embark on a steep growth path. In regional terms, the global recovery spread over a considerably broader base in the second half of the year. Almost all larger economies experienced perceptible growth of their real gross domestic product (GDP) as compared with the previous period. The pace of growth continues to differ considerably, however. Laggards in Europe include, first and foremost, those industrialised and transition countries in which large macroeconomic imbalances from the pre-crisis years are hampering economic revival. On an annual average, overall economic output worldwide, aggregated based on purchasing power parities, still shrank by ¾% on the year in 2009, according to latest IMF estimates. By the IMF's reckoning, this is the only contraction global GDP has experienced since 1980, the first year for which this metric was produced. The latest indicators show the global economy getting off to a fairly buoyant start to the year. It is generally expected to post brisk growth again in 2010.

... thanks to support measures for the financial system and macroeconomic stimulus measures

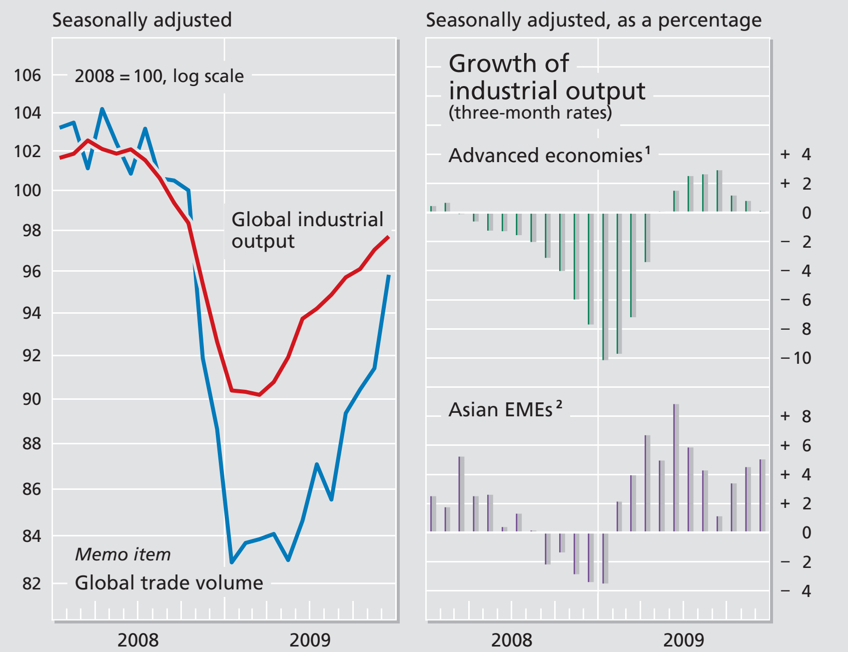
The remarkable speed and strength of the global economic revival can be attributed to the fact that the financial crisis, which had come to a head following the collapse of investment bank Lehman Brothers in September 2008, has been contained. The massive efforts by central banks to stabilise the money and credit markets, in conjunction with large-scale government support measures particularly for banks, insurers and debt-ridden homeowners, have prevented a collapse of the international financial system and paved the way for a gradual return of market participants' confidence. Moreover, strong monetary and fiscal policy stimulus measures have broken the exceptionally sharp cyclical downwards momentum.

Particularly pronounced cycle in global industrial output ...

The economic upturn centres on the industrial sector, which generally experiences greater cyclical fluctuations than the services sector and was also hit particularly hard by the recession. The intensification of the financial crisis in the second half of 2008 shook economic players' confidence and gave them a con-

Global industrial activity

Chart 1



Source: Centraal Planbureau. — **1** OECD excluding Turkey, Mexico, Korea and the new EU member states. — **2** Asia excluding Japan and the Middle East.

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siderably gloomier outlook. In response to the sudden spike in uncertainty, households and enterprises made substantial cuts in spending, in particular on durable goods. The slump in final demand was further aggravated by the stock-building cycle, with global industrial output declining by more than 9% between September 2008 and March 2009.[1] The drop in production was exceptionally pronounced in economies specialising in the manufacture of capital goods and durable consumer goods. In March 2009, for instance, seasonally adjusted German industrial output was 20% below its September 2008 level, while the Japanese figure was even 31% lower than a year earlier.

Industrial output in the Asian EMEs started to pick up as early as the first quarter of 2009 and rapidly gained momentum, partly due to large-scale fiscal stimulus programmes, mainly in China. In most advanced economies, meanwhile, manufacturing did not start to recover until the second or third quarter of the year. In many countries, government incentives to buy cars were instrumental in stabilis-

1 These data and the following figures on the latest developments in real global trade are supplied by the Netherlands Bureau for Economic Policy Analysis (Central Planbureau or CPB), which has for some time been calculating monthly indicators for world trade volume and world trade prices and in August 2009 started to produce a (seasonally adjusted) series on global industrial output.

ing demand in this key sector. Just as it had during the downturn, the stockbuilding cycle also amplified cyclical momentum as production picked up. At the end of 2009, global industrial output was 5½% up on the year, but still 6½% lower than in 2008 on an annual average.

... and in global trade

The international exchange of goods slumped even more sharply than industrial output as the global recession bit. According to the CPB, global trade for instance shrank by 13¼% in the fourth quarter of 2008/first quarter of 2009 in seasonally adjusted terms compared with the previous period. Close international production ties mean it is not uncommon for trade in goods to be highly elastic in relation to industrial output. In addition, the decline in global trade flows is partly being attributed to a temporary squeeze on foreign trade financing. However, fears that protectionist measures could be appreciably extended have proved unfounded. The recovery in global trade set in during the third quarter and quickly gained momentum. By the end of 2009, global trade volume had already risen 15½% from its low. On the whole, international production chains are therefore likely to emerge unscathed from the financial crisis and the global recession. Nevertheless, on an annual average, global trade volume still fell by 13¼%.

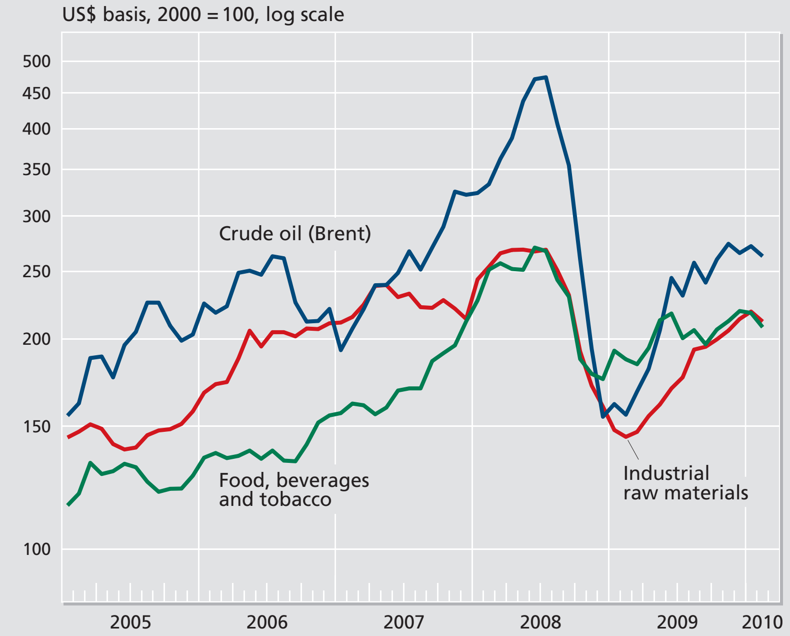
Developments in commodity prices take their lead from industrial activity

Price developments in the international commodity markets were largely reflective of global economic activity in 2009. The rapid recovery of the commodity-intensive Asian emerging market economies, in particular, caused prices to rise smartly in the second quarter, having previously dropped substantially. In the second half of the year, this development abated somewhat, but the basic upward tendency continued. Moreover, prices for individual items in the category food, beverages and tobacco were sent sharply higher at times by supply bottlenecks, caused for instance by weather-related crop shortages. In February 2010, crude oil, as measured by the price of a barrel of Brent, cost US$74½, which is 68¾% dearer than a year earlier. This was, however, still far off the highs of the third quarter of 2008. Prices for industrial raw materials were 46¼%, those for food, beverages and tobacco 11¼% higher than one year before. Average prices in 2009, however, were still significantly lower than in 2008 in all major commodity categories. Cheaper energy, in particular, considerably depressed consumer inflation, making an important contribution to stabilising households' purchasing power worldwide.

The industrialised countries were clearly at the epicentre of the recent global financial and economic crisis. Although the EMEs were unable to buck the

World market prices for crude oil, industrial raw materials and food, beverages and tobacco

Chart 2



Sources: Thomson Reuters and HWWI.

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Rapid economic turnaround in EMEs

downward trend, they were hit less hard – with the exception, in particular, of several central and east European countries including Russia. Moreover, the majority were in a fairly favourable position in terms of foreign trade when the crisis took hold and had a relatively solid macroeconomic foundation, which had been established in the preceding years through a more credible monetary and fiscal policy framework. In the case of China, in particular, the swift intervention of the central bank and an ambitious economic stimulus programme also allowed the expansionary forces rapidly to regain the upper hand. On an annual average, Chinese GDP growth was therefore only slightly weaker in 2009 than a year earlier, at 8¾%. Other EMEs, first and foremost commodities-producing economies, benefited from the revival of demand in Asia, which started as early as the winter months. For the group of emerging market and developing countries as a whole, where GDP still expanded by 2% last year according to current IMF estimates, growth looks set to rise substantially in 2010. In China, recent macro data even point to the risk of the economy overheating. Against this backdrop, the Chinese central bank has tightened monetary policy repeatedly in recent months. Moreover, the authorities are aiming to curtail credit growth sharply this year. A clear appreciation of the renminbi could also prove useful in this context.

Macroeconomic benchmark figures of selected industrialised countries — Table 1

Countries	Real GDP		Consumer prices 1		Current account balance		Unemployment rate 2	
	2008	2009 pe	2008	2009	2008	2009 pe	2008	2009 pe
	Annual percentage change				As a percentage of GDP		As a percentage	
OECD	0.6	3 – 3.5	3.7	0.5	– 1.6	3 – 0.9	6.1	8.3
of which								
Euro area	0.6	– 4.1	3.3	0.3	– 1.5	– 0.6	7.5	9.4
United Kingdom	0.5	– 5.0	3.6	2.1	– 1.6	3 – 2.6	5.6	3 8.0
United States	0.4	– 2.4	3.8	– 0.4	– 4.9	3 – 3.0	5.8	9.3
Japan	– 1.2	– 5.0	1.4	– 1.4	3.2	3 2.5	4.0	5.1
Canada	0.4	– 2.6	2.3	0.3	0.5	3 – 2.9	6.1	8.3

Sources: ECB, OECD, BIS, national statistics. — **1** HICP or CPI, OECD: private consumption deflator. — **2** Standardised unemployment rate, based on OECD and Eurostat calculations. — **3** OECD forecasts (Economic Outlook, November 2009).

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Solid output growth in the USA after long recession

In the United States, substantial growth in overall economic output in the second half of the year indicates that probably the longest and severest recession since World War II was overcome in mid-2009. From its last cyclical high at the end of 2007 to the second quarter of 2009, real GDP fell by 3¾% in real terms. Although economic activity subsequently rose by a total of 2%, it was still down 2½% compared with 2008 on an annual average for 2009. According to the available information, the US economy got off to a lively start to the new year.

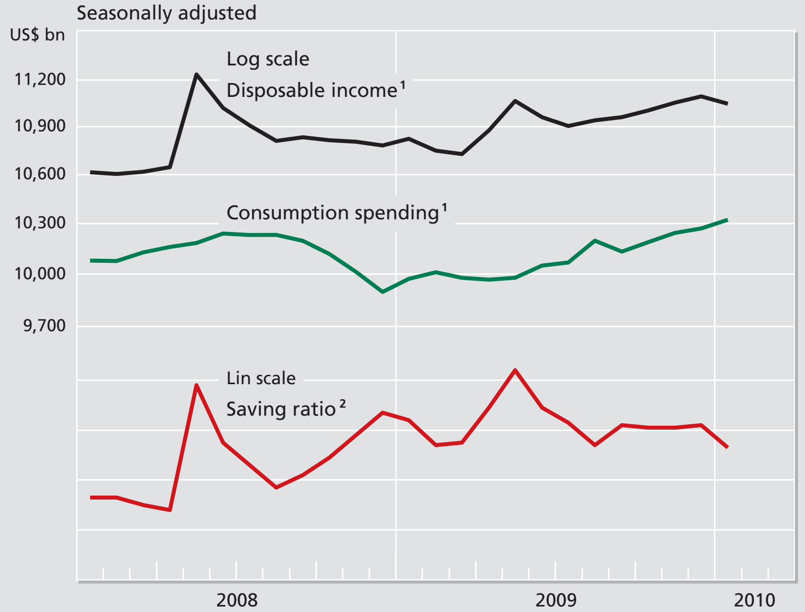
Despite strains, private consumption back on growth path ...

The main reason the recession intensified in the second half of 2008 was that the loss of confidence, the erosion of wealth and credit restrictions caused households to curtail their consumption spending noticeably, in particular on durable goods. The saving ratio rose by 3 percentage points to 4¾% from August to December 2008. This trend did not continue in 2009, however; instead, the saving ratio remained raised, with some temporary ups and downs. It averaged 4¼% over the year, a level last seen in 1998. Despite considerable strains as a result of large-scale job cuts – in the winter months alone, net job losses totalled 2¼ million – households' consumption spending remained virtually constant in the first half of 2009 in real terms. The favourable price climate is likely to have been a major factor in this stabilisation. The sharp drop in energy prices was instrumental in bringing consumer prices down by an average of 0.4% in 2009 compared with 2008, when they had risen by 3.8%. The tax rebates and

Disposable income, consumption and saving ratio of US households

Chart 3

Seasonally adjusted



Source: Bureau of Economic Analysis. — **1** Annualised. — **2** Saving as a percentage of disposable income.

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higher transfer payments under the US$790 billion economic stimulus programme agreed in the first quarter of 2009 were nonetheless mostly used to service debt and temporarily raise savings. By contrast, the limited government environmental premium provided a strong boost to passenger car sales in the third quarter. With the labour market no longer acting as a major drag, and supported by rising asset prices, private consumption has continued to increase.

... and slight recovery of gross capital formation as well as clear increase in exports

The sharp contraction of GDP in the first quarter of 2009 was almost exclusively the result of a slump in gross capital formation. One factor was increased destocking. Another was that commercial investment fell by 14% in the first half of the year. However, while the downward movement on the commercial real estate market continued apace in the second half of the year, enterprises were already perceptibly expanding investment in machinery and equipment. The improved earnings situation, particularly after the significant cost savings as a result of job cuts, paved the way for this recovery. Following a protracted and painful downward slide, which started in 2006, housing investment also picked up in mid-2009. Fiscal incentives and, not least, central bank intervention in the mortgage market had a considerable part to play in this turnaround. The substantial overall economic growth at end-2009 can largely be attributed to the stockbuilding cycle.

Recovery of the Japanese economy depends on external and economic stimuli

The Japanese economy has achieved a turnaround thanks to strong external stimuli, especially from China, as well as fiscal stimulus in the second quarter of 2009. A generous economic recovery programme, particularly incentives to buy cars and other durable goods, boosted private consumption, which had been severely dented by rising unemployment and falling wage income. In addition, public investment was temporarily stepped up substantially. While private housing construction was still contracting at the end of the year, commercial investment rallied somewhat at year-end. The large drop in output in the fourth quarter of 2008/first quarter of 2009 caused GDP to fall by 5% on the year on an annual average. Considerable capacity underutilisation helped send consumer prices lower and rekindled deflation fears. Excluding energy and food, prices dropped by 0.7% on an annual average, a rate of decline last seen in 2002. The Japanese economy will probably remain dependent on external stimuli for the foreseeable future, especially as the leeway for new fiscal and monetary policy stimulus is limited.

UK has muted growth outlook after severe and protracted recession

In the UK, the economy did not start to recover after the severe recession until the fourth quarter. The main reasons the downturn was so long and severe – GDP shrank by an average of 5% in 2009 – were distortions in the real estate market and the financial sector. However, government measures substantially mitigated the impact on the British labour market. The standardised unemployment rate, for instance, was just 1½ percentage points higher in November 2009 than a year earlier. The strongly expansionary monetary policy not only supported enterprises' funding situation, it also provided relief for households with debt to service. Real estate prices bottomed in February 2009 and have since been tending moderately upwards again. It is remarkable that in 2009 average annual consumer inflation was significantly higher, at 2.1%, than in the other major industrialised countries and did not move into negative territory even in the second and third quarters of the year. The outlook for growth is clouded mainly by the sharp rise in government debt. In January 2010, the public deficit was 60% of economic output, 10 percentage points more than a year previously.

Economies of some new EU member states under pressure

When external sources of funding dried up in the wake of the international crisis, several new EU member states (excluding Slovakia, Slovenia, Cyprus and Malta, which are euro-area members) underwent a painful process of adjustment. This was particularly dramatic in economies that had previously departed from a balanced growth path, had run up high current account deficits and were reliant on large inflows of short-term funds from abroad. In the Baltic states, real GDP shrank at double-digit rates. By contrast, Poland suffered very few after-effects of previous excesses, but did experience a significant weakening in its GDP growth to 1¾% on an annual average. At the end of the year, the economy in several other countries in the region also appeared at least to be stabilising.

Current account imbalances reduced, but still high in some cases

The year 2009 saw a reduction, in some cases significant, in global current account imbalances following the slump in demand for tradable goods in the wake of the recession and the sharp drop in prices in the oil and commodity markets. Nevertheless, imbalances were still fairly large in some countries – with the exception of the central and east European states, whose current account positions have improved distinctly or where high deficits have in several cases turned to surpluses. In the United States, the current account deficit in the first three quarters, for which official data are available, fell by almost half to 2.9% of GDP, on the year-earlier period. In the euro-area current account the relatively small deficit of the previous year fell significantly. Conversely, the group of oil-exporting countries and China, in particular, recorded lower surpluses. However, the Chinese current account surplus (excluding Hong Kong) still totalled US$284 billion, or 5.8% of GDP, in 2009 compared with US$426 billion, or 9.4% of GDP, a year earlier. Deficit countries must save more in the long term, and the exchange rate pegs between the currencies of several south and east Asian EMEs and the US dollar must be loosened. If not, there is a risk that global imbalances will become much more pronounced again as the world economy recovers and could potentially once more become a major problem for the global economy.

2 Crisis affects exchange rates

Exchange rate losses of the US dollar …

Last year the global financial and economic crisis continued to have a major impact on foreign exchange market developments. Uncertainty in the financial markets was reflected in extremely high exchange rate volatility, especially at the beginning of the year. Moreover, substantial changes in exchange rates occurred again. The US dollar was at the centre of activity. In the first few months of 2009 – as in the previous year – its effective exchange rate vis-à-vis 21 partner countries continued to rise, driven by global demand for dollar liquidity and portfolio shifts out of foreign assets with high risk premiums. In March, however, a countermovement set in as the US dollar came under pressure on the back of reports of a crisis-induced collapse in the labour market, followed by an announcement by the Fed that it planned to buy long-term government bonds in order to stimulate domestic demand. According to market participants, the extremely low level of US interest rates combined with a gradual rise in risk appetite spurred the growing use of the US dollar as a financing currency for carry trades during the course of the year. This and the very steep rise in public debt weakened the US currency. It was not until December that it recovered slightly, buoyed by a series of positive economic data. Nevertheless, over 2009 as a whole, the US dollar effectively depreciated by 6%. Thus, it relinquished almost all the gains it had made in 2008.

... are reflected in appreciation of the euro

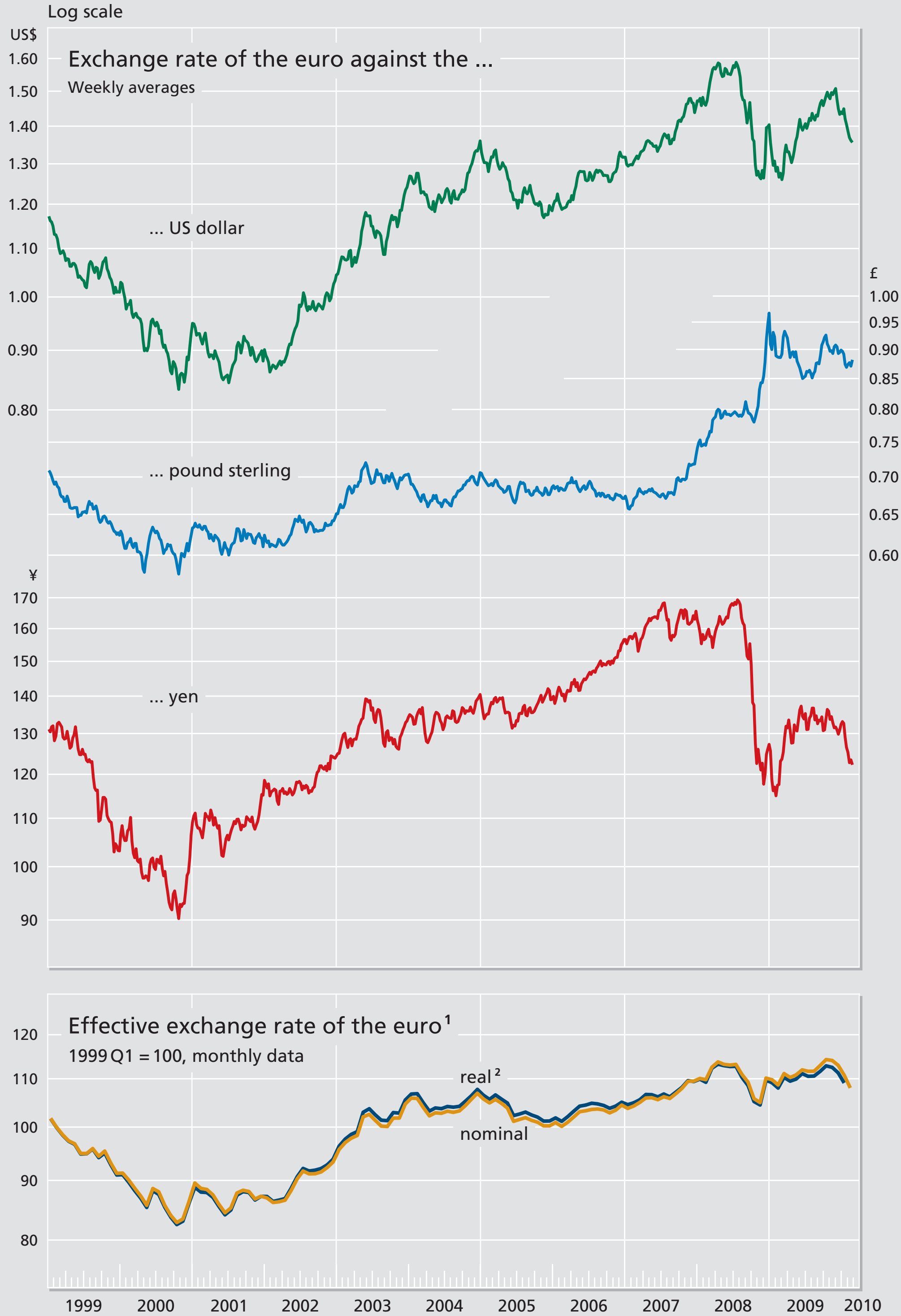
The above developments also affected the euro-US dollar exchange rate. One factor contributing to the euro's weakness in the first two months of the reporting year was that the Eurosystem – unlike the United States – was still cutting interest rates at that time. This caused the transatlantic yield spread, in particular that of short-term investments, to narrow. The subsequent appreciation of the euro was also attributable to the fact that the downturn bottomed out early in several large euro-area countries such as Germany. The single currency thus benefited from market participants' growing optimism, which resulted in high net capital imports into the euro area in portfolio investment. Since December, however, the euro has been burdened by fresh concerns about the creditworthiness of individual euro-area countries, notably Greece. On balance, the euro appreciated by 3½% to US$1.44 in 2009.

Euro weaker vis-à-vis pound sterling ...

After the euro had reached an all-time high against the pound sterling around end-2008, it declined in the first half of 2009 amidst initially fairly strong exchange rate volatility. However, the single currency strengthened significantly again in the third quarter amidst a flurry of unfavourable UK economic data on industrial output, for example. In addition, consolidation pressure in the United Kingdom proved to be even greater than anticipated, whilst problems in the British financial sector sparked debate about further monetary policy support measures. Finally, the Bank of England stated that the low exchange rate of the pound would benefit both an economic recovery and a structural realignment of the domestic economy. Although the euro, worth £0.89 at the end of 2009, was trading 7% lower than one year before, it was still 30% higher than its pre-crisis average for the years 2003 to 2007.

Exchange rate of the euro

Chart 4



1 According to ECB calculations against the currencies of 21 countries. — **2** Based on consumer price indices.

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... and stronger vis-à-vis the yen

At the beginning of the year, the euro initially came under pressure to depreciate vis-à-vis the yen as the single currency's interest rate advantage diminished. This development already went into reverse during the first quarter, however, when the scale of the collapse of the Japanese economy shook the markets and the sharp contraction in world trade severely dampened the outlook for Japan's export industry as well. The euro-yen exchange rate subsequently fluctuated with no clear trend in a fairly broad band between ¥125 and ¥138. At the turn of the year, the single currency stood at ¥133, which was 5½% higher than at the end of 2008.

Euro hardly changed in effective terms

By contrast, the euro last year recorded particularly heavy losses against the currencies of commodity-exporting industrialised countries such as Australia (-21%), Norway (-15%) and Canada (-11%), which benefited from rising commodity prices at the end of the reporting year, and where in some cases key interest rates were raised again due to a fast economic recovery. However, the different and at times rather sharp exchange rate fluctuations of the euro largely cancelled each other out in effective terms. On a weighted average against the currencies of 21 major trading partners, therefore, the euro shed only 1% on balance in 2009.

Monetary policy measures

A number of countries also reacted to the change in supply and demand conditions in foreign exchange markets by implementing monetary policy measures. For example, China, whose currency is officially pegged to a basket of currencies, *de facto* fixed the renminbi exchange rate to the US dollar throughout the year. Other east and south-east Asian countries, too, resorted to foreign exchange intervention in an attempt to curb appreciation pressures on their local currencies as a result, above all, of the emerging market economies' growth lead over the industrial countries. In Europe, Switzerland intervened against the Swiss franc and kept its exchange rate vis-à-vis the euro below CHF1.50 for most of the year. Moreover, a number of countries such as Brazil and the Republic of China (Taiwan) introduced regulations to limit capital inflows. The foreign exchange interventions contributed to a significant rise in foreign currency reserves, which at the end of 2009 totalled US$8,085 billion, or some 10½% more than one year before.

3 Capital markets in the year of the crisis: recovery after difficult start

Concerted efforts stabilise financial markets

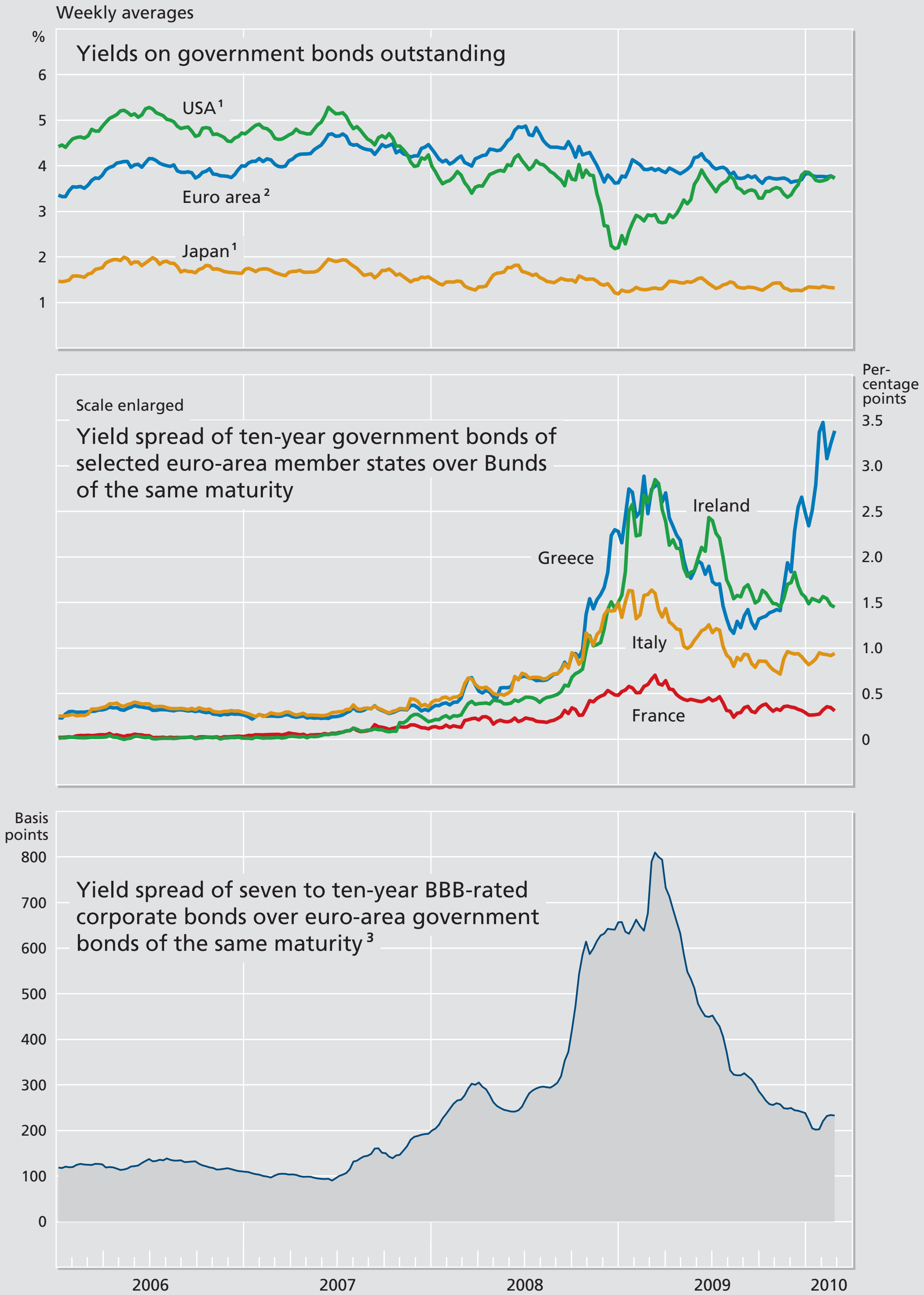
The crisis on the international financial markets passed its nadir in the second quarter of 2009. Massive turmoil in the money and capital markets had previously been reflected in high losses by financial institutions, strong risk aversion and a global economic slump. Governments responded by stepping up their efforts to contain the crisis and clear banks' balance sheets of problematic assets. Moreover, several central banks intervened directly in the financial markets in order to ease tight financing conditions. In mid-March, the equity and corporate bond markets experienced a turnaround. Since then, credit risk and liquidity premiums have fallen considerably. As the growth outlook has gradually improved, so earnings expectations for equities, too, have pointed upwards again and prices have recovered. At the same time, however, investors started to focus on the rapid growth of public debt in the industrialised countries, which weighed on the bond markets.

Government bond yields with net gains

As the real economy stabilised and market participants' risk appetite gradually returned, yields on ten-year government bonds in the major industrialised countries recorded a net increase in 2009. At year-end, yields in the euro area and Japan stood at almost 4% and just over 1¼% respectively, both up ¼ percentage point from their levels at the beginning of 2009. Yields on ten-year US Treasuries even rose almost 1¾ percentage points over the year; at just under 4%, they again slightly exceeded the GDP-weighted average of euro-area yields at the end of December. Interest rate developments displayed a similar pattern over the year. The decisions at the G20 summit in London and the US plan to purchase toxic securities were followed by a period, lasting until mid-June, of declining risk aversion associated with less demand for high-quality assets, which resulted in rising interest rates. However, not everyone shared the markets' optimism. Around the middle of the year, for example, several organisations further slashed their growth forecasts for the euro area and Japan in 2009. After that, yields in these two economies experienced a more pronounced downward correction than those in the United States. At the end of the year, however, capital market yields picked up again as the growth outlook had been revised upwards. Public sector issuance, which was high overall in the year under review, encountered strong demand from institutional investors, mainly banks, for government debt, which is likely to have slowed the increase in yields. The fact that banks held on to secure and liquid securities was probably also the result of favourable refinancing opportunities.

Bond market

Chart 5



1 Government bonds with approximately ten-year residual maturity. — **2** Average yield of ten-year euro-area government bonds outstanding (GDP-weighted). — **3** Sources: Merrill Lynch and Bloomberg.

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Yield differentials in the euro area at record high

Within the euro area, yields on government bonds fanned out, particularly at the beginning and the end of 2009. Besides liquidity considerations, yield developments were increasingly influenced by credit risks, which were also reflected in CDS premiums. For instance, the yield spreads of bonds issued by countries with sharply rising government debt or a highly indebted banking sector such as Greece or Ireland over ten-year Bunds rose to just under 300 basis points in the second quarter. As investors' risk appetite rose and the economic outlook improved, these spreads shrank somewhat by the fourth quarter before the renewed significant correction of the Greek budget deficit in November and the downgrade of the country sent yield spreads soaring to new record highs again.

Wholesale funding conditions for enterprises improved

Funding conditions for enterprises with access to the capital market improved considerably over the year. At the end of 2009, seven to ten-year bonds with the lowest investment grade rating, BBB, yielded 6%, around 4 percentage points less than at the beginning of the year, while their spreads over government bonds, which had reached new highs as recently as April, dropped by 435 to 235 basis points. Many enterprises exploited the improving conditions last year to tap the capital market (see also page 64). What is noteworthy, however, with regard to a lasting stabilisation of the financial markets, is that the signs of a recovery among non-financial corporations are not fully mirrored among those non-banks that should really be included in the financial sector. Interest rate premiums for financial corporations (excluding banks) are still well above their five-year average. This indicates that the risk assessment for players with close ties to the financial markets remains fragile. The fact that the Eurosystem intervened successfully in the covered bond market in the second half of the year, thereby improving the refinancing opportunities for issuing credit institutions, was positive for private bonds. From the announcement of the purchase programme on 7 May to year-end, interest rate premiums on three and ten-year Pfandbriefe over matched-maturity Bunds dropped by, on balance, 39 and 23 basis points respectively. At the same time, issuance picked up noticeably in the second half of 2009.

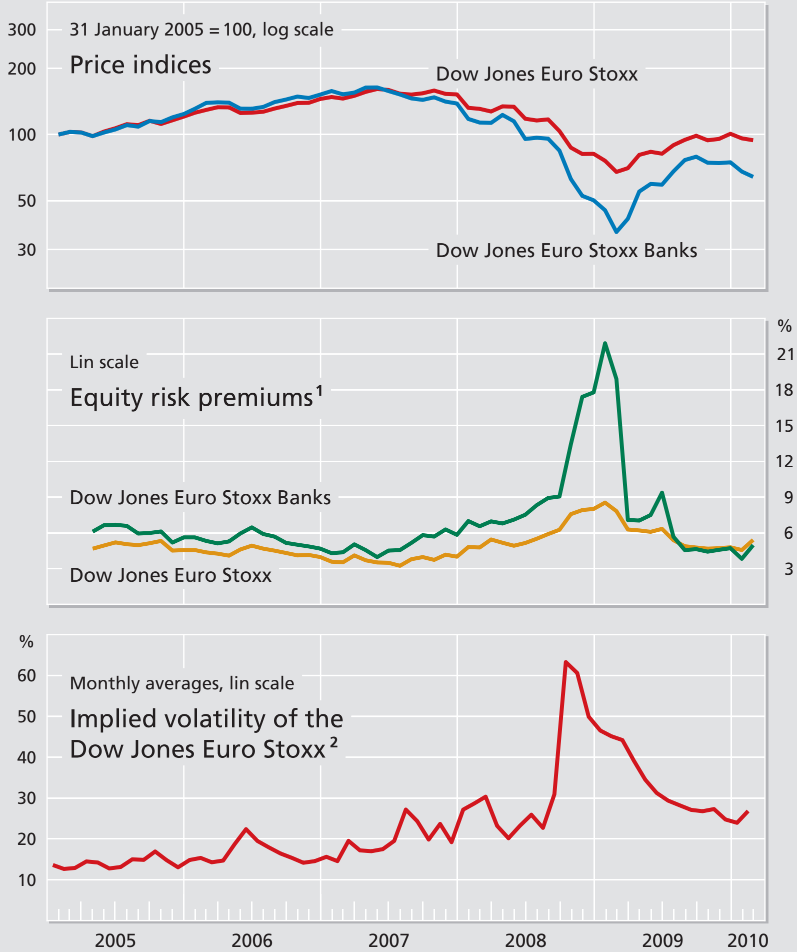
Equity markets stage clear recovery

In the reporting period, the international stock markets initially vacillated between concerns about the condition of the financial sector and the real economy, on the one hand, and hopes that the government rescue measures and key rate cuts would have a stabilising effect, on the other. Tensions in certain financial market segments and the drop in earnings expectations as a result of the recession caused stock prices on either side of the Atlantic to fall by around 20% by mid-March from their level at the end of 2008. Bank and insurance

Equity market

Chart 6

End-of-month levels



Source: Thomson Reuters and Bundesbank calculations. — **1** Measure for the risk premium demanded by investors. Calculated with the aid of a three-stage dividend discount model using three to five-year IBES earnings growth expectations and long-term GDP growth forecast (Consensus Forecast). — **2** Expected future volatility, derived from the prices of options on the Dow Jones Euro Stoxx.

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shares were hit hardest, initially sliding by up to 40% after reporting high losses in the spring months. At the same time, uncertainty about further share price developments, as measured by the implied volatility of stock options, increased further in January and February. However, as the year progressed, equities rose sharply. Initially driven by signs that the global economy was stabilising and investors' growing risk appetite, twelve-month earnings expectations also improved from the third quarter onwards. Overall, equity markets in the industrialised countries ended the year up by around one-fifth, thereby making good part of the losses suffered in 2008. The risk premium – as calculated using a dividend discount model – that investors demand for holding shares fell significantly in the second half of 2009, particularly for financials. By historical standards and compared to the market as a whole, the risk premium for bank stocks thus closed the year at a fairly low level. In an environment of low interest rates and abundant liquidity, the search for yield has, it seems, been a major factor in the stock market recovery.

II Economic and monetary developments in the euro area

1 Moderate economic recovery after severe recession

Cyclical turning point reached in second half of year

The economic situation in the euro area, which in the first half of 2009 was still characterised by the severe recession, brightened in the second half of the year. After a sharp decline in output in the first quarter and a further, although significantly weaker, decline in the second, real GDP increased noticeably in the third quarter for the first time since the beginning of 2008. The economic recovery slowed somewhat in the final quarter, however. The cyclical turnaround was given a key boost by the various economic stimulus programmes, the expansionary monetary policy and the inventory cycle. Foreign trade also made a noticeable contribution to GDP growth. In the second half of the year, private consumption was, however, not able to quite maintain its second-quarter level, which had, to a certain extent, been influenced by the sharp increase in car sales as a result of government environmental premiums. Since the cyclical peak at the beginning of 2008, household consumer spending has fallen much less than exports and real gross fixed capital formation, which was still heading downwards at the end of 2009. On an annual average, total output decreased by 4%, primarily owing to the very poor beginning to the year. A sharp drop in overall production capacity utilisation was the result, while the medium-term growth trajectory is also likely to have suffered as a result of the nature and extent of the global shock.

Significant stimulus from the three major member states

The cyclical upswing in the euro area in the third quarter was primarily driven by the major member states Germany and Italy, which had previously suffered more than most as a result of the recession. In the fourth quarter, the recovery in Germany and Italy stalled, whereas economic output in France increased sharply due, in part, to the fact that the environmental premium for new cars

Economic performance in the euro area

Table 2

Country	Real GDP 2008	Real GDP 2009	Consumer prices 1 2008	Consumer prices 1 2009	Unemployment rate 2 2008	Unemployment rate 2 2009
	Year-on-year percentage change				As a percentage	
Euro area	0.6	– 4.1	3.3	0.3	7.5	9.4
Belgium	1.0	– 3.0	4.5	0.0	7.0	7.9
Germany	1.3	– 5.0	2.8	0.2	7.3	7.5
Ireland	– 3.0	3 – 7.5	3.1	– 1.7	6.0	11.8
Greece	2.0	3 – 1.1	4.2	1.4	7.7	3 9.0
Spain	0.9	– 3.6	4.1	– 0.3	11.3	18.0
France	0.4	– 2.2	3.2	0.1	7.8	9.4
Italy	– 1.0	– 4.9	3.5	0.7	6.7	3 7.8
Cyprus	3.6	– 1.5	4.4	0.2	3.6	5.3
Luxembourg	0.0	3 – 3.6	4.1	0.0	4.9	5.7
Malta	2.1	3 – 2.2	4.7	1.8	5.9	7.0
Netherlands	2.0	– 4.0	2.2	1.0	2.8	3.5
Austria	2.0	– 3.6	3.2	0.4	3.8	5.0
Portugal	0.0	3 – 2.9	2.7	– 0.9	7.7	9.6
Slovenia	3.5	– 7.8	5.5	0.9	4.4	6.0
Slovakia	6.2	– 4.7	3.9	0.9	9.5	11.9
Finland	1.2	– 7.8	3.9	1.6	6.4	8.2

1 Harmonised Index of Consumer Prices (HICP). — **2** Standardised unemployment rate. — **3** European Commission projections (Autumn Forecast, October 2009).

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was granted in full until the end of the year. Spain, by contrast, belongs to the group of the economic laggards in Europe. Here, it is primarily the disruptions in the real estate markets and the sharp increase in unemployment which are impeding cyclical recovery. Greece's deep-rooted problems are, in large part, due to the fact that its public finances have got out of hand in recent years, causing its creditworthiness to suffer in the eyes of many investors. All in all, the growth disparities between the member states – calculated as a weighted standard deviation – increased by ¼ point to 1½ percentage points on the year in 2009.

Moderate upswing expected in 2010

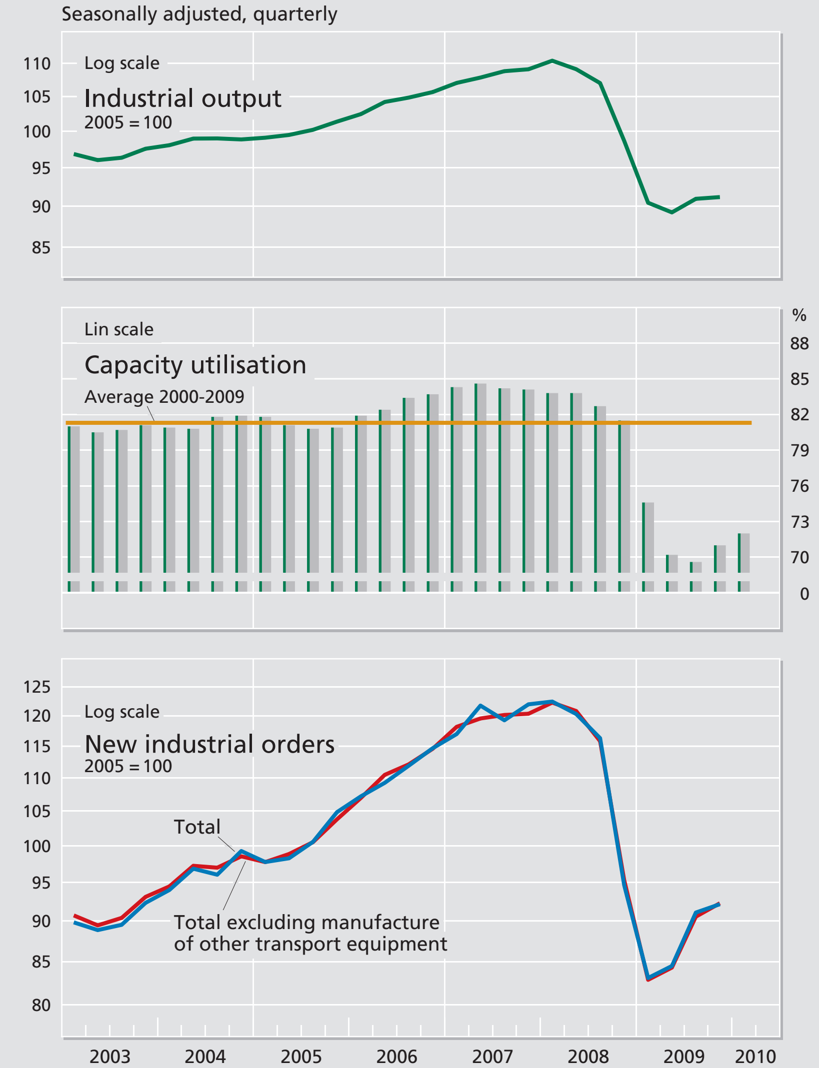
According to indicators which are still incomplete, the economic upturn in the euro area has continued at a slow rate after the turn of 2009-10. This is mainly because the stimulus from fiscal programmes has subsided and a self-sustaining upswing is only slowly getting into gear. According to the European Commission's latest forecast, real GDP growth of ¾% in 2010 will strengthen to 1½% in 2011.

The euro-area recession, which lasted into the second and third quarters of 2009, left deep scars in the labour market. Experience suggests that the labour market will be fairly slow to bounce back even after the cyclical recovery has

Differing reactions in the labour markets of the member states

Selected indicators of industrial activity in the euro area

Chart 7



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begun. For that reason, employment continued to decline. It fell by 1¾% on an average in the first three quarters of 2009. After its cyclical low in March 2008, the seasonally adjusted standardised unemployment rate increased by 2.7 percentage points to 9.9% in January 2010. However, this obscures major differences between the various countries. While Spain alone accounts for more than half of the total increase in unemployment in the euro area, in Germany there was only a relatively small increase. Other countries with a high degree of labour flexibility – partly due to government support for attractive short-time work schemes – also saw a limited increase in unemployment.

Economic policy coordination and European integration

Economic policy coordination: European stimulus package and exit strategies

In December 2008, with the financial and economic crisis deepening, the European Council approved a coordinated European economic stimulus package. This provides for additional demand-support measures by the member states and at EU level in 2009 and 2010, totalling 1.5% of overall EU gross domestic product (GDP). However, in its report for the meeting of the European heads of state or government in June 2009, the ECOFIN Council noted that general government's contribution to stabilising the economy – including the effects of the automatic stabilisers – is likely, in fact, to amount to roughly 5% of EU GDP in both years together.

In most countries, the recession and stabilisation programmes have led to a marked deterioration in government fiscal positions. In its autumn forecast, the European Commission estimated that budget deficits had risen to an average of 6.4% of GDP in the euro area for 2009, and to 6.9% of GDP in the EU as a whole, following deficits of 2.0% and 2.3% respectively in 2008. A further slight increase is expected for 2010, when EU government debt ratios, too, will probably be 20 percentage points higher than in 2007 at an average of around 80% of GDP. Given this situation, in October 2009 the European Council approved the main objectives of a coordinated exit strategy as part of the Stability and Growth Pact. Fiscal consolidation is to begin as soon as a self-sustaining recovery has set in, but no later than 2011, and is to be reinforced by national budgetary rules to enhance the credibility of these efforts.

At the end of 2009, 20 of the 27 EU member states were involved in excessive deficit procedures; Finland, Luxembourg and Cyprus were among the euro-area countries unaffected, as were the non-euro-area countries Bulgaria, Denmark, Estonia and Sweden. In many cases the deadlines for correction extend to 2013, although Ireland and the United Kingdom were granted even longer deadlines with budget deficits latterly at 11% and 12% of GDP respectively. As the Greek government has failed to take adequate measures to reduce its deficit, Ecofin, at its meeting on 16 February 2010, officially gave notice to Greece, pursuant to Article 126 (9) of the Treaty on the Functioning of the European Union, and recommended strict fiscal consolidation. This decision was supplemented by concurrent Council recommendations, pursuant to Article 121 (4) of the Treaty on the Functioning of the European Union, to rectify the lack of consistency with the broad economic policy guidelines and allay the risk of jeopardising the proper functioning of the economic and monetary union. Infringement proceedings have also been initiated against Greece as it has been remiss in its duty to submit reliable budgetary statistics.

In addition to correcting excessive deficits, the member states must also move as soon as possible on to paths of adjustment to achieve their medium-term budget targets as set out in the Stability and Growth Pact. In summer 2009, the EU member states agreed on a method to determine these targets, taking account not only of the level of debt, but also now the level of future age-related budgetary expenditure.

Changes due to the Lisbon Treaty

The Treaty of Lisbon entered into force on 1 December 2009. Its aim is to improve the Community's institutional capacity to act and its democratic legitimacy. The new regulations amend the Treaty on European Union; the Treaty on the Functioning of the European Union supersedes the Treaty establishing the European Community. These changes include an upgrading of the European Commission's position. It now has the right to issue an early warning, which it can exercise against member states whose economic policy is not consistent with the guidelines' recommendations or which jeopardises the functioning of the economic and monetary union, or against countries with a looming excessive budget deficit. In future, the Council will make decisions without conferring with the member state in question and also decide on the existence of an excessive deficit on the basis of a Commission proposal in such a way that the Council can only change the Commission's submission by a unanimous vote. The Treaty of Lisbon also grants the Council the possibility of intensifying its monitoring of a member state's budgetary policy and of adopting special economic policy guidelines. Only Council members representing euro-area countries may vote in this decision. The Council shall approve the introduction of the euro in a member state with a derogation on the recommendation of a qualified majority of euro-area members.

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Sharp disinflation but no deflation

The recessionary trends in the global economy were also reflected in consumer prices, primarily as a result of the dramatic decline in commodity prices in the second half of 2008 caused by the cyclical downturn. Consequently, on average in 2009, consumer prices for energy in the euro area fell by 8.1% while prices for food, beverages and tobacco increased by only 0.7%. In the case of other goods and services, price inflation weakened over the course of 2009 due to declining demand. Annual inflation in 2009, at 0.3%, was the lowest since the beginning of economic and monetary union after having increased by a record 3.3% in 2008. The core index (excluding food and energy) increased by 1.4% compared with 1.8% in the preceding year; the increase was only 1.1% at the end of 2009. Headline HICP inflation, which had decreased to -0.7% at the beginning of the third quarter, converged back towards the core inflation rate towards the end of the year after the elimination of the baseline effects caused largely by sharp decreases in energy prices. This process continued at the start of 2010. In January-February, headline HICP inflation was 1.0% on the year, which largely corresponded to the non-energy, non-food inflation rate of January (0.9%), for which a more recent value is not yet available.

2 Monetary policy and money market developments

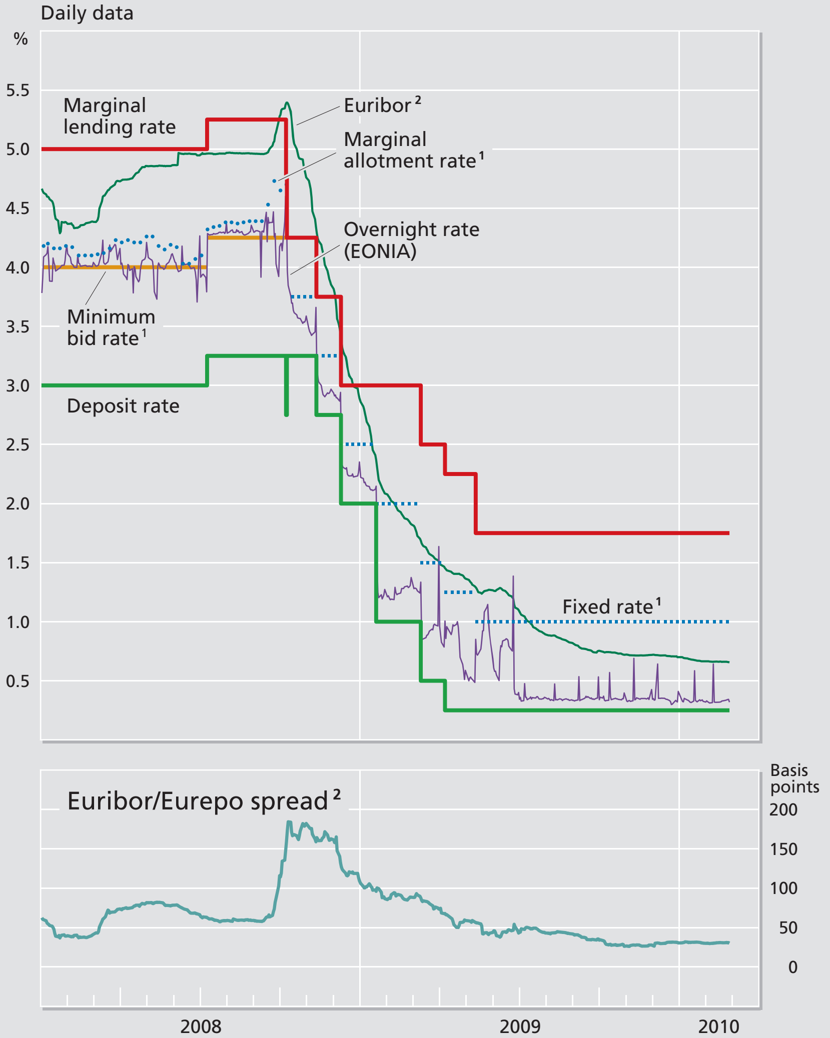
Continued easing of monetary policy stance ...

Given intensifying economic downward pressure, significantly muted monetary expansion and the resulting decline in inflationary risks as well as solidly anchored inflation expectations, the Governing Council of the ECB continued its policy of monetary easing in the first half of 2009. By May, the Eurosystem’s top decision-making body had lowered the interest rate for main refinancing operations to 1% in a total of four steps. Furthermore, the Governing Council decided to conduct main and longer-term Eurosystem refinancing operations throughout 2009 as fixed-rate tenders with full allotment. This included a total of three 12-month refinancing operations. These measures were accompanied by the launch of a covered bond purchase programme with a total volume of €60 billion over a period of 12 months. At the same time, the interest rate corridor around the main refinancing rate was narrowed from ±100 basis points to ±75 basis points, thus ensuring that, in an environment of low short-term interest rates, the recovery trend on the money market was not placed under additional stress. Accordingly, since May 2009, the Eurosystem has paid 0.25% on balances under the deposit facility and charged 1.75% for use of the marginal lending facility. This package of measures has succeeded in sustainably improving the financing situation in the banking system, which plays an important role

Key interest rates and money market rates

Chart 8

Daily data



1 Interest rate for main refinancing operations. As of 15 October 2008, fixed rate. — **2** Maturity of three months.

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in monetary policy transmission in the euro area, maintaining the transmission process for monetary policy measures in the real economy and cushioning any further negative impact of the financial crisis on economic activity.

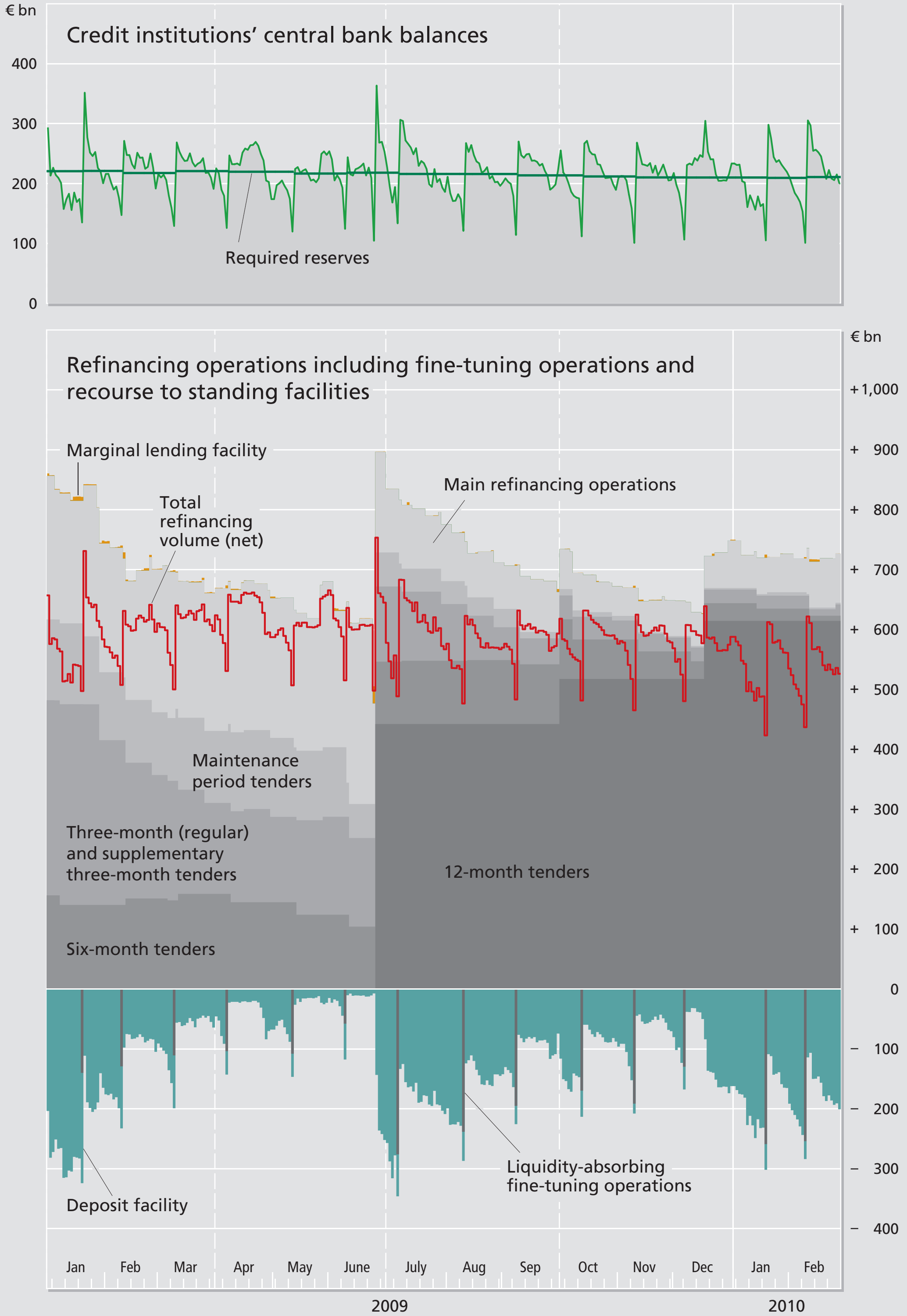
... causes money market interest rates to fall to historic lows

Swept along by the reduction in key policy rates, euro money market rates also fell significantly. The overnight rate (EONIA), in particular, was subject to noticeably elevated volatility until mid-year, and remained more or less consistently well below the main refinancing rate, not least due to the ample supply of liquidity in the banking system as a result of the full allotment regime. Since the allotment of the first 12-month refinancing operation at the end of June, when

Liquidity management of the Eurosystem

Chart 9

Daily data



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1,121 credit institutions received a total of €442.2 billion, the EONIA has been essentially stable at around ten basis points above the interest rate on the Eurosystem's deposit facility. Virtually the only significant and temporary increases came in response to the regular liquidity-absorbing fine-tuning operations at the end of the maintenance periods.

12-month tenders stabilise banks' liquidity supply

Following the great success of the first one-year tender, demand for the two subsequent 12-month tenders was more restrained. At €75.2 billion, the volume of the second one-year tender at the end of September, which was also conducted at a fixed interest rate of 1% with full allotment, was significantly smaller than that of the first operation of this kind. At the same time, the number of participating counterparties halved to 589 institutions. The last 12-month operation, which was conducted in December, likewise fell short of the volume of the first transaction. In total, €96.9 billion was allotted to only 224 counterparties. As well as the extremely healthy liquidity situation of banks, a further reason for the depressed demand from European credit institutions for long-term refinancing may be the fact that, unlike the two previous long-term operations, the one-year tender in December was interest-indexed rather than being conducted at a pre-defined interest rate. Upon maturity of the transaction, banks participating in the tender will therefore be charged the average main refinancing or minimum bid rate over the lifetime of the operation.

Eurosystem purchases covered bonds

The non-standard monetary policy measures were supplemented by the Eurosystem's adoption of a covered bond purchase programme with a total maximum volume of €60 billion, of which national central banks and the European Central Bank have thus far used around €39 billion for purchases on the primary and secondary markets. This programme has brought about a lasting reduction in the risk premiums on these bonds and a further improvement in the financing situation of the European banking system.

Longer-term money market interest rates at historic lows

In addition to the overnight rate, longer-term uncollateralised money market rates also fell further in the first half of 2009 on the heels of the expansionary monetary policy measures and extremely generous provision of liquidity by the Eurosystem and remained at historically low levels from September onwards, with little fluctuation. For example, uncollateralised three-month money on the euro money market (three-month Euribor) has fallen by just over 2.2 percentage points since the beginning of 2009 to only 0.66% as this report went to press. The risk premium on uncollateralised three-month money declined sharply over the same period. The spread between the three-month Euribor and its collateral-

Money market management and liquidity needs

In the year following the collapse of Lehman Brothers, Eurosystem money market management continued to be concentrated primarily on guaranteeing all solvent banks access to central bank money and supporting the functioning of the money markets through generous liquidity supply. In pursuit of these aims, all regular and supplementary refinancing operations were conducted as fixed-rate tenders with full allotment. Additionally, for the first time, three longer-term refinancing operations with a maturity of 12 months were carried out, also as fixed-rate tenders with full allotment. This made a significant contribution to increasing the refinancing volume and led to increased recourse to the deposit facility and to falling money market rates as a result of the rise in excess liquidity. In addition to this, the Eurosystem began purchasing covered bonds (such as Pfandbriefe) at the beginning of July. Overall, all credit institutions in the euro area were able to meet their minimum reserve requirements without problems.

Interest rate cuts and widening of standing facilities corridor

The first half of the year was characterised not only by interest rate cuts but also by the re-widening of the corridor of standing facility rates to 200 basis points as of 21 January, followed by adjustment to 150 basis points with effect from 13 May; it had been symmetrically narrowed to 100 basis points in October 2008. Owing to the high levels of excess liquidity, the overnight interest rates were more closely oriented to the deposit facility rate. Although credit institutions' demand for central bank liquidity remained strong, it decreased slightly from maintenance period to maintenance period when measured against the benchmark. On a daily average, this excess liquidity dropped to just over €220 billion in the January-February 2009 reserve maintenance period after having stood at over €300 billion per day throughout most of the December 2008-January 2009 maintenance period. As a result of this reduction in liquidity, recourse to the Eurosystem's deposit facility also fell, to an average of €175 billion, compared with almost €240 billion in the previous period. The receding demand for liquidity is evidenced by declining bidder numbers; in the case of longer-term refinancing operations it is likely that expectations of interest rate cuts played a role, particularly in March and April. The ECB Governing Council decision of 5 March to continue carrying out the main and longer-term refinancing operations as fixed-rate tenders with full allotment past the initial deadline of end-March 2009 at least until the end of 2009 also had the effect of reducing the demand for liquidity. This measure, along with the provision of liquidity in US dollars and Swiss francs and the maintaining of the expanded collateral framework for the entire year, gave banks more certainty in their liquidity planning.

Liquidity demand picked up in the second half of the year

The second half of the year was predominantly influenced by the three 12-month tenders carried out in the Eurosystem for the first time. Owing to the attractiveness of this longer-term refinancing option at a fixed rate of 1.00%, there were clear shifts in the refinancing structure in the run-up to the first 12-month tender on 25 June. The volume of longer-term refinancing operations decreased to its lowest level since the introduction of the fixed-rate tender in October 2008 while at the same time the demand for main refinancing operations increased sharply. This changed suddenly when, in the 12-month tender, €442 billion was bid and allotted. The outstanding refinancing volume reached a record level of almost €900 billion; all in all, with

Money market management and liquidity needs (cont'd)

the allotment of the 12-month tender, a new phase of liquidity provision began in which the Eurosystem's intermediation activity resurged owing to the high levels of use of the deposit facility. There was also evidence of this in the daily turnover in the interbank money market: EONIA turnover fell from €40.7 billion to €34.2 billion on average after the allotment of the first 12-month tender, and collateralised overnight turnover on the Euro GC Pooling electronic trading platform decreased from €9.3 billion to €8.7 billion on average. The purchasing programme for covered bonds, which was started in July 2009, also falls within this new phase of liquidity management, though this scheme is less about liquidity policy and more about promoting the steady decline in money market rates and easing the refinancing conditions for credit institutions and enterprises. It can be viewed as a sign of decreasing tension that the usual liquidity shortages feared around Christmas and at the end of the year did not occur in 2009. In December 2009, the Governing Council of the ECB made initial moves to withdraw its non-standard measures.

Short and longer-term money market rates

The allotment of the first 12-month tender in June 2009 had a significant influence on the development of overnight money in two respects. One, it led to a sharp decrease in the EONIA, bringing it near to the level of the deposit facility and thus around 70 bp below the key interest rate. The other was that fluctuations became less pronounced; volatility, measured as the standard deviation of the spread between the EONIA and the minimum bid rate, fell from 25 bp to 5 bp. At the same time, the significant increase in liquidity also allowed the longer-term euro money market rates to sink further, after the sharp interest rate cuts between January and May 2009 had already brought about significant decreases. The three-month Euribor fell by 220 bp to 0.70% during the course of 2009. During the same period, the three-month Euribor/Eurepo spread – as one of the indicators of uncertainty in the money market – narrowed from 100 bp to 31 bp. The money market remained segmented in a sense between banks with a strong credit rating that were able to borrow overnight money at rates below the EONIA and those with a poorer credit rating that had to borrow at significantly higher rates or were entirely dependent on liquidity provided by the Eurosystem.

Development of the factors determining bank liquidity

The usual core function of money market management, of refinancing an increase in credit institutions' liquidity needs stemming from the rise in the minimum reserve requirement (of €5.4 billion) and from autonomous factors (of €105.5 billion) to an annual average of €596.2 billion (see table on page 39), receded somewhat into the background in 2009 in view of the dominance of essentially "excessive" liquidity provision to support the money market. The additional demand arising from autonomous factors was caused mainly by growth in the volume of banknotes in circulation and the increase in general government deposits. By contrast, €33.7 billion net flowed into the market from the residual autonomous factors. This was primarily due to the fact that the Eurosystem increased its holdings of euro-denominated securities by €37 billion. The value of banknotes in circulation increased strongly by €77.7 billion. Thus, the strong demand for cash as a result of the financial crisis, which intensified in autumn 2008, continued in 2009. Slovakia's accession to monetary union also contributed to the increase in euro banknotes in circulation. On 30 December 2009, the volume of banknotes in circulation peaked

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Money market management and liquidity needs (cont'd)

at €807 billion. At a rate of around 11%, average growth in 2009 was stronger than in the previous year (9%). Amidst a renewed increase in volatility, liquidity needs arising from general government deposits with the Eurosystem rose over the course of the year by a very strong €61.5 billion (2008: €17.5 billion). This reflected, among other things, government financial support programmes, which were often carried out using central bank accounts. The total volatility for the autonomous factors, at €17.6 billion, was clearly below the value for 2008 (€50.9 billion) and was, therefore, returning to pre-crisis levels.

In light of this, the Eurosystem sharply increased its monetary policy operations by an annual average of €167.9 billion (2008: €92.4 billion). In view of the very generous provision of liquidity, in contrast to the previous year, liquidity-providing fine-tuning operations were not required in 2009.

On an annual average, credit institutions' central bank balances in 2009 were €4.3 billion up on the year, roughly reflecting the increase in the minimum reserve requirement. Given the weak monetary expansion, the reserve requirement increased only slightly, by 2.6%, in comparison with the previous year (12%).

All in all, the Eurosystem's money market management in 2009 once again proved reliable in implementing the ECB Governing Council's monetary policy stance in an eventful environment.

Factors determining bank liquidity

Year-on-year changes in annual average values, in € billion

Item	2008	2009
I Provision (+) or absorption (–) of central bank balances owing to changes in autonomous factors		
1 Banknotes in circulation (increase: –)	– 55.7	– 77.7
2 Government deposits with the Eurosystem (increase: –)	– 17.5	– 61.5
3 Net foreign reserves[1]	+ 91.6	+ 50.7
4 Other factors[1]	– 41.0	– 17.0
Total	– 22.6	– 105.5
II Monetary policy operations of the Eurosystem		
1 Open market operations		
(a) Main refinancing operations	– 61.1	– 50.2
(b) Longer-term refinancing operations	+ 153.5	+ 218.1
(c) Other operations	+ 0.8	+ 2.8
2 Standing facilities		
(a) Marginal lending facility	+ 2.0	– 1.4
(b) Deposit facility (increase: –)	– 49.3	– 59.6
Total	+ 45.9	+ 109.8
III Change in credit institutions' current accounts (I + II)	+ 23.3	+ 4.3
IV Change in the minimum reserve requirement (increase: –)	– 23.5	– 5.4

1 Including liquidity-neutral valuation adjustments at the end of the quarter.

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Refinancing and eligible assets

In 2009, the implementation of monetary policy operations continued to be shaped by the financial market crisis. The full allotment policy adopted in October 2008 remained in place throughout 2009.

With regard to the relative shares of main refinancing operations and longer-term financing operations in the total outstanding refinancing volume, there was a continued shift in favour of longer-term refinancing. This was mainly due to three longer-term refinancing operations, each with a maturity of one year. After the settlement of the first 12-month tender in June, the outstanding volume rose by more than one-third to just short of €900 billion. Since then, longer-term refinancing operations have accounted for more than 80% of the total. A number of savings banks and credit cooperatives in Germany used this opportunity to take part in a tender for the first time. Despite the steady drop in bidding volumes for other longer-term operations (one, three and six months), the share increased to more than 90% at year-end owing to a similar fall in demand for weekly tenders. The average share of main refinancing operations thus fell to 21%, compared with 38% in the previous year. Overall, the allotment volume for main refinancing operations fell sharply in 2009. While the allotment volumes had been exceeding €200 billion up to mid-year, the volume had fallen by the end of the year to between €50 billion and €60 billion throughout the Eurosystem. The number of bidders participating in weekly tenders via the Bundesbank averaged just 288 in 2009, compared with 316 in 2008.

Longer-term refinancing operations were mainly characterised by 12-month tenders. In June, 1,121 bidders received €442.2 billion; in September, 589 bidders received €75.2 billion. Both tenders were conducted at the current main refinancing rate of 1.0%. The last 12-month tender in December was announced as a fixed-rate tender, with the fixed interest rate subsequently determined on the basis of the average minimum bid rates for main refinancing operations over the life of the operation. As a result, 224 bidders received a further €96.9 billion. Overall, the number of participants in longer-term refinancing operations fell considerably. On average, there were still 91 bidders throughout the Eurosystem, 54 of which participated via the Bundesbank (2008: 154, of which 73).

In 2009, contrary to the trend in earlier years, no more than 12 quick tenders were carried out by collecting fixed-term deposits on the last day of each of the maintenance periods.

Standing facilities proved extremely popular. The marginal lending facility was used in the Eurosystem to an amount of €897 million on an annual average (Germany: €602 million). The deposit facility totalled €109.4 billion on an annual average, €46.1 billion of which came from counterparties of the Bundesbank.

The total value of assets submitted by the Bundesbank's counterparties went up from €802 billion in 2008 to €819 billion in 2009 (year-end levels). Of this, €339 billion was accounted for by assets held in custody in other Eurosystem member states and, therefore, mobilised on a cross-border basis for refinancing at the Bundesbank.

As in the previous year, a larger volume of eligible assets submitted was noticeable in connection with the turbulence in the financial markets. Against this backdrop and in view of the counterparties' liquidity situation, the Eurosystem, in October 2008, agreed on temporary measures (until the end of 2010) to expand the collateral framework. By the end of 2009, German counterparties had submitted about €38 billion in additional eligible assets on the basis of this temporary expansion of the collateral framework. The temporary expansion comprises, among other things, the acceptance of BBB-rated debt instruments (with the exception of asset-backed securities) and debt instruments denominated in US dollars, pound sterling and Japanese yen.

At the end of 2009, 43% of eligible assets submitted to the Bundesbank were uncovered bank debt securities, 18% were covered bank debt securities (Pfandbriefe) and 14% were government bonds. The share of asset-backed securities fell slightly on the year to 9%. Other marketable assets had a share of 6%. The share of credit claims rose further, accounting for 10%.

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ised counterpart (Eurepo) diminished between January and November by around 0.75 percentage point to just under 0.25%, but has climbed slightly since then and currently stands at around 0.35%. Despite the steep decline, the present risk premium level is, in a historical context, still very high.

The Eurosystem has now begun announcing the gradual phasing-out of its non-standard monetary policy measures. In light of the significant drop in demand, the Governing Council of the ECB and the Federal Reserve agreed to discontinue the 84-day refinancing operations in US dollars by as early as 6 October 2009. The Eurosystem stopped conducting one-week US-dollar swap operations and refinancing operations for Swiss francs on 1 February 2010. Furthermore, supplementary three-month tenders were discontinued at the beginning of 2010 and the last six-month tender will be conducted at the end of March 2010. The Governing Council's decision on the phasing-out of other non-standard monetary policy measures will depend on the degree of recovery in the financial markets. At its meeting on 4 March 2010, it decided to continue conducting its main refinancing operations as fixed-rate tender procedures with full allotment and its refinancing operations with a maturity of one maintenance period until at least 12 October 2010.

3 Slight decline in monetary and credit growth

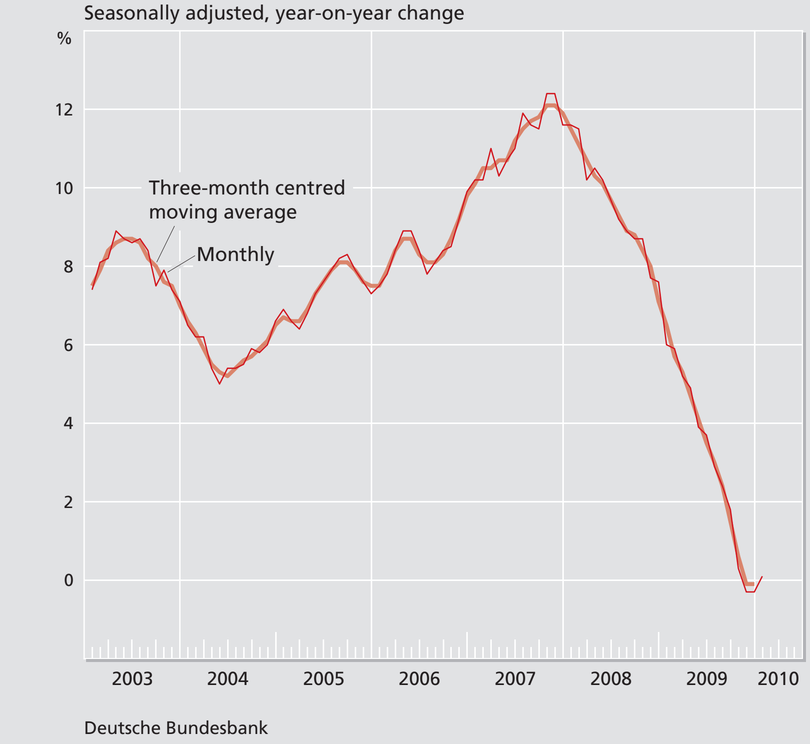
Slight decline in monetary growth and exceptionally sharp reduction in components remunerated at close-to-market rates ...

At the end of the year, euro-area M3 was below the previous year's level for the first time since the start of monetary union. With the escalation of the financial crisis in the autumn of 2008, the 12-month rate of M3 fell from 7.6% in December 2008 to -0.3% in December 2009. This was due to the exceptionally sharp decrease in M3 components remunerated at close-to-market rates. The decline in short-term time deposits was particularly steep and affected all investor groups (-24.3%). However, there was also an unusually substantial reduction in marketable instruments (money market fund shares (-1.8%), repurchase agreements (-1.5%) and, above all, short-term bank debt securities (-46.7%)) in the course of the year. These movements are attributable to the low short-term yields – compared with interest rates in the medium to long-term segment – in the reporting year and investors' desire to await further developments in the financial markets and the real economy before taking longer-term investment decisions.

Both factors contributed to the exceptionally high takeup of the particularly liquid components of M3. Growth in overnight deposits, at 13.6%, was signifi-

M3 growth in the euro area

Chart 10



... and unusually steep rise in liquid components

cantly stronger than in the preceding years, as was the rise in deposits redeemable at up to three months' notice (15.1%). In comparison, the expansion in cash holdings, at 6.1%, was only moderate.

Underlying monetary dynamics indicate no pronounced risks to price stability

These countervailing developments in the subcomponents of M3 virtually offset one another on balance. The underlying monetary dynamics – in other words, the developments in monetary growth that are ultimately relevant to inflation – therefore weakened again significantly in 2009. Thus, from a monetary perspective, there are no pronounced inflationary risks for the coming years in the euro area. Although the Eurosystem's non-standard monetary policy measures have massively increased central bank money, ie the volume of banknotes in circulation and banks' sight deposits with central banks, this liquidity has not yet triggered a rise in monetary growth. In particular, lending to the domestic private sector – as commercial banks' primary means of creating money – lost a great deal of momentum.

Slight decline in lending to the private sector

Among the monetary counterparts, the most striking development was that, in loans to the domestic private sector, there was a co-movement with broad money (M3) in 2009. Unsecuritised lending to enterprises and households in the

Monetary developments in the euro area

Table 3

Changes in the course of the year [1]

Item	2008	2009
	as a percentage	
I Growth of the monetary aggregates		
M1 [2]	3.3	12.3
M2 [3]	8.3	1.5
M3 [4]	7.6	– 0.3
	€ billion	
II Money stock and its counterparts		
M3 (=1+2–3–4–5)	659.3	– 12.2
Currency in circulation and overnight deposits	126.8	489.8
Other short-term deposits	486.0	– 368.3
Marketable instruments	46.5	– 149.6
Balance sheet counterparts		
1 Total credit to non-MFIs in the euro area	1,005.5	378.6
Credit to general government	71.0	288.1
Credit to private-sector non-MFIs in the euro area	934.6	90.5
2 Net claims on non-euro-area residents	– 176.3	134.6
3 Central government deposits	129.5	– 4.8
4 Longer-term financial liabilities to other non-MFIs in the euro area	260.3	415.9
5 Other counterparts of M3 [5]	219.9	– 114.3

1 Seasonally adjusted. — **2** Currency in circulation and overnight deposits held by euro-area residents with MFIs in the euro area. — **3** M1 plus other short-term bank deposits held by euro-area residents with MFIs in the euro area (deposits with an agreed maturity of up to two years and deposits redeemable at up to three months' notice). — **4** M2 plus marketable instruments held by euro-area residents (repurchase agreements concluded by MFIs with non-MFIs in the euro area, money market fund shares/units and debt securities issued with a maturity of up to two years by MFIs in the euro area). — **5** Calculated as a residual.

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euro area stagnated on balance in the reporting year for the first time since the introduction of the single currency. This was due to a decline of 2.2% in lending to non-financial corporations in 2009. The tightening of credit standards, particularly in the first half of the year, and subdued lending were caused less by bank-related factors than by the severe slump in the real economy experienced in the euro area. At the same time, growth in loans to households, at 1.3%, was significantly weaker than in the preceding years. Nonetheless, lending to households – particularly for house purchase – increased continuously from mid-2009. Both the low interest rates and the moderate growth in housing prices are likely to have played a role here.

Net increase in banks' stocks of securities

As a sort of substitute for direct lending business, banks boosted their activities in the securities markets. For example, holdings of fixed-income securities from public and private issuers in Germany climbed by 15.9% and 6.5% respectively. Investment in German shares and other equities – which is fairly insignificant in quantitative terms – edged upward by 1.2% following the outflows in 2008. Overall, the banks' direct and indirect granting of credit to the non-bank sector in the euro area thus rose by 2.4% last year.

Discernible increase in banks' net external assets

In 2009, cross-border payment transactions also lent a discernible boost to monetary growth. After declining in the two preceding years, the net external asset position of the banking system – which reflects the transactions of residents with non-euro-area counterparties – experienced a sharp rise of €134.6 billion in the reporting year. However, the increase in net external assets is essentially attributable to the global reduction in banks' external positions in the wake of the financial crisis, whereby euro-area banks' external liabilities fell more steeply than their claims vis-à-vis non-residents.

Substantial monetary capital formation

While monetary capital formation had no appreciable impact on monetary growth in 2008, it had a significant dampening effect in 2009. In the course of last year, euro-area non-banks increased their longer-term investment with banks by 6.6%; the largest share was accounted for by the uptake of longer-term time deposits with an agreed maturity of over two years (9.6%). Like the movements within M3, this development is likely to have been strongly influenced by the steep slope of the yield curve during the year. Growth in capital and reserves (8.5%) likewise contributed to the increased momentum of monetary capital formation.

III Economic trends in Germany

1 Severe recession in the wake of the global economic downturn; labour market robust

Underlying trends

Economic developments in Germany in 2009 were shaped by the severe recession which took hold in the final quarter of 2008 and the first quarter of 2009 in all the major regions of the world economy. On an annual average, the decline in real GDP, at 5.0%, was sharper than at any time before in the history of the

Federal Republic of Germany. Although economic output bottomed out during the year, it remained at an exceptionally low level overall. It is therefore all the more remarkable that the labour market response has, to date, been very muted. The price climate was extremely benign in 2009, with consumer price inflation standing at just 0.4% on an annual average.

Severe recession at beginning of year, clear signs of recovery in second half of year

The German economy contracted sharply at the beginning of 2009, as it had done in the fourth quarter of 2008. The sharp and sychronous slump in the global economy placed an exceptionally heavy strain on German enterprises' export activity, especially in industry which then drastically revised its investment plans. Besides the measures taken to stabilise the financial markets, the resolute, rapid and comprehensive monetary and fiscal policy action taken worldwide was instrumental in overcoming fairly rapidly the sudden paralysis in global activity that had set in following the insolvency of US investment bank Lehman Brothers. The German economy stabilised as early as during the second quarter, not least owing to the fact that central government's spending programmes were rapidly taking effect in some areas. For example, there was a marked expansion in public construction investment from the second quarter onwards. Private consumption also picked up temporarily after the turn of the year owing to the strong incentives to buy new cars in connection with the granting of the environmental premium for scrapping old and non-commercially used vehicles. However, significant progress was not made in the recovery process until the third quarter when exports picked up again on a regionally broader basis. The incipient recovery remained intact up to the end of the period under review, even though the cyclical upturn faltered in the fourth quarter. This was due, not least, to the waning impact of specific measures contained in the economic stimulus packages as well as temporary negative factors in industry and construction.

Exports curtailed by global economic downturn

The sharp economic downturn experienced by Germany's most important trading partners in the fourth quarter of 2008 and the first quarter of 2009 led to an exceptionally strong decline in the volume of exports. Trade with non-euro-area countries was affected even more severely than trade with euro-area countries. For example, exports to the new EU members states, in particular, but also to the United Kingdom, the United States, South-East Asia and Japan, underwent a sharp decline. Furthermore, there was an enormous contraction in demand from the Russian Federation, whose scope for expenditure narrowed owing to a sharp fall in energy prices. All major sectors suffered a marked decline in export activity. Sales of capital goods, which traditionally feature prominently among

Germany's range of export goods, fell particularly sharply in price-adjusted terms. Added to this was the slump in exports in the automotive sector. Initial demand impulses from China and South-East Asia were recorded as early as the second quarter, however. These stimuli became stronger and more broadly based regionally from mid-year onwards, with exports to other EU countries and Japan picking up considerably again first. In the final quarter of 2009, exports to the OPEC countries, the United States and Russia also increased markedly. Owing to the global rise in industrial output and earlier destocking, it was initially intermediate goods that were exported in larger volumes. Furthermore, exports of motor vehicles, boosted by car scrappage schemes in other industrial countries, had been showing strong growth since as early as the second quarter. Export sales by engineering companies also picked up again in the fourth quarter. Despite the recovery during the course of the year, German exports of goods and services in 2009 were down by an average of 14.2% on the year in real terms.

Business investment severely affected by recessionary influences

The sharp contraction in foreign trade in the fourth quarter of 2008 and the first quarter of 2009 had a severe knock-on effect on business investment. Overall capacity utilisation, which was still above the longer-term average in 2008, fell well below the corridor of normal utilisation within just a matter of months. This resulted in a massive reduction in purchases of new machinery and equipment. One contributory factor in this was that firms were finding it more difficult to obtain funding given the less favourable business outlook and the ongoing need for balance sheet adjustments in the banking sector. According to the available indicators, there were no signs of a broadly based credit crunch in 2009, however. Investment in machinery and equipment was affected, in particular, by the reluctance of enterprises to invest; it was down one-fifth on the year. By contrast, the downturn in economic activity was much less pronounced in the case of commercial construction investment.

Housing construction robust, public construction investment strongly boosted by economic stimulus programmes

Private housing investment was not significantly affected by the economic crisis. Starting from a low level at the end of 2008, private housing investment picked up slowly in the reporting period. Income prospects, which had been affected only to a relatively small extent during the crisis until then, and a widely perceived low risk of unemployment are likely to have played a part in this in much the same way as the favourable interest rates for housing loans and perceptibly lower construction price inflation. Public construction investment received a considerable boost from the government measures to stabilise the economy, especially in the second half of 2009.

Key economic variables in Germany

Table 4

Annual percentage change

Item	2006	2007	2008	2009
Growth (real) [1]				
Private consumption	+ 1.3	– 0.3	+ 0.4	+ 0.2
Government consumption	+ 1.0	+ 1.7	+ 2.1	+ 3.0
Machinery and equipment	+ 11.8	+ 11.0	+ 3.3	– 20.5
Premises	+ 4.6	0.0	+ 2.6	– 0.8
Other investment	+ 8.9	+ 6.5	+ 5.3	+ 4.9
Domestic demand	+ 2.2	+ 1.0	+ 1.7	– 2.1
Exports [2]	+ 13.0	+ 7.5	+ 2.9	– 14.2
Imports [2]	+ 11.9	+ 4.8	+ 4.3	– 8.9
Gross domestic product	+ 3.2	+ 2.5	+ 1.3	– 5.0
Contribution to GDP growth in percentage points				
Domestic demand (excluding inventories)	+ 2.3	+ 1.0	+ 1.2	– 1.0
Changes in inventories	– 0.2	0.0	+ 0.4	– 0.9
Net exports	+ 1.0	+ 1.5	– 0.3	– 3.0
Employment				
Employed [3]	+ 0.6	+ 1.7	+ 1.4	– 0.0
Average working time per employed person	– 0.3	+ 0.1	– 0.1	– 2.8
Total number of hours worked	+ 0.3	+ 1.8	+ 1.3	– 2.8
Unemployed (in thousands) [4]	4,487	3,777	3,268	3,423
Western Germany	3,007	2,486	2,145	2,320
Eastern Germany	1,480	1,291	1,123	1,103
as a percentage of the civilian labour force	10.8	9.0	7.8	8.2
Western Germany	9.1	7.5	6.4	6.9
Eastern Germany	17.3	15.1	13.1	13.0
Prices				
Consumer prices	+ 1.6	+ 2.3	+ 2.6	+ 0.4
Producer prices of industrial products [5]	+ 5.4	+ 1.3	+ 5.5	– 4.2
Construction prices [6]	+ 2.4	+ 6.7	+ 3.4	+ 1.2
Import prices	+ 4.4	+ 0.7	+ 4.6	– 8.6
Export prices	+ 1.8	+ 1.2	+ 1.7	– 2.2
Terms of trade	– 2.5	+ 0.5	– 2.6	+ 6.8
GDP deflator	+ 0.5	+ 1.9	+ 1.5	+ 1.5
Productivity and labour costs				
GDP per hour worked by employed persons [1]	+ 2.9	+ 0.7	– 0.0	– 2.2
Compensation per hour worked by employees [3]	+ 1.2	+ 0.8	+ 2.2	+ 3.3
Labour costs per unit of value added in real terms in the economy as a whole [7]	– 1.6	+ 0.1	+ 2.2	+ 5.6

Sources: Federal Statistical Office; Federal Employment Agency. — **1** At previous year's prices, chain-linked (2000=100). — **2** Balance of transactions in goods and services with the rest of the world. — **3** Domestic concept. — **4** As defined by the Federal Employment Agency. — **5** Domestic sales. — **6** Calculated by the Bundesbank on the basis of Federal Statistical Office data. — **7** Gross compensation generated in Germany per hour worked by employees divided by real GDP per hour worked by employed persons.

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Consumer climate influenced by special factors

Private consumption made a significant contribution to stabilisation in the reporting period, going up by a total of 0.2%. This was confined to the first half of the year, however, and was due, first and foremost, to fiscal policy measures. The propensity to purchase was selectively influenced by the incentives to buy a new car. Furthermore, the loss of income which is usual in times of recession was dampened by the generous granting of short-time working subsidies. In addition, households benefited from a number of tax reductions as well as one-off payments for families and tax refunds for commuters. The extremely benign price climate also had a supporting effect in 2009. The sharply increased volume of car sales due to the car scrappage scheme gradually subsided in the second half of the year. Given the overall decline in expenditure on other consumer durables and on non-durables and services, the private saving ratio went up again after being somewhat depressed in the first half of the year owing to special factors. Over the year as a whole, the private saving ratio, at 11.3%, was slightly above its 2008 level.

Imports dented by decline in domestic output

The slump in domestic output in the fourth quarter of 2008 and the first quarter of 2009, along with the close international production ties, the depletion of inventories and the weak propensity to invest in Germany, resulted in a massive decline in German imports on a broad front well into the second quarter. Car imports showed a marked increase for a time following the introduction of the environmental premium. Owing to the recovery in economic activity in Germany, imports of intermediate goods went up again in the second half of the year. Overall, real imports declined in 2009 by 8.9% on the year. In statistical terms, foreign trade had a considerable dampening effect on the GDP result for 2009. By contrast, real income benefited from the energy-related gain in purchasing power of €25¾ billion, resulting from the sharp year-on-year fall in the cost of imported energy on an annual average.

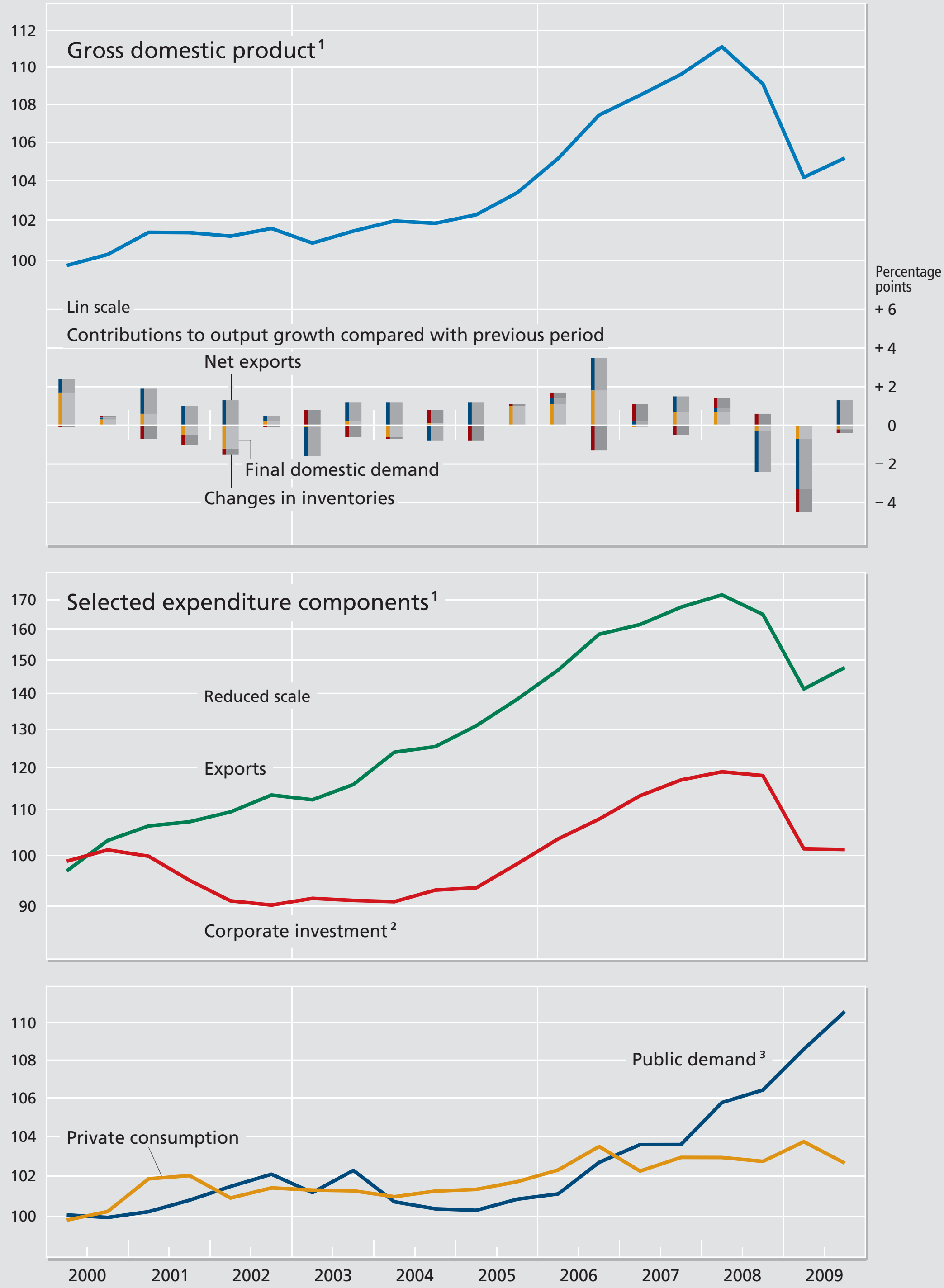
Sectoral production trends

The exceptionally sharp decline in overall economic output in the reporting period was due, first and foremost, to the slump in industrial production. Knock-on effects stemming from the closely integrated nature of economic activity led to the shock quickly spreading to other sectors of the economy, such as wholesale and foreign trade, the transport sector and numerous business-related services. Owing, not least, to the government stabilisation measures, the construction sector and the provision of public and household services remained largely unaffected by the sharp contraction in the production of industrial goods.

Overall economic output and demand

Chart 11

Seasonally adjusted, half-yearly, log scale



1 At previous year's prices and chain-linked (2000 = 100). — 2 Private investment in machinery, equipment and other plant as well as in commercial construction. — 3 Government consumption and gross public investment.

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Comparatively muted decline in employment ...

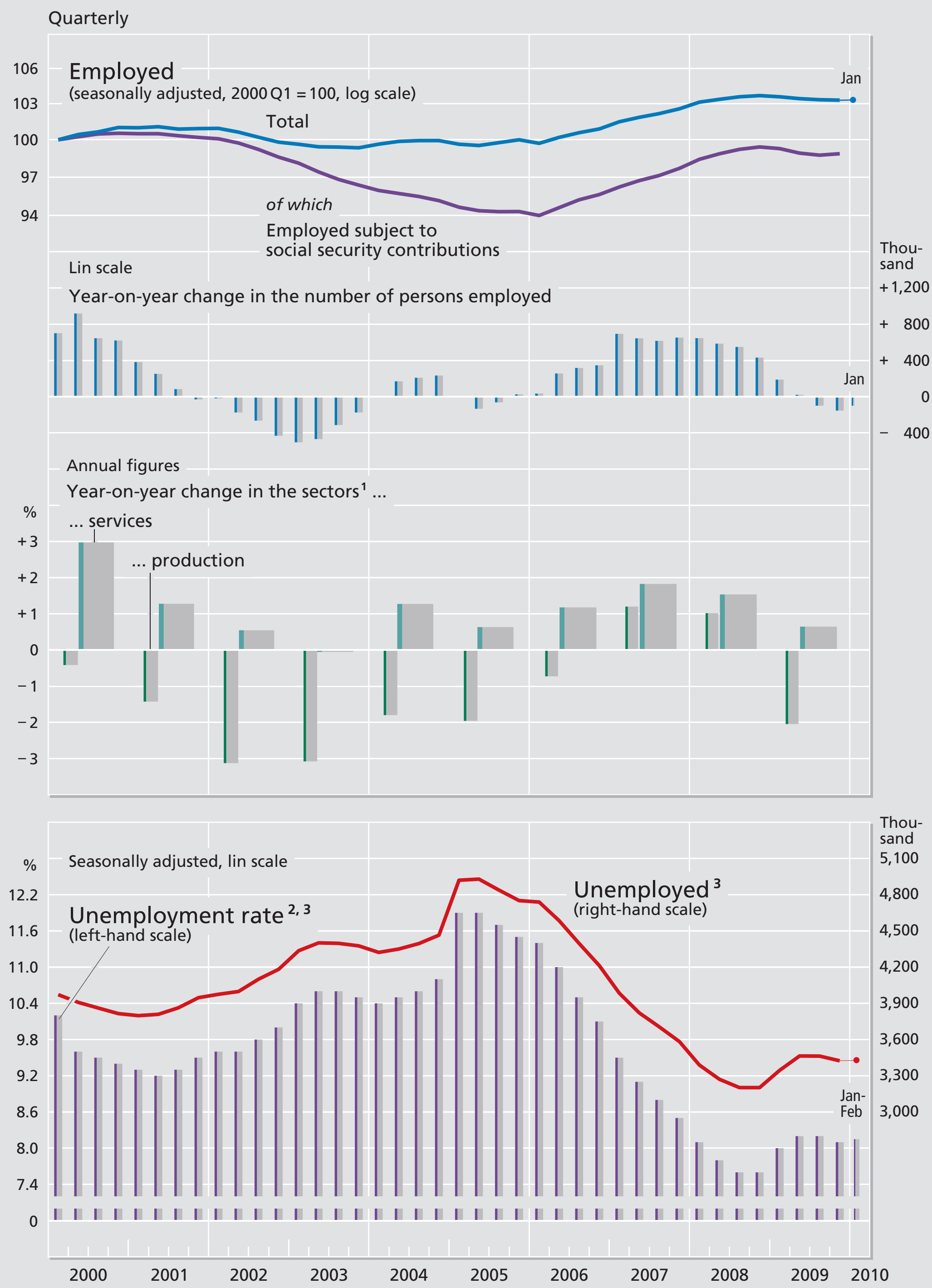
There was hardly any decline in employment overall, despite the severe contraction in overall economic output. On an annual average in 2009, the number of persons in work in Germany declined only marginally on the year (-14,000). There were quite obvious job losses in manufacturing and in the business services sector, which embraces subcontract working. In relation to the sharp contraction in industrial demand, however, these losses are to be considered as moderate. This contrasted with increases in staffing levels in the case of largely publicly financed social services. The number of low-paid part-time jobs also showed a further increase. The decline in industrial employment was contained because working hours were reduced and enterprises tolerated a sharp drop in hourly productivity, at least temporarily. Working hours were initially reduced by eliminating overtime and by depleting working time accounts. Use was also made of options for limiting regular weekly working hours, which formed part of the collective wage agreements. This was followed later by greater use of government-assisted short-time working arrangements. The decline in employment accelerated at first before slowing down again later in the year. This means that enterprises entered 2010 with substantial reserves of labour. Given a corresponding rise in demand, this would allow a rapid expansion of output.

... and only a moderate rise in unemployment

The rise in unemployment was also kept within comparatively narrow bounds. The number of persons officially registered as unemployed went up by 155,000 on an annual average to 3.42 million. This corresponds to an unemployment rate of 8.2%, compared with 7.8% in 2008. Without the changeover in the labour market statistics, which accompanied a reorganisation of the labour market policy measures, the increase would have been 273,000, however. Despite the declining trend in the working-age population, the increase in unemployment was therefore far greater than the decline in employment. This was probably due in part to the fact that the newly created jobs in social services are often taken by women who were previously neither in employment nor unemployed. Furthermore, many of these jobs are likely to be part-time. At all events, according to estimates by the Institute for Employment Research (IAB), the ratio of part-time work went up from 33.8% to 34.5%. By contrast, it was men that were primarily affected by the job losses in the manufacturing sector and in temporary work. The unemployment rate among men went up by 0.9 percentage point on the year to 8.4%, whereas the equivalent figure for women fell by 0.3 percentage point to 7.9%. Added to this was the fact that the commuter balance went up by 35,000 on the year in 2009 on an annual average. In the first two months of 2010, the seasonally adjusted number of persons registered as unemployed was up slightly on the December level.

Labour market

Chart 12



1 Column width proportional to the number of persons employed. — **2** Unemployed as a percentage of the civilian labour force — **3** As defined by the Federal Employment Agency. From January 2004, unemployed excluding participants in aptitude testing and training schemes. From January 2005, including recipients of social assistance who are able to work. From May 2009, excluding persons newly registered on the books of private employment agencies.

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Sharp rise in unit labour costs despite marked decline in actual earnings

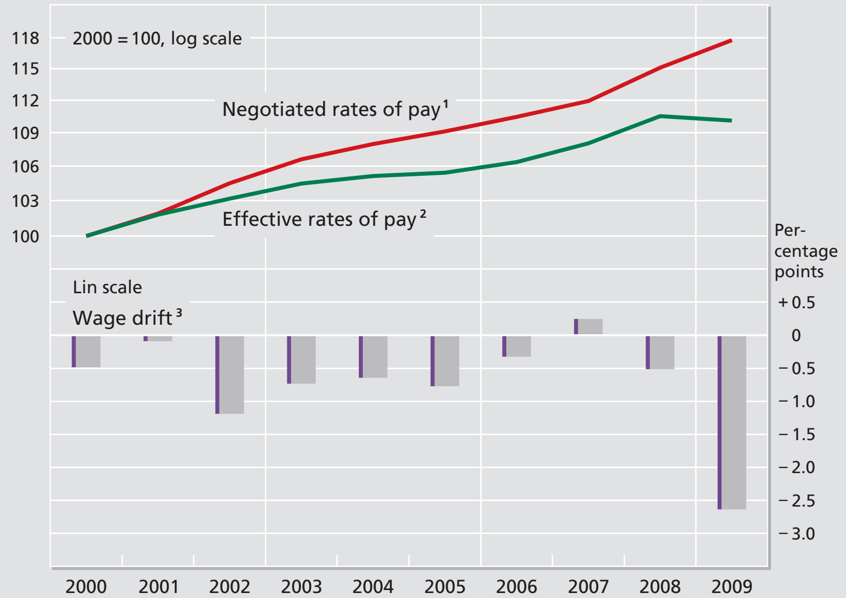
The 2009 pay round was crucially shaped by the economic crisis. On the whole, the negotiating parties agreed no more than moderate linear wage increases, mostly as part of a two-year settlement following a lump-sum payment, with the result that the long-term additional burden on enterprises is limited. Furthermore, the wage bargainers used a wide variety of instruments to mitigate the effects of previously agreed phased increases and to minimise crisis-induced job losses. These include taking advantage of liberalisation clauses to reduce working hours and rates of pay, concluding supplementary wage agreements to safeguard employment, and deferring one-off payments. As a result of these measures, not all employees were able to reap the full benefit of the 2.3% wage increase shown in the Bundesbank's negotiated pay rate statistics. This is because these statistics are based on normal case scenarios and therefore do not take exceptional circumstances into consideration. For example, actual earnings on a monthly basis fell by 0.4% in 2009. On an hourly basis, however, actual earnings went up more rapidly, at 2.9%, than negotiated rates of pay. This was principally due to the fact that, while employees were running down their working time accounts, standard monthly wages were paid and short-time working benefits were often increased. The marked contraction in labour productivity due to labour hoarding was reflected in a sharp rise of 5.2% in unit labour costs per employee in 2009. Calculated on an hourly basis, unit labour costs went up by 5.6%.

Slower rate of price increase

The rise in prices of domestically produced goods and services – measured by the GDP deflator – at 1.5%, was no sharper than in 2008. Given the significantly higher unit labour costs, this was due to an extremely sharp recession-induced decline in profit margins. By contrast, there was marked disinflation in the price component of domestic demand: an increase of 1.9% in 2008 was followed by a rise of just 0.3% in 2009. This was attributable to sharp price reductions in the case of imported goods and services which, with export prices falling, led to a marked improvement in the terms of trade. In particular, there was a marked reduction in the price of commodity imports owing to the declining prices in the international markets, whereas the price trend for final products changed only slowly. Consumers benefited primarily from considerably lower energy and food prices in the reporting year. In line with developments at the import level, the economic downturn initially had scarcely any impact on other goods and services, however. Overall, consumer prices in 2009 went up by just 0.4% according to the national Consumer Price Index (CPI) and by 0.2% according to the Harmonised Index of Consumer Prices (HICP), which does not include owner-occupied housing. The rate of inflation declined initially during the course of

Labour income

Chart 13



1 Level of negotiated wages and salaries calculated on a monthly basis. — **2** Wages and salaries per employee. — **3** Deviation in rates of change between effective rates of pay and negotiated rates of pay.

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2009. This was due to price corrections in the case of energy and food products that had begun as early as mid-2008; the year-on-year inflation rate even entered negative territory for a time in the third quarter. It then went up again owing to baseline effects stemming from price developments in the previous year and as a result of emerging price inflation in the international commodity markets against the backdrop of improving global economic conditions. Year-on-year CPI on an average of the January and February period of 2010 was just over ½%.

Subdued price developments in the real estate market

According to the figures of the Federal Statistical Office, residential construction prices rose by no more than 0.9% in 2009. This followed quite a sharp rise in construction prices in the two preceding years owing to the increase in VAT and rising commodity prices. This increase in construction costs was reflected only to a limited extent in the German real estate market. According to Bundesbank calculations based on BulwienGesa AG data, prices of new housing went up moderately again (+2%), whereas prices of existing housing, in fact, showed a slight decline (-1%). According to the consumer price statistics, which primarily reflect movements in existing rents, housing rents went up slightly by 1.1%.

Prices at various levels of the economy

Table 5

Annual percentage change

Item	2008 Q4	2009 Q1	Q2	Q3	Q4
Import prices	– 0.7	– 6.6	– 10.6	– 11.9	– 4.8
of which					
Commodities	1.1	– 19.6	– 31.8	– 36.7	– 13.6
Finished goods	0.6	0.5	0.5	– 0.3	– 1.9
Export prices	1.0	– 1.2	– 2.5	– 3.3	– 1.6
Terms of trade	1.7	5.7	8.8	9.8	3.4
Industrial producer prices	5.3	0.8	– 3.6	– 7.4	– 6.3
Construction prices	3.4	2.6	1.5	0.4	0.4
of which					
Residential buildings	2.7	2.0	1.0	0.2	0.3
Consumer prices	1.7	0.9	0.3	– 0.3	0.4
Energy	3.5	– 2.3	– 7.0	– 9.2	– 3.0
Refined petroleum products	– 7.0	– 17.9	– 21.6	– 20.5	– 0.4
Gas, electricity and heat energy	12.8	11.8	6.9	1.4	– 4.9
Food products	2.8	0.8	– 0.9	– 2.8	– 2.6
Industrial goods (excluding energy)	0.8	1.1	1.4	1.5	1.4
Services (excluding rents)	1.7	1.4	1.9	1.5	1.3
Housing rents	1.3	1.2	1.1	1.1	1.0
Memo items					
GDP deflator	2.0	1.6	1.3	1.9	1.0
Use of domestic product deflator	1.3	0.5	0.2	0.1	0.1
Deflator of imported goods and services	– 1.3	– 5.4	– 7.1	– 8.3	– 4.8

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According to BulwienGesa AG data, rents for new lettings of existing housing remained virtually unchanged in 2009.

2 Public finances worsened dramatically in 2009

Public finances worsened dramatically in 2009

The sharp economic downturn, which was accompanied by a correction of the previous exceptional positive development of profit-related taxes, and the extensive fiscal support measures led to a dramatic worsening of public finances.

After a balanced budget in 2008, a deficit of 3.3% of GDP was recorded in 2009, thus exceeding the EU reference value.

Revenue ratio higher despite tax cuts

In 2009, government revenue fell significantly by 2.4%. In addition to the negative cyclical impact and plummeting profit-related taxes, this also reflects cuts in income and corporate taxation adopted to support the economy. In the area of revenue from social contributions, the lower contribution rate to the Federal Employment Agency was virtually offset by higher average annual contribution rates to the statutory health and public long-term care insurance schemes. All in all, the revenue ratio rose by 0.5 percentage point to 44.3% as gross wages and salaries and private consumption, both of which are important reference variables for revenue, developed much more favourably than overall GDP.

Expenditure ratio shot up

The government expenditure ratio shot up by 3.9 percentage points to 47.6% in 2009. This primarily reflects the impact of weak economic activity both through higher labour-market-related expenditure and through the denominator effect of the fall in GDP. Added to this was temporary additional expenditure as a result of the fiscal stimulus packages (especially the car scrappage scheme, the expansion both of government investment and of active labour market policy measures as well as the child bonus), higher spending on healthcare, old-age provision and personnel as well as growth in intermediate consumption and the rise in child benefit.

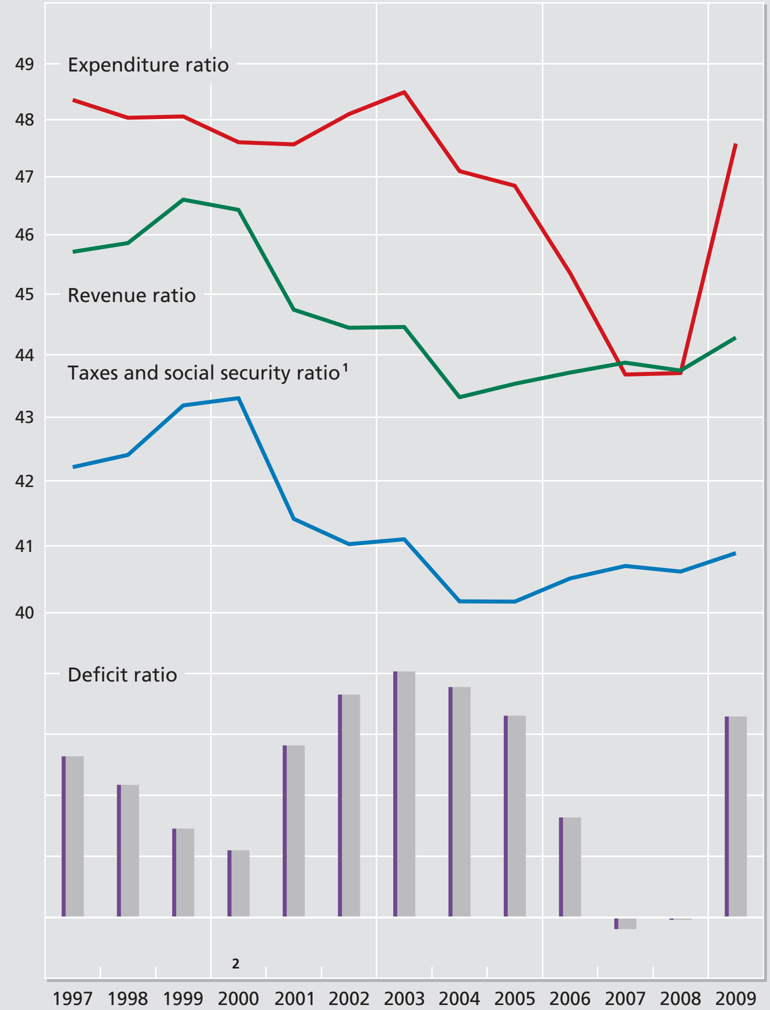
Central, state and local government budgets deteriorated massively

The combined deficit of central, state and local government as defined in the government's financial statistics soared in 2009 and is likely to have reached just over €85 billion. State and local government concluded the year with significant funding gaps of slightly more than €30 billion following surpluses on balance one year previously. Central government's budgetary situation also deteriorated massively. The core budget deficit increased to €34½ billion compared with €12 billion in 2008. It was thus €15 billion below the figure of €49½ billion estimated in the second supplementary budget. This was due chiefly to the fact that the loan to the health insurance fund was not taken up, that spending on interest payments, long-term unemployment and calls on guarantees was lower and that tax revenue was higher than forecast. On the revenue side, sharp drops in tax receipts and in asset realisations were recorded compared with 2008. Expenditure rose steeply, mainly due to higher payments for the statutory health insurance scheme and compensation to be paid to state government since mid-2009 for the transfer of motor vehicle tax. Central government's off-budget entities posted a deficit of just over €20 billion. The increase of almost €15 billion

General government fiscal ratios*

Chart 14

As a percentage of GDP



* As defined in the national accounts. — 1 Taxes and social contributions plus customs duties and EU share in VAT. — 2 Excluding proceeds from the UMTS auction.

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on 2008 was predominantly due to bank recapitalisations and the new Investment and Repayment Fund from which payments, in particular for the car scrappage scheme from the second economic stimulus package, were made in 2009.

Large deficit for social security funds

The social security funds concluded 2009 with a deficit (as defined in the government's financial statistics) of €11½ billion. The sharp deterioration of €18½ billion vis-à-vis 2008 primarily reflects the economic downturn, but also discretionary increases in expenditure. By contrast, the effects that changing the contribution rate had on revenue largely cancelled each other out. Higher expenditure and lower revenue due to cyclical factors, but also the cut in the contribu-

General government as defined in the national accounts* — Table 6

Item	2007	2008	2009 pe	2007	2008	2009 pe
				Year-on-year change		
	€ billion			as a percentage		
Expenditure	1,060.7	1,090.8	1,145.3	0.6	2.8	5.0
of which						
Social benefits	596.8	607.4	640.8	– 0.3	1.8	5.5
Compensation of employees	168.4	172.1	177.0	0.3	2.2	2.8
Interest	67.3	67.1	63.5	2.7	– 0.3	– 5.3
Gross capital formation	34.3	37.4	40.1	6.0	9.1	7.0
Memo item						
Old-age provision 1	291.3	296.3	303.1	0.8	1.7	2.3
Healthcare 2	157.0	164.4	175.4	3.9	4.7	6.7
Revenue	1,065.3	1,091.8	1,066.0	4.8	2.5	– 2.4
of which						
Taxes	576.3	592.6	562.9	8.6	2.8	– 5.0
Social contributions	399.8	408.1	411.1	0.0	2.1	0.7
				€ billion		
Balance	4.7	1.0	– 79.3	42.8	– 3.7	– 80.3
Memo item						
As defined in the Maastricht Treaty				as a percentage		
Debt level	1,577.7	1,644.5	...	0.4	4.2	...
	as a percentage of GDP			in percentage points		
Debt ratio	65.0	65.9	...	– 2.6	0.9	...
Deficit 3	0.2	0.0	...	1.8	– 0.2	...

* In accordance with ESA 95. — **1** Expenditure of the statutory pension insurance scheme and on civil servants' pensions. — **2** Expenditure of the statutory health insurance scheme and on government assistance towards civil servants' medical bills. — **3** In contrast to the budget balance in the national accounts, the Maastricht deficit is calculated taking into account interest payments from swap transactions and forward rate agreements.

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tion rate and burdens from the second economic stimulus package, caused the Federal Employment Agency to record a particularly high deficit. Following a clear surplus in 2008, the statutory pension insurance scheme reported a virtually balanced result. Cyclically induced revenue shortfalls were limited as contributions are also paid on wage substitutes. Expenditure rose markedly following the mid-year pension increase. By contrast, the statutory health insurance scheme (including the health insurance fund) and the public long-term care insurance scheme both posted a surplus, which was due to an increase in the central government grant to the health insurance fund as well as higher contribution rates on an annual average to both insurance schemes.

Sharp deterioration of government budgets to continue in 2010

Public finances will again deteriorate substantially in 2010, and the deficit as defined in the national accounts could jump to around 5% of GDP. The revenue ratio is likely to decrease perceptibly owing to a further decline in profit-related taxes from previous peaks, the unfavourable growth profile and, above all, the large-scale cuts in tax and social contributions (especially greater tax deductibility of contributions to the health and long-term care insurance schemes, additional tax relief measures for income and corporate taxation, new tax allowances for turnover tax as well as the lower contribution rate to the health insur-

General government finances* Table 7

Item	2007 pe	2008 pe	2009 pe	2007 pe	2008 pe	2009 pe
	€ billion			Year-on-year change		
Central, state and local government				as a percentage		
Expenditure	644.2	677.4	714	1.8	5.2	5.5
of which						
Central government	292.1	303.8	317	3.3	4.0	4.5
State government	267.5	278.0	289	2.9	3.9	4
Revenue	644.8	668.9	627.5	8.8	3.7	– 6
of which						
Taxes	538.2	561.2	525	10.2	4.3	– 6.5
				€ billion		
Balance	0.6	– 8.5	– 86.5	40.4	– 9.1	– 78
of which						
Central government	– 14.7	– 11.8	– 34.5	13.5	2.9	– 22.5
State government	8.4	1.3	– 25.5	18.7	– 7.1	– 27
Social security funds				as a percentage		
Expenditure	466.4	478.9	506.0	– 0.0	2.7	5.5
Revenue	475.3	485.7	494.5	– 2.3	2.2	2
				€ billion		
Balance	8.9	6.9	– 11.5	– 10.8	– 2.1	– 18.5
of which						
Statutory pension insurance scheme	1.0	3.6	– 0	– 6.3	2.6	– 3.5
Statutory health insurance scheme	1.5	1.2	1	0.1	– 0.3	– 0.5
Federal Employment Agency	6.6	1.6	– 13.5	– 4.6	– 5.0	– 15

* As defined in the government's financial statistics. This differs from the definition of the government account within the national accounts.

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ance fund on an annual average). By contrast, the expenditure ratio may rise slightly. This is attributable to both the increase in child benefit as well as higher spending on healthcare and government investment. The increase is likely to be moderated chiefly by the fact that some temporary stimulus measures, such as the car scrappage scheme and child bonus, will have come to an end.

Excessive deficit procedure requirements included in updated stability programme

In October 2009, an EU excessive deficit procedure was initiated against Germany; a further 12 of the 16 euro-area countries are also currently subject to such a procedure. Following the Ecofin Council's decision of December 2009, Germany must again comply with the 3% ceiling by 2013 and, to achieve this, must reduce its structural deficit by an average of at least 0.5% of GDP per year starting in 2011. According to the Federal Government's updated stability programme published in February 2010, these requirements should be met. The programme foresees a 1.4% increase in real GDP in 2010 and an annual increase of 2% for the years thereafter up to 2013. The deficit ratio is expected to increase to 5½% in 2010, in particular due to a further expansion in discretionary budgetary burdens. From 2011, the ratio is to be reduced by an average of just under 1 percentage point a year with the aim of just undershooting the 3% ceiling in 2013. However, just how this improvement is to be funded is not yet clear, as to date no concrete measures to achieve the planned deficit reduction have been specified.

3 Investment and financing

Basic structures of financial flows in 2009

Real economic and fiscal developments in the reporting year were shaped by the financial and economic crisis and are reflected in the investment and financing decisions of the individual sectors. Data on the precise composition of the financial relations among the various sectors – which are captured in the financial accounts – are not yet all available for the whole of 2009, however. Nevertheless, it is possible to give a broad outline of the main trends and ranges of figures on the basis of the data available so far.

Sharp drop in financial investment

According to the available financial accounts figures, in the first three quarters of 2009 there was a fall of more than 50% in the financial investment of the German non-financial sectors. It amounted to only €110 billion, compared with €245 billion in the same period of 2008. The main reason for this was a €50 billion reduction in financial assets in the corporate sector, compared with an increase of €90 billion during the same period of 2008. This shift was due, above all, to a reduction in securities holdings and the fact that the acquisition of equities was relatively subdued. In addition, financial investment by general government was more than €10 billion down on the year. Even so, at a total of €43 billion, it was high compared with the longer-term average. Roughly one-half of this was due to an increase in equities in credit institutions owing to support measures. Unlike general government and producing enterprises, households expanded their financial investment significantly, investing almost €120 billion net, which was around €20 billion higher than the previous year's figure.

Markedly smaller increase in bank deposits in 2009

A noticeable part of the financial investment of all domestic non-monetary sectors flowed into deposits with domestic banks in 2009, although the figure was considerably smaller than in earlier years. These deposits grew by just over €55 billion, or 2.1%, compared with almost €171½ billion, or 6.9%, in 2008. This lower demand for bank deposits was reflected in extremely strong outlows in the case of short-term time deposits. Owing to their sharply declining remuneration, these deposits became considerably less attractive for all types of investors, with households recording the strongest outflows. By contrast, overnight deposits – especially those of households and non-financial corporations – as well as short-term savings deposits were built up to an increasing extent.

Longer-term deposits, too, clearly benefited from the steep yield curve in the reporting year, albeit on a smaller scale. This affected, in particular, longer-term time deposits of households and – in connection with banks' securitisation schemes – of other financial intermediaries as well as longer-term savings deposits.

Purchases of securities

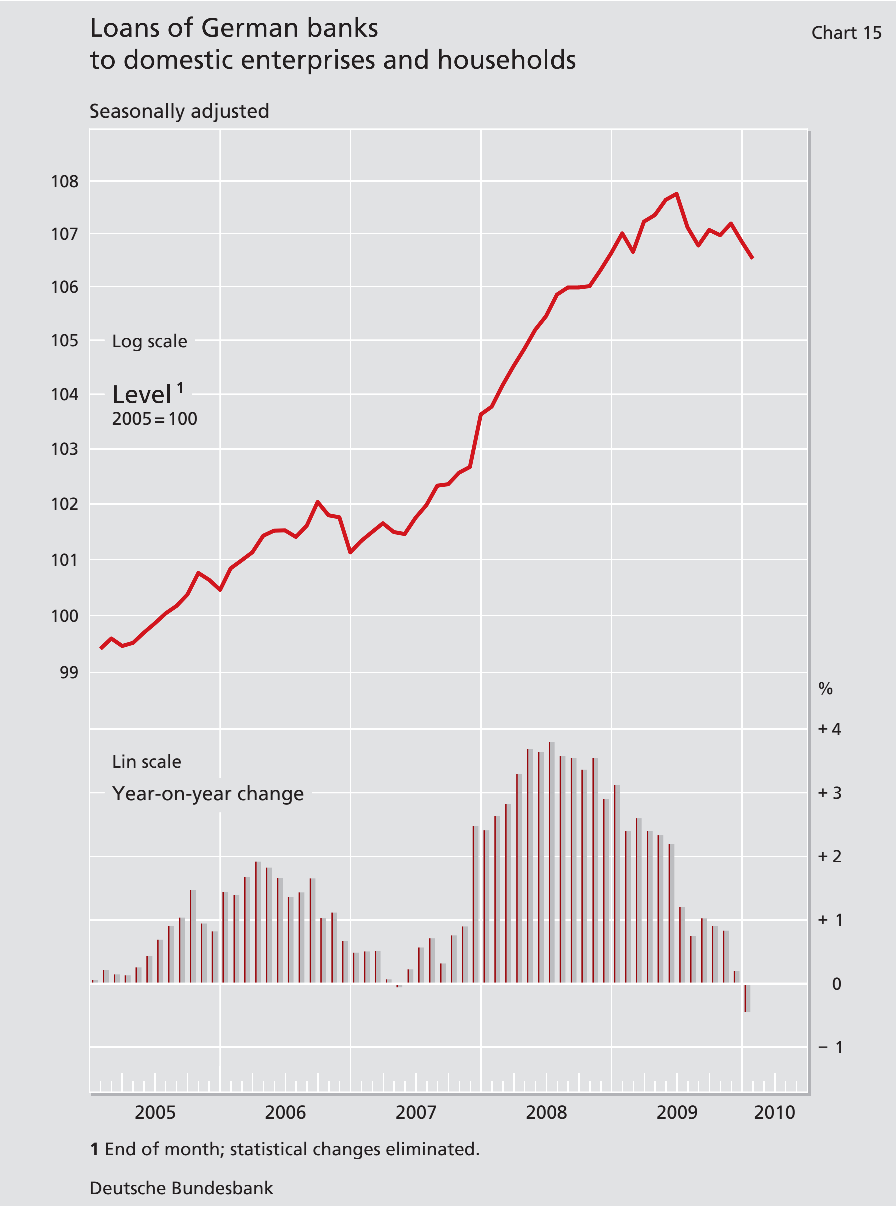
Domestic non-banks also invested significantly in the capital market. In 2009, they acquired mainly debt securities (€83½ billion) consisting on balance solely of foreign paper, which is mainly denominated in euro and therefore not exposed to any exchange rate risk. Mutual fund shares/units were acquired in the amount of €58 billion with interest focused on domestic instruments. Shares, which had been recording marked gains from the second quarter onwards, were also acquired in the amount of €26½ billion.

Declining demand for external financing

Borrowing by the non-financial sectors amounted to slightly more than €80 billion in the first three quarters of 2009 taken together, which was roughly €30 billion lower than the figure in the corresponding period of 2008. Developments varied very widely among the individual sectors. While new government borrowing in the credit and capital markets, at €90 billion net, was almost twice as high as in the same period of 2008 (€50 billion), producing enterprises' external financing dropped sharply. Following inflows of funds amounting to as much as €73 billion in the first three quarters of 2008, liabilities of €8 billion net were, in fact, redeemed in the reporting period, with a sharp decline especially in loans. For larger enterprises, the sale of bonds was quite productive, however. In contrast to earlier years, households slightly increased their borrowing from banks and insurance companies by roughly €3 billion.

Much slower growth in loans to the private sector

There was a perceptible increase in German banks' credit to domestic customers in the reporting year, albeit on a noticeably smaller scale than in 2008. Securitised lending to government was the driving force. At just under €27½ billion, or 19.6%, this showed exceptionally strong growth as a "substitute" for weak traditional lending business. By contrast, unsecuritised lending to the domestic private sector increased by only slightly more than €4½ billion, or 0.2%, in 2009 (see the chart on adjacent page). There were, however, clear differences in lending to the individual sectors. Loans to financial corporations showed a sharp increase of 25.4%; to a large extent, this reflects special refinancing operations by German banks. At +0.3%, banks' lending business with domestic households expanded slightly in terms of both loans for house purchase and consumer credit following two years of negative growth.



Decline in loans to non-financial corporations largely macro-economic in origin

The much slower pace of growth in loans to the domestic private sector is therefore due to loans to non-financial corporations, which fell steadily last year by 3.3%. The downward movement in loans to non-financial corporations was, in itself, faster than in earlier economic slowdowns, but the reduction in the annual rate of growth was not exceptionally strong when measured against developments in the real economy. The decline can easily be explained by the extremely sharp slump in overall activity in the final quarter of 2008 and the first quarter of 2009. This reduced enterprises' demand for loans and at the same time increased the probability of default. In the reporting year, bank-imposed supply constraints beyond such real economic determinants probably did not play any crucial role overall in terms of lending to non-financial corporations.

Fewer tightenings of credit standards ...

This is indicated by the results of the Bank Lending Survey. These show that the still quite pronounced tightenings of credit standings for non-financial corporations at the start of the year came to halt as the year progressed (see the chart on page 63). According to the survey respondents, this initial tightening was due mainly to the deterioration in the outlook for general economic activity as well sector-specific and firm-specific factors. Bank-specific factors were, by contrast, of secondary importance. In the wake of adjustments in credit standards, there was, above all, a significant widening of margins in corporate lending. Other credit conditions – such as collateral requirements and non-interest rate charges – were also tightened accordingly, however. While large enterprises were still more severely affected at the beginning of the year, changes in credit standards by firm size converged in the second half of the year. Households, too, found their access to financing more difficult at the beginning of the reporting period, but to a much lesser extent than for non-financial corporations. According to the institutions taking part in the survey, this was due chiefly to the worsened general economic outlook.

... along with a simultaneous increase in demand for funds ...

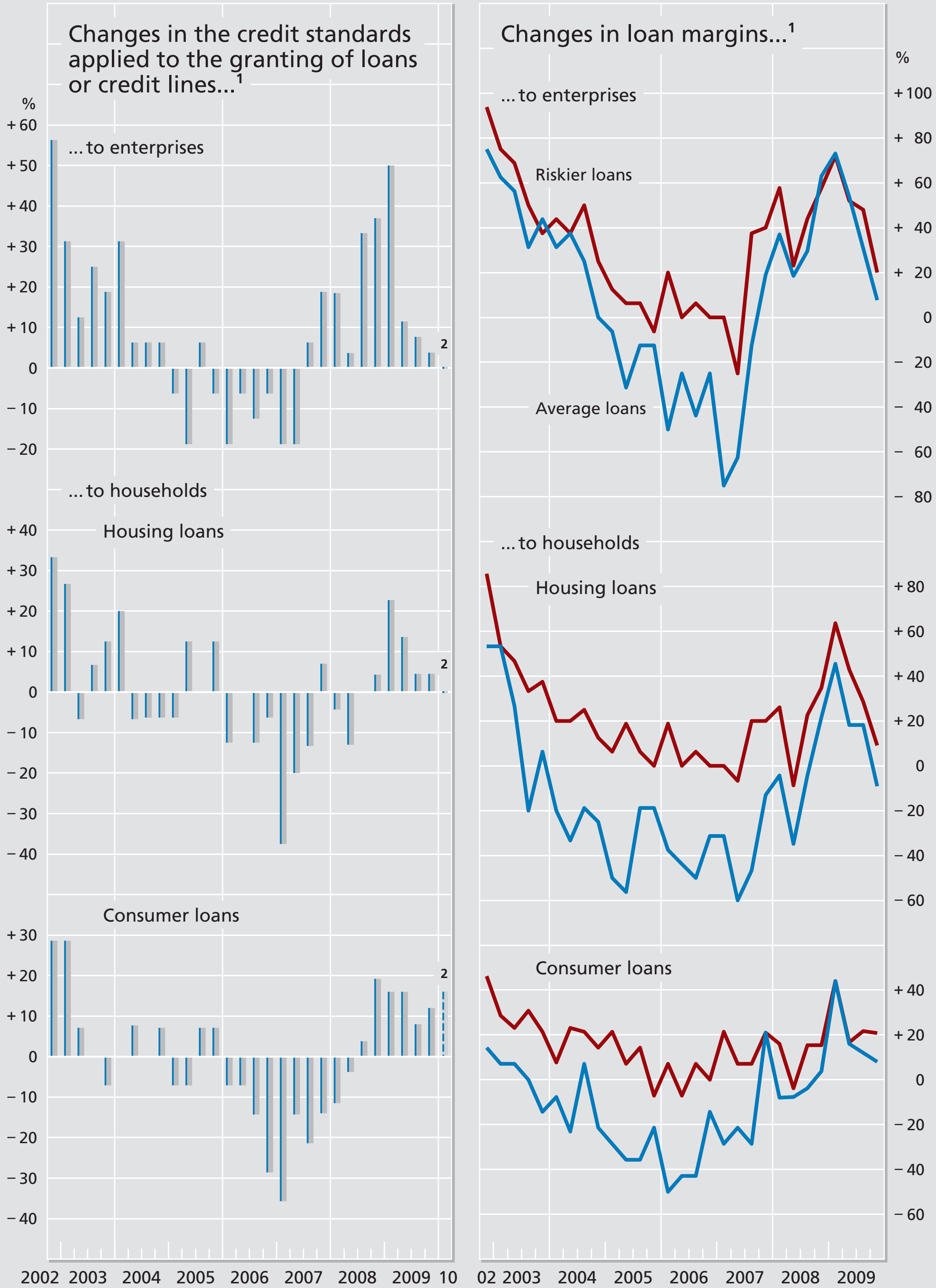
At the same time, the surveyed banks reported an increased demand for funds on the part of non-financial corporations and households, although this was actually due only in part to aggregate growth in the need for funding. In the reporting year, it was, in particular, restraint on the part of other banks that played a key role in corporate demand for credit from the banks participating in the survey. In addition, debt rescheduling as well as expenditure on inventory management and operating costs tended to lead to increased borrowing by producing enterprises, while there was a sharp fall in funding needs for fixed capital investment.

... and continuing fall in bank lending rates

In new lending business with domestic households and non-financial corporations, bank lending rates essentially tracked developments in the money and capital markets and, as the year progressed, eased markedly mainly at the short end of the yield curve (see the chart on page 65). In nearly all lines of business, the decline matched pre-crisis behaviour. One exception was households' overdrafts, which were slow to adjust to declining wholesale funding costs. At the end of the year, German banks were charging, depending on the volume of the loan, between 3.9% and 4.1% for loans to enterprises with an interest rate fixation of more than five years and 4.3% for loans for house purchase with an

Bank Lending Survey
Results for Germany

Chart 16



1 Difference between the respondents reporting "tightened considerably" and "tightened somewhat" and the respondents reporting "eased somewhat" and "eased considerably" as a percentage of the responses given. — 2 Expectations for Q1.

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interest rate fixation of over five and up to ten years.[1] Following the seasonal pattern of the past few years, the cost of long-term consumer loans fell sharply to an average of 7.6% in December.

Less borrowing in the German bond market

Despite the comparatively low rate of interest and new peaks in gross issuance, domestic debtors redeemed debt securities in the amount of €½ billion on balance, compared with net sales of €66 billion in 2008. This was ultimately attributable solely to domestic credit institutions, which reduced their capital market debt by €115 billion net, compared with net redemptions of €45½ billion in 2008. There was a further considerable fall in the outstanding volumes of public Pfandbriefe (€90 billion) and of other bank debt securities which can be structured flexibly (€43½ billion). Only the specialised credit institutions tapped the capital market (€19½ billion). While shifts in the financing of general government have resulted in public Pfandbriefe becoming less important for a number of years now, demand for "certificates" (which are included under "other bank debt securities") has been declining considerably since the onset of the financial crisis in mid-2007. Government (SoFFin) guarantees and the Eurosystem's purchase programme for covered bonds – which also benefited domestic Pfandbriefe – had a stabilising effect on the sale of bank debt securities. Overall, the fall in banks' capital market debt also has to be seen in the context of increased savings deposits and the full allotment of refinancing operations by the Eurosystem.

Despite improved financing conditions, domestic enterprises expanded their market debt through domestically issued debt securities by just €22½ billion in 2009, which was less than in the previous year. Non-bank financial corporations issued debt securities for more than €27½ billion. About €14½ billion of this was due to securitisations by special-purpose vehicles. All in all, enterprises mostly issued longer-term securities, while commercial paper was redeemed on balance for €24½ billion. Given the fiscal stimulus packages to contain the financial and economic crisis, there was a marked rise in the government borrowing requirement. As a consequence, general government issuance set a new record last year at €91½ billion net (2008: €25½ billion).

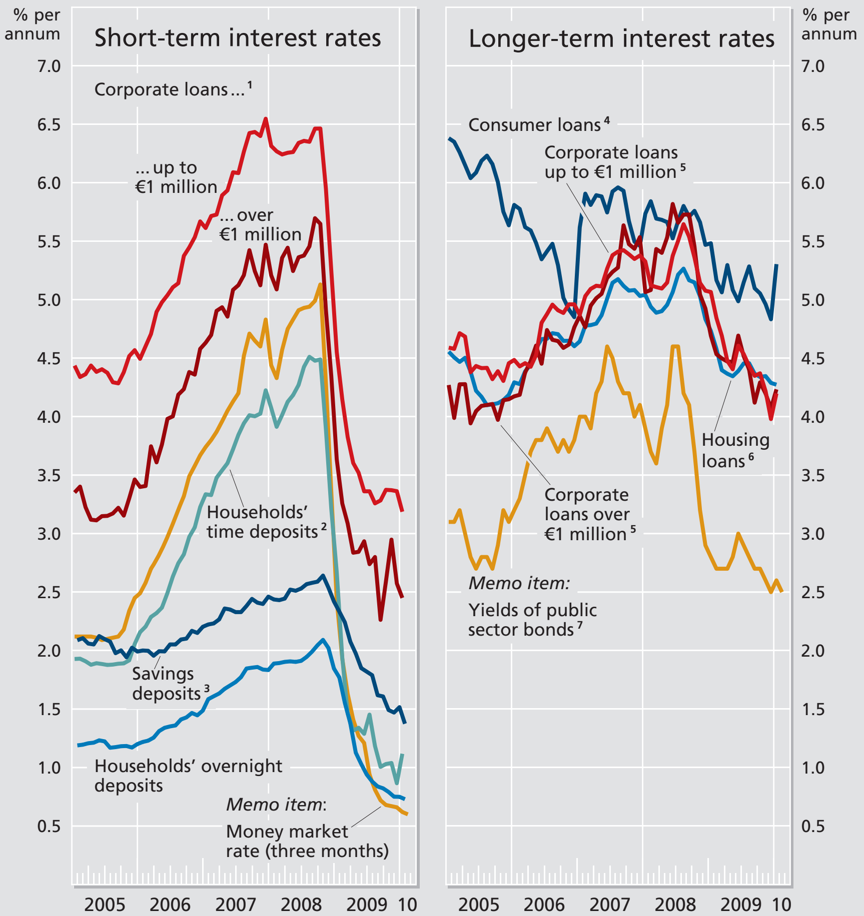
Pick-up in equity issuance

Issuing activity in the German equity market picked up in the wake of the improved stock market environment. At €24 billion in the reporting year, twice as much equity capital flowed into domestic incorporated enterprises as in 2008

1 It should be noted that the recorded interest rate changes in December 2009 were also influenced by special factors.

Bank interest rates in Germany

Chart 17



1 To non-financial corporations with an initial rate fixation of up to one year. — **2** With an agreed maturity of up to one year. — **3** Households' deposits redeemable at notice of up to three months. — **4** To households with an initial rate fixation of over one year and up to five years. — **5** To non-financial corporations with an initial rate fixation of over five years. — **6** To households with an initial rate fixation of over five years and up to ten years. — **7** Residual maturity of over five years and up to six years.

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(€11½ billion), of which listed enterprises accounted for €16½ billion. This consisted predominantly of capital increases by existing enterprises, with government support measures playing a key role.

Inflows of funds to domestic mutual funds

Domestic mutual funds, which had suffered from shifts in favour of protected bank deposits in 2008, sold their own shares in the amount of €43½ billion last year. Sales are likely to have been encouraged by the stock market recovery and investors' diminishing aversion to risk. The total volume of resources raised benefited mainly specialised funds reserved for institutional investors, which placed €33 billion worth of mutual shares. Among the funds open to the general public, it was chiefly equity and bond-based funds that acquired new resources (€6 billion and €4 billion respectively), although open-end real estate funds (€2½ billion), mixed securities-based funds (€2 billion) and mixed funds (€½ billion) were successful in the market, too. Given very low short-term interest rates, money market funds suffered outflows amounting to €5 billion.

German net external assets

As in earlier years, part of financial investment was formed abroad in 2009, too. In the first three quarters of the year, for which data on the international investment position are currently available, German net external assets went up by €141 billion. This increase corresponded in real economic terms to Germany's current account surplus. This stood at €119 billion in 2009 as a whole and was thus down considerably from 2008 (€167 billion). Rising prices in the international equity and bond markets also contributed to the increase in Germany's net external assets.

Chronology of economic and monetary policy measures

1 January 2009
Slovakia becomes the 16th member state of the EU to introduce the euro as legal tender.

A withholding tax on private capital income is introduced. As a general rule, the tax liability is settled by deducting the investment income tax at source at a rate of 25% plus the solidarity surcharge and, where applicable, church tax. If the investor's personal income tax rate is lower, a refund is claimable in his or her tax assessment. Furthermore, the Inheritance Tax Reform Act (*Erbschaftsteuerreformgesetz*) enters into force.

The basic income tax allowance is raised from €7,664 to €7,834 with retroactive effect from 1 January 2009, the bottom tax rate is reduced from 15% to 14% and the income tax thresholds are increased by €400.

Monthly child benefit increases for the first two children by €10 to €164; for the third child it rises by €16 to €170 and for subsequent children by €16 per child to €195. Child tax allowances are raised by €216 to €6,024 in total.

The health insurance fund extends the financing system of the statutory health insurance scheme and the uniform contribution rate is set at 15.5%. Health insurance institutions receive risk-adjusted insurance premiums from the fund. Furthermore, they can demand additional contributions, provided these do not exceed 1% of income subject to compulsory insurance contributions. Up to €8 per month can be charged without taking account of income. The contribution rate to the Federal Employment Agency is reduced from 3.3% to 2.8%.

15 January 2009
At its regular monetary policy meeting, the Governing Council of the ECB lowers the Eurosystem's key policy rates by 0.5 percentage point each. The interest rate on the main refinancing operations of the Eurosystem is thus set at 2%, while interest of 3% is charged on the marginal lending facility. Credit balances under the deposit facility are remunerated at 1%.

16 January 2009
The ECB and the Swiss National Bank extend the tendering of swap transactions to provide Swiss franc liquidity until at least the end of April 2009.

20 January 2009
The Governing Council of the ECB approves changes regarding collateral for monetary policy refinancing oper-

ations. Accordingly, asset-backed securities issued as of 1 March 2009 which are used as collateral in the Eurosystem must be given an AAA/Aaa rating by a recognised external credit assessment institution when they are issued and must not be rated lower than "A" over their lifetime. Furthermore, the pool underlying these securities should not consist of any tranches of other asset-backed securities. In addition, the Governing Council also approves limits on the use of uncovered bank bonds as collateral for monetary policy operations.

27 January 2009
The Federal Cabinet approves the draft of a supplementary budget to the Federal budget for 2009, which had been adopted by the Bundestag at the end of November 2008. This covers tax shortfalls of €11 billion from the poor macroeconomic development which is forecast, the court ruling reinstating the commuting allowance and a second economic stimulus package. Additional expenditure of €7½ billion is envisaged, in particular for grants to the health insurance fund, benefits for the long-term unemployed and guarantees. At €37 billion, net borrowing, which has doubled on balance, exceeds total investment expenditure (€29 billion). This is justified by invoking the exemption clause that it serves to avert a disruption of the macroeconomic equilibrium. Furthermore, a special "Investment and Repayment Fund" is set up, which is to finance measures to support the economy in the amount of €17 billion up to the end of 2011 by means of further borrowing. In addition to investment grants of €10 billion for state and local government and €4 billion for central government investment, in particular, €1½ billion is envisaged for a car scrappage premium of €2,500 for scrapping an old car and replacing it with a new one. The fund's debts are to be redeemed from parts of the Bundesbank's profit distributions.

28 January 2009
In its Annual Economic Report, the Federal Government expects a fall in real gross domestic product (GDP) of 2¼% in 2009. At ½% in real terms, world trade, according to the report, will grow much less strongly than in 2008. The forecast is also based on the assumption that the financial crisis will not deteriorate further. Lower commodity prices are expected to have a strong dampening effect on the increase in consumer prices and thus contribute to raising purchasing power. However, this is forecast to be countered by a fall in employment of 0.7%, or around 280,000 persons. The report states that private consumption will go up by 0.8% in real terms, also as a result of the fiscal stimulus packages. By contrast, investment is forecast to drop markedly, and the external sector is also expected to make a negative contribution to growth.

3 February 2009
The Governing Council of the ECB and the Federal Reserve decide to continue US dollar swap transactions until at least 30 October 2009.

12 February 2009
The Federal Reform Commission II agrees, *inter alia*, on a new regulation on constitutional borrowing limits for central and state government. Central government's structural new borrowing is to be limited to 0.35% of GDP from 2016, and state governments are to be prohibited from borrowing at all from 2020 onwards. Exceptions (with a redemption plan) can be made in the case of particularly severe economic crises or, for example, natural disasters. Subject to conditions, it is planned that the federal states of Bremen and Saarland, which face particular budgetary problems, as well as Berlin, Saxony-Anhalt and Schleswig-Holstein, will receive financial assistance from

Chronology of economic and monetary policy measures

(cont'd)

2011 to 2019 amounting to €800 million per year from central and state government. A Stability Council is to monitor observance of the rules.

20 February 2009
The supplementary Federal budget for 2009 and the Act Safeguarding Employment and Stability in Germany (*Gesetz zur Sicherung von Beschäftigung und Stabilität in Deutschland*) are passed by the Bundesrat. Expansive fiscal policy measures, with funding of around €50 billion, are to counter the economic slump. In addition to extensive public investment, in particular, business guarantees, research and development promotion and a car scrappage premium are provided for. Furthermore, income tax rates are lowered with retroactive effect from 1 January 2009 and also from 2010 onwards by increasing the basic tax allowance, lowering the bottom tax rate and readjusting the tax scale. The contribution rate to the health insurance fund is cut from 15.5% to 14.9% with effect from 1 July 2009 and the plan to put the contribution rate to the Federal Employment Agency back up from 2.8% to 3.0% is postponed from mid-2010 to the beginning of 2011. Up to the end of 2010, half of the employer's share of social contributions for recipients of short-time working benefits is to be refunded; if the firm provides retraining, the employer's share is to be refunded in full. There is a one-off increase of €100 in child benefit and the mean rate of basic allowance for children from households in need is increased until the end of 2011.

5 March 2009
At its regular monetary policy meeting, the Governing Council of the ECB decides to lower the interest rate on the main refinancing operations of the Eurosystem by 50 basis points to 1.5%. At the same time, the Governing Council lowers the interest rates on the marginal lending facility and the deposit facility by the same amount to 2.5% and 0.5% respectively.

10 March 2009
The Bundesbank presents its annual accounts for 2008. The profit of €6,261 million is transferred in full to central government.

31 March 2009
Deficit and debt levels are reported to the European Commission under the European budgetary surveillance procedure. The Federal Government announces a planned deficit ratio of 2.9% and a debt ratio of 69.7% for 2009. With a deficit ratio of 0.1%, a close-to-

balance budgetary position is posted for 2008. Nevertheless, as a result of financial market stabilisation measures, the debt ratio has increased by 0.8 percentage point on 2007 to 65.9%.

2 April 2009
At its regular monetary policy meeting, the Governing Council of the ECB decides to lower the interest rate on the main refinancing operations of the Eurosystem by 25 basis points to 1.25%. The interest rates on the marginal lending facility and the deposit facility are likewise reduced by 0.25 percentage point to 2.25% and 0.25% respectively.

3 April 2009
The Bundesrat approves the Act on Reinstating the Status Quo of 2006 Regarding the Standard Travel Allowance for Commuters (*Gesetz zur Fortführung der Gesetzeslage 2006 bei der Entfernungspauschale*). This legal ruling has been applicable again since the Federal Constitutional Court's ruling of 9 December 2008 stipulating that the restrictions on the standard travel allowance for commuters that were introduced in 2007 are unconstitutional.

7 May 2009
At its regular monetary policy meeting, the Governing Council of the ECB decides to lower the interest rate on the main refinancing operations of the Eurosytem by 25 basis points to 1%. At the same time, the interest rate on the marginal lending facility is reduced by 50 basis points to 1.75%. To maintain the symmetry of the interest rate corridor around the main refinancing rate, the Governing Council leaves the interest rate on the deposit facility unchanged at 0.25%.

The Governing Council furthermore decides to launch a purchase programme for euro-denominated covered bonds. Moreover, it accepts the European Investment Bank as an eligible counterparty in the Eurosystem's monetary policy operations.

27 May 2009
The Federal Cabinet approves the draft of a second supplementary Federal budget for 2009. This takes into account the results of the May tax estimate (-€8 billion) and budgets for additional expenditure on a loan to the health insurance fund (€4 billion) as well as in connection with long-term unemployment (€1½ billion). The fact that the Bundesbank's profit distribution can, on a one-off basis, be used in full to finance the budget, as none of the debts of the Redemption Fund for Inherited Liabilities are due to be repaid, eases the strain on the budget. Net borrowing increases on balance from €37 billion to €47½ billion with investment expenditure amounting to €33 billion.

28 May 2009
The Bundestag approves a €3½ billion increase in the budget for the car scrappage scheme to €5 billion.

29 May 2009
A regulation is passed extending the maximum period of entitlement to short-time working benefits from 18 to 24 months until the end of 2009.

4 June 2009
The Governing Council of the ECB announces the technical modalities of a purchase programme for euro-denominated covered bonds, which it had agreed on 7 May. Accordingly, between July 2009 and June 2010, the ECB and the national central banks in the Eurosystem will purchase such bonds up to a total volume of €60 billion.

10 June 2009
The ECB and the Swedish Central Bank decide to activate the swap line in the amount of €10 billion which

Chronology of economic and monetary policy measures

(cont'd)

they agreed on 20 December 2007.

12 June 2009
After the Bundestag has given its consent, the Bundesrat also approves the constitutional amendment with the required two-thirds majority. In particular, this amendment revises the borrowing limit for central and state government, as agreed by the Federal Reform Commission II.

23 June 2009
The Eurosystem and the Committee of European Securities Regulators (CESR) publish recommendations for securities settlement systems and central counterparties in the European Union.

24 June 2009
The Federal Government approves a draft Federal budget for 2010. Compared with the draft of the second supplementary Federal budget for 2009, expenditure is to rise by just over 8%, primarily owing to a loan of €20 billion to the Federal Employment Agency to bridge its expected deficit. Furthermore, tax revenue in particular is expected to decline by €11½ billion. Net borrowing is estimated to amount to €86 billion with investment expenditure totalling €48 ½ billion. The medium-term financial plan up to 2013 envisages a reduction in net borrowing to €46 billion. The structural deficit for 2010, which, according to the new debt rule is to be reduced in equal annual steps between 2011 and 2016 to a maximum of 0.35% of GDP, is estimated at 1.6% of GDP (€39 ½ billion). Specific measures to achieve the prescribed reduction in the structural deficit by 2013 are not yet set out in the financial plan, which instead factors in global savings that are gradually creeping up to a total of €20 billion.

25 June 2009
The Governing Council of the ECB extends its existing swap line with the Federal Reserve to 1 February 2010. At the same time, it decides to continue conducting US dollar refinancing transactions with terms of 7 and 84 days until at least 30 September 2009. By contrast, the 28-day US dollar operations will be discontinued after 28 July 2009.

Furthermore, the Governing Council decides to continue conducting one-week Swiss franc swaps with the Swiss National Bank until at least 31 October 2009.

1 July 2009
The uniform contribution rate to the health insurance

fund is reduced from 15.5% to 14.9% for fiscal stimulus reasons. The resulting revenue shortfalls of just over €3 billion in the second half of 2009 and almost €6½ billion in 2010 are to be offset by higher grants from central government.

3 July 2009
The Bundestag approves the second supplementary Federal budget for 2009. Planned net borrowing increases vis-à-vis the draft budget by a further €1½ billion to €49 billion, mainly as a result of further tax cuts.

8 July 2009
The Financial Planning Council expects a Maastricht deficit ratio of 4% for 2009 and a further rise to 6% in 2010. In order to adhere to the new national borrowing limit, as well as to the requirements of the Stability and Growth Pact, there is no alternative to strict budgetary consolidation on both the revenue and expenditure side from 2011 onwards. The assessment of debt development, which has changed significantly vis-à-vis the spring notification, is also reported to the European Commission.

10 July 2009
The Financial Market Stabilisation Development Act (*Gesetz zur Fortentwicklung der Finanzmarktstabilisierung*) is passed by the Bundesrat. It aims, in particular, to support banks' profitability and free up regulatory capital. The Act envisages three "bad bank" models. Under the "special purpose vehicle" (SPV) model, credit institutions can transfer structured securities with severe impairment risk to SPVs. The "consolidation" model also enables further risk positions and business lines that in future will no longer be necessary from a strategic point of view to be hived off to resolution agencies, which can be set up either at central government level under the aegis of the Financial Market Stabilisation Agency (FMSA) (resolution agencies under German federal law) or at state level (resolution agencies under state law). Potential losses of bad banks are assumed either by owners of the parent bank foregoing dividends distributable to them or by a direct loss transfer as a result of these shareholders participating in the share capital of the bad bank. The government's liability is thus significantly limited, as long as the government itself is not the owner and has to compensate for the losses.

By virtue of the Third Act Amending the Fourth Book of the Social Security Code, Setting Up a Pension Compensation Fund and Amending other Acts (*Drittes Gesetz zur Änderung des Vierten Buches Sozialgesetzbuch, zur Errichtung einer Versorgungsausgleichskasse und zur Änderung anderer Gesetze*), the extended pension guarantee is passed by the Bundesrat. Thus, in future, pension cuts will be ruled out even if *per capita* wages fell during the previous year. This Act furthermore rules that the employer's share of social contributions for recipients of short-time working benefits is generally to be refunded in full from the seventh month of short-time working, regardless of whether the employee concerned receives further training.

The Bundesrat approves the Act Providing Tax Relief for Health Insurance Contributions (*Bürgerentlastungsgesetz Krankenversicherung*). From 2010 onwards, an income tax allowance for contributions to health and long-term care insurance schemes will be granted up to an amount that provides for the minimum level of benefits stipulated in the legislation on social assistance. Parliament is thus responding to a ruling of the Federal Constitutional Court of 13 February 2008 stipulating that the existing legal arrangements are unconstitutional. Moreover, the Act contains further tax relief measures for enterprises to support the eco-

Chronology of economic and monetary policy measures

(cont'd)

nomy (higher ceiling for transferring VAT only after actual receipt, temporary liberalisation regarding purchases of shell companies and the interest payment offset limit).

16 July 2009
The Eurosystem and 27 European central securities depositories sign a Memorandum of Understanding in which the parties involved show their commitment to continuing the TARGET2-Securities (T2S) project. T2S is planned to be implemented in June 2013.

20 August 2009
The Bundesbank expands its data provision service and makes a comprehensive real-time database for the German economy available on its website.

28 August 2009
The Bundesbank publishes the results of its first special survey among selected banks and banking associations on lending in Germany.

As a result of the G20 backing an increase in IMF resources, the Bundesbank signs a bilateral loan agreement with the IMF in the amount of €15 billion.

24 September 2009
The Governing Council of the ECB decides to continue conducting one-week Swiss franc swaps with the Swiss National Bank until at least 31 January 2010. Furthermore, the Governing Council decides to also offer one-week US dollar operations until January 2010. By contrast, the 84-day operations will be discontinued after 6 October 2009.

30 September 2009
Under the European budgetary surveillance procedure, the Federal Government reports a deficit ratio of 3.7% and a debt ratio of 74.2% to the European Commission for 2009. Owing to methodological revisions, surpluses have now been posted for 2007 and 2008 (+0.2% and +0.0% of GDP). This is due to the implementation of the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support the financial markets, whereby various measures to support distressed banks are now no longer to be recorded as increasing the deficit.

24 October 2009
Following the German general election on 27 September, the coalition partners CDU/CSU and FDP present their coalition agreement. This contains firm commitments to the Stability and Growth Pact and the new national borrowing limit, as well as a general proviso that all

measures are subject to financing. Despite the already high deficit, the agreement notably envisages income tax cuts of €24 billion for 2010 and 2011. However, measures to meet the exceptionally high consolidation requirement are not clearly defined.

2 November 2009
With immediate effect, the Bundesbank offers banks and public administrations a new service for the settlement of SEPA (Single Euro Payments Area) direct debits. This brings the full realisation of the single European market for cashless payments a step closer.

9 November 2009
The new Federal Cabinet adopts the draft Act to Accelerate Growth (*Wachstumsbeschleunigungsgesetz*), which contains tax relief measures totalling €8½ billion. The child benefit and child tax allowance are raised again. The draft Act also contains tax relief measures for enterprises, preferential turnover tax treatment for the hotel trade and inheritance tax relief.

13 November 2009
The German Council of Economic Experts issues its Annual Report. It forecasts a moderate upturn in real GDP of 1.6% for 2010. This growth is expected to be supported primarily by net exports. The report states that exports will rise sharply, also owing to the temporary, particularly severe slump at the start of 2009, whereas imports will lag behind somewhat. Government construction investment is also forecast to increase. By contrast, in light of substantial macroeconomic underutilisation, industrial construction investment is expected to decline. Investment in machinery and equipment is forecast to increase only moderately. The report states that private consumption will fall slightly as a result of increasing unemployment. Official unemployment is expected to rise by 1.2 percentage points to 9.4%.

20 November 2009
The Governing Council of the ECB decides to amend the rating requirements for asset-backed securities (ABS) eligible for use as collateral in monetary policy operations. Consequently, for securities issued as of 1 March 2010, only those ABS that can provide at least two ratings from recognised external credit assessment institutions and whose poorer credit rating at least fulfils the requirements that the Governing Council of the ECB decided on for such securities on 20 January 2009 can still be submitted as collateral.

25 November 2009
The Bundesbank publishes its *Financial Stability Review* for 2009. It confirms a palpable stabilisation of the German financial system, but warns against regarding the financial crisis as already having been overcome.

The Federal Cabinet decides to pass a regulation extending the maximum period of entitlement to short-time working benefits from 6 months, as the legislation had generally envisaged, to 18 months in 2010.

2 December 2009
The Ecofin Council adjudges Germany to have an excessive deficit for 2009. The reference value of 3% of GDP must be complied with again by 2013. The structural deficit is to be reduced by an average of at least 0.5% of GDP per year starting in 2011. A total of 13 euro-area countries are currently subject to an excessive deficit procedure.

16 December 2009
The Federal Cabinet approves the revised draft Federal budget for 2010. Compared with the previous government's draft of 24 June, the revised draft makes provisions for additional budgetary burdens, particularly owing to planned further tax cuts of €4 billion, a one-off

Chronology of economic and monetary policy measures

(cont'd)

grant to the health insurance fund of €4 billion to offset crisis-induced contribution shortfalls, and additional expenditure of €1 billion for education and research as well as agricultural subsidies. Against the backdrop of the more favourable estimate of the macroeconomic environment and lower lending rates, payments to offset the Federal Employment Agency's deficit, which, on a one-off basis, are included in the budget as a grant rather than a loan, as well as spending on debt servicing and benefits for the long-term unemployed, are set at a significantly lower level. At just under €86 billion, net borrowing is only slightly lower than envisaged in the draft budget from mid-2009. A downward revision of the estimate for the cyclical component and the conversion of the loan to the Federal Employment Agency into a grant mean that the structural deficit is forecast to be €29 billion higher at €68 ½ billion. Unlike when the previous new government took office in 2005, no new medium-term financial plan is presented with the revised draft Federal budget.

18 December 2009
The Bundesrat approves the Act to Accelerate Growth (*Wachstumsbeschleunigungsgesetz*).

1 January 2010
The basic income tax allowance is raised from €7,834 to €8,004 and the other income tax thresholds are increased by €330. The tax deductibility of contributions to health and long-term care insurance schemes is extended and now granted up to an amount that provides for the minimum level of benefits stipulated in the legislation on social assistance. Monthly child benefit increases by €20 per child to €184 for the first two children, to €190 for the third child and to €215 for subsequent children. Child tax allowances are raised by €984 to €7,008 in total. Adjustments to the counterfinancing measures from the 2008 business tax reform provide relief for enterprises. The hotel trade is now subject to turnover tax at the reduced rate. Changes to inheritance tax, providing tax relief for transferring a family-owned business and reduced rates for close family members, enter into force. The benefit rates of the public long-term care insurance scheme are raised by around 2% on average.

14 January 2010
According to the provisional figures, the 2009 Federal budget records a deficit of €34 ½ billion. Higher-than-expected tax revenue and lower expenditure, particularly on the

loan to the health insurance fund, which was not required, and on interest payments, enabled the planned deficit to be undershot by €15 billion.

27 January 2010
In its Annual Economic Report, the Federal Government expects a 1.4% increase in real GDP in 2010 – 0.1 percentage point less after calendar adjustment – with the pace of growth assumed to increase during the course of the year. The number of employed persons is forecast to fall by 1.0%. Nevertheless, the Federal Government expects disposable income to increase owing not least to income tax relief and additional government measures. The report states that private consumption will still fall by 0.5% as many purchases of new cars were brought forward to 2009. Investment in machinery and equipment is forecast to rise substantially and an increase in housing construction is also expected. Gross fixed capital formation is forecast to go up by a total of 2.1%. Overall domestic demand is expected to account for around half of the expected growth and net exports for the other half. As a result of a pick-up in the global economy, exports are forecast to rise at a considerably stronger pace (+5.1%) than imports (+3.4%).

9 February 2010
Under the European budgetary surveillance procedure, the Federal Cabinet presents an updated stability programme for Germany. The programme is based on a 1.4% increase in real GDP in 2010 and an annual increase of 2% for the years thereafter up to 2013. The deficit ratio is expected to increase to 5½% in 2010, in particular due to a further expansion in discretionary budgetary burdens. From 2011, the structural deficit is to be reduced by an average of at least 0.5% of GDP per year and the 3% ceiling is to be observed again from 2013, thereby complying with the provisions of the excessive deficit procedure. However, no concrete measures to achieve the planned deficit reduction are specified.

The Federal Constitutional Court issues a ruling on benefits for the long-term unemployed. This states that the benefit rates for unemployment benefit II and for the allowance for dependants are not sufficiently substantiated. The annual adjustment of the standard rates in line with pensions is also rejected. However, the level of the benefits is not considered to clearly contravene basic human rights. Atypical special needs must be taken into account to a greater extent with immediate effect. Parliament has until the end of 2010 to introduce new legislation.

24 February 2010
The Federal Statistical Office reports a general government deficit ratio (pursuant to the Maastricht criteria) of 3.3% for 2009, thus exceeding the European reference value.

9 March 2010
The Bundesbank's profit distribution to central government amounts to €4,147 million.

Financial and monetary system

In the past year, events in the international financial and monetary system continued to be characterised by the most severe financial and economic crisis seen in decades. Considerable government support measures were necessary to avert a looming collapse. Although the financial sector has recovered visibly in the meantime, the markets have not yet regained their full functional capability. Concurrently, work on restructuring the regulatory environment for the international financial system was continued and prioritised. The aim is to strengthen the resilience both of individual institutions and of the system as a whole. The International Monetary Fund (IMF) has intensified its surveillance activities and is now placing a greater focus on the financial sector. The decision to massively increase the IMF's financial resources in the wake of the crisis is not without risk. In particular, an expansion of the Fund's financing mandate to embrace direct budgetary assistance or the assumption of a global insurance and guarantee function might potentially encourage members to abrogate individual responsibility and give rise to moral hazard that could jeopardise stability. The IMF would be better advised to develop its own exit strategy for unwinding its crisis-related special measures, in line with national governments which have launched the necessary process of withdrawing their support measures.

The German financial system was successfully stabilised in the past year. The operating income of the German banking system has improved significantly. Credit institutions should now use available financial scope primarily for risk provisioning and continue to increase their capital cushion, as an insufficient capital base might constrain their ability to supply credit and thus constrict the process of economic recovery.

I International financial and monetary system – international cooperation

1 International financial system

Financial system stabilised by extraordinary public sector measures

The situation in the international financial system has calmed perceptibly since early 2009 following successful efforts by governments and central banks to avert a looming collapse by taking an array of measures that were historically unprecedented in nature and size.[1] The government aid packages assembled in many countries included guarantees for bank deposits and bank debt securities, capital injections and also the option of offloading problem assets from balance sheets into so-called "bad banks". Some central banks supplemented the extensive provision of liquidity in the money markets with quantitative easing measures in the form of asset purchase programmes, such as for covered bonds in the euro area and, to a much greater extent, Treasury bonds and mortgage-backed securities in the United States. The financial system also benefited from indirect support through fiscal stimulus measures and automatic stabilisers. While there was no alternative to government intervention, the momentum triggered by these measures will create worryingly high government debt levels and thus enormous burdens on public finances. This will necessitate considerable fiscal consolidation in the medium term, and for some countries in the short term. Stabilisation will require substantial primary budget surpluses, ie surpluses of government revenue over expenditure excluding interest charges. The enormousness of the challenge is already being reflected in sharply rising bond spreads and credit default spreads in a number of countries with especially serious problems in their public finances.

Value of many assets increased sharply

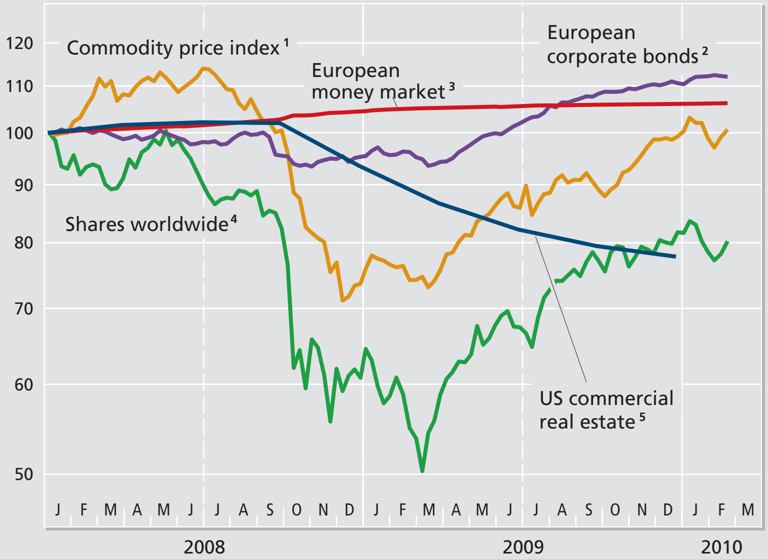
The global financial market recovery that began in the early part of 2009 was initially driven mainly by the gradual reversal of the earlier extreme liquidity hoarding and by market participants' decreased risk aversion. The preceding, and in some cases dramatic, reduction in trading positions leveraged with debt or derivatives levelled off. Market concerns about counterparty risk gradually subsided following the guarantee issued by the G7 in October 2008 that it would not let any systemically relevant institution fail and the largely positive quarterly results posted by major intermediaries. Trading activities, which in some markets had ground to a virtual halt, were resumed. The rebound in the

1 For a more detailed account see Deutsche Bundesbank, Financial Stability Review 2009, p 19 ff.

Selected international assets

Chart 18

Beginning of 2008 = 100, end-of-week levels, log scale



Sources: Bloomberg, Thomson Reuters and Bundesbank calculations. — **1** Commodity Research Bureau and Reuters. — **2** Barclays Capital Euro Corporate Index. — **3** Barclays Capital Euro Treasury 0–12 Months Index. — **4** Morgan Stanley Capital International (MSCI). — **5** National Council of Real Investment Fiduciaries (NCREIF), quarterly data.

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financial markets was underpinned from the third quarter by mounting signs that the real economy was recovering. Many market segments saw sharp value rises, including for equities, corporate bonds and commodity-related instruments. This was due not only to a brightened outlook for the real sector but also to a greater risk appetite among market participants. By contrast, the downward adjustment of real estate prices, especially relating to commercial real estate, persisted in several industrial countries.

Environment for financial institutions still extremely difficult

Notwithstanding the recovery in the international financial markets, many financial institutions still face an extremely difficult operating environment. The economic downswing bears a downstream danger of rating downgrades or even insolvencies among firms and households. Similarly, increased default risk is inherent, in particular, in the considerable need for rolling over financing in the commercial real estate markets and in the highly leveraged companies segment. Financial sector enterprises therefore face the prospect of an ongoing need for substantial write-downs on their loan portfolios, which will force them to bolster their risk-bearing capacity.[1] In addition, many financial institutions need to re-

1 According to Bloomberg, international banks have written down a total of more than US$1,200 billion since 2007.

view their business models. In the medium term, capital and liquidity requirements will inevitably be tightened permanently by tougher regulatory requirements. But the markets, too, are demanding an increased ability to absorb risks. This could mean that institutions' refinancing costs will tend to increase. Moreover, the securitisation market has so far regained little of the confidence its participants had lost in it. It is largely being sustained by the public sector, especially by central banks' quantitative and collateral easing. A new, self-sustaining market has yet to emerge. Transparent structures and partial risk retention by the originator – at European level a retention rate of 5% is envisaged – are, in principle, more likely to be conducive to restoring confidence than direct government assistance for the securitisation market.

Exit from public support measures in financial sector has begun

The necessary adjustments in the financial sector are currently taking place against the background of exceptionally large government intervention measures. Now that systemic risk has receded, some countries have begun to engineer an exit from the exceptional measures, which from the outset were conceived as being temporary. A number of temporary measures are, moreover, automatically expiring as scheduled. A gradual exit tailored to the progress of the recovery process is indispensable since otherwise questionable incentive structures would remain in place and market participants might once again be tempted to offload risks onto the public sector. Implementation of the national exit strategies requires both transparency and international cooperation in order to lessen the danger of market disruptions and competitive distortions.

Reform of international financial system continued and prioritised

The historic magnitude of the financial crisis and the global economic crisis that it caused have led to the recognition that the regulatory framework for the financial system is in need of comprehensive reform. There is a basic international consensus for the need to minimise the likelihood of an acute systemic crisis, such as that triggered by the collapse of the US investment bank Lehman Brothers, from recurring. Work on reforming the regulatory framework for the financial system based on the G20 proposals was continued and prioritised in the past year in the competent forums – especially the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (see page 88 ff). The fact that parallel efforts are being undertaken at European level will ensure that rapid progress is made. The aim of this close international cooperation is to maintain systemic stability by setting effective global rules. A key requirement for achieving this is a level playing field.

2 International monetary system and IMF issues

Discussion on reforming the international monetary system re-energised

Following the global financial crisis, the International Monetary Fund (IMF) has intensified its economic policy advice activities, also known as surveillance. The reform of national financial systems and the challenges associated with exiting from governmental support and stimulus measures are currently coming increasingly to the fore. The risks resulting from growing government debt levels have also revived the debate on a possible reform of the international monetary system. This debate will continue in 2010.

Further strengthening of IMF surveillance

In the past year, the IMF's scope of surveillance was strengthened further. In future, the IMF will examine in greater detail the macroprudential aspects of the financial sector, the interaction between the financial sector and the real economy as well as cross-border effects and will take these issues into account in the regular evaluations of its members, the Article IV consultations. Moreover, the Financial Sector Assessment Program (FSAP), conducted jointly by the IMF and the World Bank, is to be revamped to make it more flexible and targeted. Furthermore, the IMF, in cooperation with the FSB, will continuously analyse systemic or macrofinancial risks in Early Warning Exercises.

Review of the surveillance mandate

The IMF's surveillance of financial markets can be expanded within the current mandate while also taking account of the desired division of tasks among international institutions. Nonetheless, the severity of the financial crisis has ignited a debate on extending the IMF's mandate specifically to include responsibility for international capital movements and global financial stability.

Expansion of lending mandate problematic

Several more far-reaching proposals to reform the IMF's mandate would amount to a fundamental change in IMF lending policy. Under these proposals, the IMF would not only provide temporary financial support for balance of payments needs – the Fund's *raison d'être* as a monetary institution – but would also be able to use central bank funds to directly finance government budget deficits. That would constitute monetary financing of fiscal tasks, which is prohibited in the EU for stability reasons. Another option under discussion, namely transferring to the IMF the function of a global insurer or guarantor for its members' financial and economic risks or those of their financial institutions, would have major adverse implications for the incentive and liability structures of borrowers and investors. At the same time, the risks to the Fund's financial integrity, to its underlying reserves-based financing and thus ultimately to its shareholders would increase.

Credit commitments up significantly and lending policy reformed

In the wake of the financial crisis, the volume of IMF credit outstanding increased strongly from its end-2007 all-time low of around 6 billion Special Drawing Rights (SDR) (approximately US$9 billion) to its current level of around SDR 37 billion (approximately US$58 billion), yet it remains well below its all-time high of SDR 69 billion (approximately US$109 billion) of June 2003. By contrast, the IMF's credit commitments since the escalation of the crisis total SDR 108 billion (approximately US$170 billion), of which SDR 31 billion (approximately US$49 billion) have been disbursed. Under the Flexible Credit Line (FCL) alone, the IMF has approved a total of SDR 52 billion worth of funds to Mexico, Poland and Colombia. The FCL was introduced in March 2009 in connection with a comprehensive reform of IMF lending policy. This facility is designed for countries with sound fundamentals and strong economic policies, and enables IMF resources to be made available even in the absence of an acute balance of payments need and without conditionality. There is no explicit cap on FCL credit lines. Moreover, the regular access limits for standard lending were doubled from 300% to 600% of quota, the structural performance criteria were abolished and the criteria for exceptional access were strongly relaxed.

Extraordinary crisis-related increase in resources

In view of the severity of the financial crisis, the G20, at their meeting in London in April 2009, announced a tripling of IMF lending resources to over US$750 billion. Along with other IMF member countries with strong reserve positions, they agreed to immediately give temporary bilateral credit lines of around US$250 billion to the IMF. The Bundesbank and the IMF signed a bilateral borrowing agreement to provide the Fund with €15 billion (approximately US$21.6 billion); the agreement is for two years and can be extended to up to four years. The additional bilateral credit lines are to be incorporated into the expanded New Arrangements to Borrow (NAB). The idea is to make the modalities of this multilateral credit line to the IMF – a facility which has been in existence since 1998 – much more flexible. The medium-term plan is to expand the NAB further to around US$600 billion, more than ten times larger than its current volume. Around US$35 billion (approximately €24 billion) of this figure would be attributable to the Bundesbank. From the Bundesbank's point of view, it is essential that these funds maintain the character of a pure emergency reserve fund to be tapped in cases where the IMF's regular quota resources are insufficient to surmount a crisis in the international monetary system.

SDR holdings up tenfold

In order to replenish their reserves in line with their respective quotas, all IMF member countries received an SDR allocation worth a total of around US$280 billion, a tenfold increase in pre-crisis holdings. This was an extreme measure which, in principle, should remain temporary in order to limit any associated stability risks. In line with the IMF Articles of Agreement, once the financial crisis has subsided, the Fund should review whether the allocated SDR can be cancelled in full or in part. At the very least, an obligation to constantly hold a given volume of SDR reserves (reconstitution requirement) should be reintroduced. The use of SDR to finance development policy projects would be problematic because that is a fiscal task and not a monetary one.

IMF should develop strategy for exiting from crisis-related measures

All of these exceptional measures have to be viewed against the backdrop of the extraordinary crisis situation. To that extent, the IMF is called upon to follow the lead of national governments and to develop its own strategy for exiting from its crisis-related policies and associated financing. In addition, despite the increase in credit commitments and disbursements, the IMF has ample liquidity at its disposal. According to IMF information, even if NAB funds are excluded and considerable prudential balances are taken into account, around SDR 150 billion (approximately US$237 billion) are still available as one-year forward commitment capacity.

Strengthening the IMF as a quota-based institution

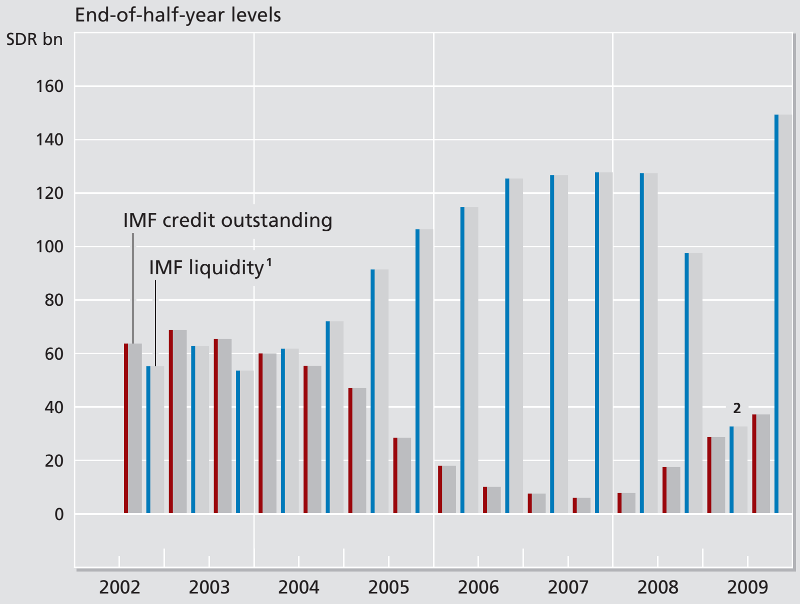
The enormous extension of the credit lines of financially strong member countries to the IMF has also effectively undermined the central role of quotas in distributing voting rights, setting the level of payment obligations and regulating the extent to which individual member countries can access IMF financial support. An appropriate balance needs to be struck between regular quota-based financing and temporary credit-based financing. In order to restore this balance, the quotas should be adapted to the IMF's long-term liquidity requirements, while additionally available lending resources should be reduced and held only as a backstop.

Representation in the IMF must be commensurate with financial obligations

The necessary strengthening of the IMF as a quota-based institution is important primarily for the Fund's legitimacy. The aim of the April 2008 quota reform was, therefore, to better align quotas and voting rights to the members' changed weight in the world economy. This benefited, above all, the fast-growing emerging market economies. Owing to persistent imbalances, the G20 have affirmed the goal of a further increase in quota shares for underrepresented countries, scheduled for agreement by January 2011. It should be noted in this context that Germany and the EU countries as a whole are currently represented in the IMF in line with their weight in the world economy. Calls for a distinct reduction in the EU countries' voting rights and representation in the IMF Executive Board in favour of developing countries and emerging market economies – which al-

IMF credit outstanding and IMF liquidity since 2002

Chart 19



1 One-year forward commitment capacity (FCC); liquidity is decreased by (undisbursed) credit commitments. — **2** Decline owing to new arrangements under the FCL with Mexico, Poland and Colombia (for a total of SDR 52 billion) which are precautionary and have not been disbursed to date.

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ready have more than half of the seats – are inconsistent with the equivalence principle of financing and representation.[1] They likewise run counter to the rule of equal treatment of all IMF member countries.

3 International cooperation

G20 established as premier forum for international economic cooperation

At their third summit held in Pittsburgh in September 2009, the G20 leaders designated the G20 the premier forum for international economic cooperation. However, in contrast to the international financial institutions, whose membership is universal, the G20 remains an informal group, whose effectiveness is based largely on its ability to reach a consensus on key issues.

"G20 Framework for Strong, Sustainable and Balanced Growth" agreed

In Pittsburgh, the G20 leaders pledged to promote strong, sustainable and balanced global economic growth. To this end, they adopted a new procedure for the joint assessment of members' economic development and policies with assistance from the IMF. This is intended to facilitate the withdrawal from the ex-

1 See Deutsche Bundesbank, Financing and representation in the IMF, Monthly Report, March 2010.

Implementation of the reform agenda for the regulatory framework of the international financial system

The reform agenda for a stability-oriented reform of the regulatory framework of the global financial system, which was mandated by the G20 summits in Washington, London and Pittsburgh, is currently being fleshed out and progressively finalised by the competent national and international agencies and bodies in a spirit of constructive cooperation. Last year, considerable progress and substantial results were achieved in working on these reforms. The FSB is monitoring progress in implementation and reports to the G20 at the level of the finance ministers and central bank governors and will do so directly to the G20 summits that will be held regularly in future; hence, pressure for reform is and will remain strong.[1]

The G20 are focusing on strengthening the resilience of both individual credit institutions and the financial system as a whole. With regard to banking regulation, the G20 countries have committed themselves to introducing the Basel II international capital framework by 2011. Furthermore, the capital and liquidity requirements are being enhanced in the parameters of quantity and quality. A concrete proposal by the Basel Committee on Banking Supervision, designed to dampen the procyclicality of the financial system, is currently the subject of a public consultation procedure.[2] In order to mitigate the special systemic risks emanating from large or highly interconnected financial institutions, ("too big to fail" problem), the FSB, in cooperation with its member institutions, is drawing up a solution strategy, which is to be completed by the autumn. This will recommend to national legislators and authorities a catalogue of suitable instruments which focus both directly on these institutions and on the ability of the system as a whole to better absorb the collapse of a systemically relevant institution. The exchange of information between public agencies has already been institutionalised through the establishment of supervisory colleges for about 30 of the largest internationally active financial institutions; principles for internationally compatible resolution procedures in insolvency cases are shortly to be adopted following a public consultation procedure. Requirements with respect to individual contingency provisions are currently being specified by institutions and supervisors.

Moreover, a start has been made on adjusting incentive structures in a manner that is compatible with stability. For instance, the FSB Principles for Sound Compensation Practices aim to eliminate misguided incentives to take excessive risks at financial institutions and envisage for this purpose, among other things, the linking of variable compensation components to performance criteria and a deferral of payments over an extended period; guaranteed bonuses are ruled out.[3] The application of the FSB Principles already forms part of supervisory examinations. The FSB will present the findings of its study on the practical implementation of these principles in its member states and by financial institutions at the end of March 2010.

With regard to enhancing the resilience of the financial system as a whole, the development of additional macroprudential supervisory instruments is of key importance, but requires further analysis and ongoing discussion. By contrast, the trading and settlement infrastructure has already been strengthened by the establishment of central counterparties (CCPs) for standardised over-the-counter (OTC) derivatives. Furthermore, most of the trading in these instruments is to be transferred to regulated markets such as stock exchanges or other electronic trading platforms by the end of 2012. Central databases for all OTC derivatives are being set up.

Under the aegis of the International Organization of Securities Commissions (IOSCO), the competent agencies have reached agreement on guidelines for the supervision of credit rating agencies. The aim is to create an internationally consistent regulatory framework and oversight regime for all rating agencies whose ratings are used for regulatory purposes. The IOSCO Code of Conduct for Credit Rating Agencies serves as the common basis for this. General principles designed to ensure internationally consistent regulatory requirements have been developed for the supervision of hedge funds. After a number of obvious shortcomings in the accounting rules had already been eliminated, the accounting standard-setting bodies, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), are now working on further improving and harmonising their hitherto sometimes widely diverging accounting rules by mid-2011.

Above and beyond these concrete activities and projects, the G20 have forged ahead with the implementation of international standards and have declared their intention to take resolute action against non-cooperative jurisdictions. Pressure on countries evading the application of international supervisory and information standards has been increased. The FSB is in the process of identifying these countries and inducing them to cooperate.

1 See: Overview of Progress in Implementing the London Summit Recommendations for Strengthening Financial Stability at http://www.financialstabilityboard.org/publications/r_090925a.pdf. — **2** See Refinement of international prudential supervisory standards on p 96 ff. — **3** See FSB Principles for Sound Compensation Practices – Implementation Standards at http://www.financial-stabilityboard.org/publications/r_090925c.pdf.

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ceptional measures introduced to overcome the international financial crisis and support the transition to a process of sound global economic growth. An intensified international exchange of opinions and cooperation in economic policy is to be welcomed, not least in the current environment. Care must be taken in the assessment procedure to ensure that due account is taken of the structural differences between the economies. The extent to which the procedure can meet its ambitious goals ultimately hinges on the political will of all parties concerned.

Progress in reforming the international financial system under the aegis of the G20

The past year saw progress in reforming the regulatory and supervisory framework for the global financial system. At their second summit in London in April 2009, the G20 leaders spelled out and expanded the decisions taken at their first meeting in Washington in November 2008. These agreements are now being translated into regulatory provisions by the responsible international expert bodies according to a schedule that is, in part, very ambitious (see box on page 87). Examples include more stringent international capital adequacy and liquidity requirements for banks. In London and Pittsburgh, the G20 countries, moreover, emphasised the importance of complying with international standards and accordingly committed, for instance, to adopt the Basel II international capital framework. At the G20's request, several international bodies and institutions are currently collaborating to develop blueprints for the macroprudential supervision of the international financial system. These are centred on a systematic analysis and observation of systemic risk and address stability policy issues created by the interlinkages between institutions in a holistic approach. They deal particularly with supervisory rules for large, complex financial institutions which, owing to their systemic relevance, effectively have an implicit government guarantee – which is undesirable in terms of regulatory incentive structures.

Financial Stability Board coordinating financial sector issues at international level

The G20 entrusted the Financial Stability Board (FSB), formerly the Financial Stability Forum (FSF), with the responsibility for overseeing progress in implementing the agenda for financial sector reform. The FSB's membership was expanded at the London summit to include the G20 countries. The FSB was also given a much broader mandate, thereby making it the central international body for the coordination of financial sector issues.

II Current issues relating to the German financial system

1 Stability of the German financial system

2009 sees stabilisation

After the turning point in the wake of the insolvency of US investment bank Lehman Brothers in September 2008, which brought the international financial system to the brink of collapse, 2009 has seen a stabilisation of the economy. This development was due, to a large extent, to unprecedented measures taken by fiscal, monetary and financial market policymakers. It was also bolstered by major initiatives, both in Germany and in Europe, to sustainably improve financial stability, *inter alia* by revising supervisory structures and the regulatory framework (see the box on page 90).

State as "risk-taker of last resort"

Government intervention – in Germany, above all, an extensive provision of liquidity, guarantees for private savings deposits by central government and capital assistance from the Financial Market Stabilisation Fund (SoFFin), through which the state assumed the role of "risk-taker of last resort" – paved the way for a new start. Furthermore, German legislators amended the Financial Market Stabilisation Act *(Finanzmarktstabilisierungsgesetz)* twice in 2009 to extend the toolbox at their disposal for stabilising financial institutions (see the box on page 91).

Vicious circle broken

After direct intervention had improved the situation on the major wholesale funding markets, German banks increasingly also benefited from the recovery of the real economy as the year progressed. The outlook has brightened considerably, not least thanks to the stimulus packages which have been implemented in many countries, particularly for the heavily export-oriented German economy. This has largely mitigated the feared vicious circle of a weakened financial system and a real economic downturn.

Varying levels of adjustment pressure

In the reporting period, the adjustment pressure in response to the crisis differed for the various categories of banks. For credit cooperatives and savings banks it was comparatively low, partly because these institutions held almost no structured securities and had virtually no trading business. By contrast, institutions active on the markets were naturally unable to escape the pressure emanating from the wholesale and securitisation markets. Individual banks whose business strategy focused on those markets that ran into difficulties were hardest hit.

Reacting to the crisis: reform agenda in Europe and Germany

In their efforts to enhance financial stability, both the European Commission and German legislators have introduced measures which derive from the international financial system reform strategy.[1] An important precondition for achieving a stable single European financial market is to revise the European financial supervisory structure. In June 2009, the European Council adopted a European Commission proposal introducing the basic elements of a two-pillar supervisory structure for the European financial system, thereby endorsing recommendations made in February 2009 by a panel of experts chaired by Jacques de Larosière. To strengthen macro-prudential oversight of the financial system, these recommendations envisage the establishment of a European Systemic Risk Board (ESRB). The ESRB General Board is to comprise the President of the ECB and, if he or she is elected Chair of the ESRB, the Vice-President of the ECB, all 27 ESCB central bank governors, one representative of the European Commission and the chairs of the three new European Supervisory Authorities. The president of the EFC (Economic and Financial Committee) is also to be present, as is one representative of the national supervisory authorities per member state. These members are to have no voting rights, however. The ESRB structure also consists of a Steering Committee, an Advisory Technical Committee (ATC) and a Secretariat, whose function will be performed by the ECB. The ESRB's remit includes the timely identification of potential systemic risks, the issuing of risk warnings and the proposal of specific recommendations in order to counteract these risks effectively. For micro-prudential supervision a European System of Financial Supervisors (ESFS) is also to be established.[2] The European Commission presented four draft regulations and one draft decision regarding the supervisory structure on 23 September 2009, as well as one draft directive on 26 October 2009.

With respect to the crisis, specific regulatory amendments were undertaken especially regarding the legal framework for credit institutions.[3] These concern, for example, stricter capital requirements for the banking and the trading book, tightening the regulations on securitisations and liquidity lines, revising large exposures rules, reducing procyclicality and strengthening incentive-compatible requirements for remuneration systems. There are currently a total of three amendments to the Banking Directive at various stages of the European legislative process.

Stronger emphasis has also been placed on the financial stability objective in insurance legislation. Two important regulatory measures had been initiated even before the current financial market crisis arose. The first, the new solvency directive (Solvency II), was adopted by the Council of the European Union on 10 November 2009, while the Minimum Requirements for Risk Management in Insurance Undertakings (MaRisk (VA)) came into force in Germany at the beginning of 2009. Crisis prevention has also been further advanced in the insurance sector through the Act to Strengthen Financial Market and Insurance Supervision, enacted on 29 July 2009, introducing, for example, qualitative standards for members of supervisory boards.

Various measures have also already been taken in the securities sector. On 29 April 2009, for example, the European Commission presented a draft directive calling for a largely standardised regulation of managers of alternative investment funds (AIFM), including hedge funds and private equity funds, at a European level. The draft is currently the subject of controversial debate by the Council and the European Parliament.

Furthermore, a regulation came into force at the European level in December 2009 stipulating approval and supervision procedures for rating agencies, under which they must fulfil specific requirements with regard to transparency, conflict of interest avoidance and maintaining a high level of rating quality.

In addition, on 20 October 2009 the European Commission announced its intention to strengthen the OTC derivatives markets. By improving the financial market infrastructure, tightening regulatory banking standards regarding bilateral clearing, centralising supervisory responsibilities at the EU level and harmonising prudential legislation, market conditions in the OTC derivatives market are to be given a more stable foundation. Measures such as using organised trading venues and central counterparty clearing houses are to become the norm.

1 See box Implementation of the reform agenda for the regulatory framework of the international financial system on p 87. — **2** See Creation of the European System of Financial Supervisors on pp 99. — **3** See Banking supervision on pp 95 ff.

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Package of measures taken to stabilise the financial system

The Financial Market Stabilisation Act *(Finanzmarktstabilisierungsgesetz)* adopted in October 2008 has made an important contribution towards stabilising the German financial system. In 2009 further measures were taken with a view to achieving this goal.

Financial Market Stabilisation Amendment Act

The Financial Market Stabilisation Amendment Act *(Finanzmarktstabilisierungsergänzungsgesetz)* of April 2009 extended the maximum maturity of the liabilities guaranteed by the Financial Market Stabilisation Fund (SoFFin) from 36 to 60 months. It also contained changes to company and takeover law, *inter alia* to facilitate recapitalisation measures of SoFFin. In addition, the Act simplified and accelerated the acquisition of risk assets of or capital shares in financial institutions by SoFFin. Furthermore, the Act provided a temporary option of expropriating and nationalising financial sector enterprises until 30 June 2009.

Bad Bank Act[1]

In July 2009 the Financial Market Stabilisation Development Act *(Gesetz zur Fortentwicklung der Finanzmarktstabilisierung)*, commonly known as the "Bad Bank Act", came into force. This introduced two further instruments for removing risk assets from banks' balance sheets. The aim of both bad bank models is to free up equity capital for new lending and to reinforce banks' liquidity position through SoFFin's guarantee.

Under the special purpose vehicle model banks can transfer structured securities purchased up to the end of 2008 to special purpose vehicles set up by the bank at their real economic value or at their book value less a 10% haircut. In return the transferring institution receives bonds guaranteed by SoFFin from the special purpose vehicle. These bonds need not be backed with equity capital and – in contrast to banks' problematic assets – can be used as collateral in, for example, Eurosystem refinancing transactions. SoFFin charges a fee at market rates for its guarantee. The bank has to compensate the special purpose vehicle annually for the value impairments that have accrued on its transferred risk assets. Existing shareholders bear liability for this in the amount of distributable dividends, but subscribers to new shares in the context of capital increases are excluded from this liability. Any remaining losses at the end of the contract term will have to be offset for an indefinite period. The deadline for applying to adopt the special purpose vehicle model was 22 January 2010.

Under the consolidation model banks can hive off structured securities, other risk positions and non-strategic business lines to resolution agencies and concentrate on their core business. Such agencies can be set up under either federal or state legislation, though only the former can be established under aegis of the Financial Market Stabilisation Agency (FMSA). SoFFin can assume guarantees in the context of refinancing structured securities for resolution agencies set up under federal but not state legislation. The bank's owners are directly liable for any losses incurred by the agency. Applications are still possible until 31 December 2010; however, each case is subject to approval by the European Commission.

The (voluntary) participation in a bad bank model is subject to meeting certain conditions, particularly the requirement of a sufficient capital base. A key principle of the model is the firm assignment of direct and extensive liability to the bank's owners for the losses of the bad banks. Providers of new equity and debt capital are to be shielded from risks arising from the changes in market values of problematic assets. At the same time the share of the losses to be borne by taxpayers is to be limited by the junior status of government liability. The envisaged levy of a market-based charge for SoFFin's guarantees ensures a level playing field for institutions which opt not to make use of the new instruments. This takes due account of EU legal requirements.

Take-up of the measures

Up to 31 December 2009 the volume of signed contracts for stability support amounted to €188.7 billion[2]. €160.7 billion of this sum was accounted for by the granting of guarantees and €28.0 billion by capital injections. On balance, the volume of applications (adjusted for applications to prolong existing contracts) for stability support from SoFFin amounted to €230.9 billion. The option provided for in the Financial Market Stabilisation Amendment Act of the takeover of a financial institution by SoFFin was exercised in the case of Hypo Real Estate Holding AG (HRE) in autumn 2009. In December 2009 the FMSA established a resolution agency for WestLB. In January 2010 HRE likewise applied for a bad bank to be set up in the form of a resolution agency.

1 See also Deutsche Bundesbank, Monthly Report, May 2009, pp 54-57 — **2** The total volume of support available under the bank rescue programme amounts to €480 billion.

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Banks still face major challenges

In 2009, the large internationally active German banks responded to the challenges raised by the crisis in various ways. They have begun to consolidate their balance sheets, increase their capital and lower their leverage. This was in part achieved by scaling back interbank exposures. However, the incipient restructuring remains vulnerable to setbacks in the real economic recovery process and the associated credit defaults. The necessary exit from the stabilisation strategy must therefore be predicated on and calibrated to an ongoing improvement in the market environment and financial sector resilience. However, at the same time, extensive measures to support and stimulate the economy also harbour considerable medium and long-term risks. Prime examples are ballooning government debt in many industrialised countries and possible moral hazard issues associated with bank rescue plans. Transparent and credible strategies for unwinding the monetary and fiscal policy stimuli and the support measures in the banking sector are therefore crucial.

More write-downs necessary

Considerably more write-downs of structured securities may have to be made on credit institutions' balance sheets. However, banks have probably already put the largest wave of write-downs on securitisations behind them. In the credit book, where defaults typically occur with a cyclical lag, value adjustments will dent earnings for 2009 and 2010.

Use leeway to strengthen capital base

Credit institutions should use any available leeway first and foremost to increase risk provisions and to strengthen capital buffers. This would pave the way for a sustained upturn in which credit supply is not limited by insufficient capital cover. Where business models have proven unsustainable – in particular, exposures to structured products financed on wholesale markets – institutions must continue restructuring. This mainly relates to banks that conduct wholesale business where margins are low, volumes are high and refinancing is largely concentrated on the interbank market.

2 Profitability of German banks

Profitability supported by operating business, ...

After the financial crisis massively dented the profitability of German banks in 2008, the information currently available suggests that, overall, earnings did not strengthen sustainably in the 2009 financial year. Given the general recovery in the financial markets, operating business is likely to have improved significantly, probably driven mainly by profits in proprietary trading. Moreover, the yield curve, which has been much steeper since the final quarter of 2008, has in all likelihood had a positive effect on net interest income.

... but depressed by risk provisioning

However, while there are stabilisation tendencies on the earnings side, there is also significant credit risk, especially in light of the international economic slump. Profitability in the reporting year is thus likely to have been depressed considerably by a marked increase in risk provisioning in lending business. Despite already extraordinarily high write-downs on structured products in the 2008 financial year, market price losses which are yet to be recognised in the balance sheet could additionally have a negative impact on profitability, albeit to a much lesser extent than credit risk provisioning.

Earnings developments mixed

According to the information currently available for the 2009 financial year, earnings developments are likely to have been mixed across the various categories of banks. Thus savings banks and credit cooperatives are thought to have increased their pre-tax earnings on average in the reporting year. This was probably due to an improvement in net interest income and securities valuation results, which is likely to have enabled these institutions to cope well with increased credit risk provisioning so far. However, the available information indicates that the situation at big banks and Landesbanken falls into one of two categories; some are likely to return to profit, while others are expected to stay in the red, in particular owing to much higher credit risk provisioning.

Consolidation process continues

The consolidation process in the German banking sector with regard to the number of institutions continued in 2009. It again affected those categories of banks specialising in retail business. The largest number of closures were recorded by credit cooperatives (40) and savings banks (7) as a result of mergers, whereas the number of regional banks increased slightly by 6. The banking statistics recorded a total of 1,939 credit institutions at the end of 2009, which was 42 fewer than in 2008.

Banking supervision

The financial crisis led to further adjustments to the prudential regulatory framework at an international and national level in 2009, with the Bundesbank closely involved in consultations. At the international level, for example, the Basel Committee on Banking Supervision worked on improving the quality of regulatory capital and drawing up a quantitative liquidity standard. At the European level, the establishment of regulatory authorities for banking, insurance and securities market supervision, scheduled for 2011, constitutes a key element of future European financial market regulation and supervision. In addition, the European Commission is working on proposals to improve cross-border crisis management in the European banking sector. At the same time, cooperation in the supervision of EU cross-border banking groups through supervisory colleges has been stepped up. At a national level, the first lessons learned from the financial crisis were implemented, leading to an extension of supervisors' powers of intervention and a revision of the Minimum Requirements for Risk Management.

I Refinement of international prudential supervisory standards

(a) Capital

Work in the BCBS and at the European level

In 2009, work continued on refining the definition of regulatory capital both within the Basel Committee on Banking Supervision (BCBS) and at the European level. In response to the financial crisis, the G20 asked the BCBS to submit proposals on how to improve the quality and quantity of regulatory capital. Enhanced transparency requirements are also intended to allow market participants to better assess banks' capital adequacy. The BCBS issued its proposals for revising the definition of capital for consultation on 17 December 2009.[1] In future, supervisors will focus more strongly on core tier 1 capital which, according to a G20 resolution, may consist only of paid-in capital and open reserves in the case of joint stock companies. For non-joint stock companies, the eligibility of capital instruments for inclusion in core tier 1 capital will be laid down in a catalogue of criteria. This will take into consideration the special features of company law applicable, for instance, to credit cooperatives or savings banks. However, the minimum required ratio of core tier 1 capital to total tier 1 capital will, like the issue of appropriate transitional arrangements for the new rules, not be finalised until after the impact study on the new proposals has been conducted in the first half of 2010.

Supervisors to focus more on core tier 1 capital in future

In Europe: guidelines for recognition of hybrid capital components and for core tier 1 capital

At the European level, the Committee of European Banking Supervisors (CEBS) has developed guidelines for the recognition of hybrid capital instruments as stipulated in the directive amending the Capital Requirements Directive (CRD). In addition, a consultation paper was published detailing the criteria for recognising components of core tier 1 capital; this catalogue of criteria corresponds, in terms of content, to that issued by the BCBS.

(b) Quantitative liquidity requirements

2008 "Sound Principles" expanded

In addition to revising the qualitative standards for managing and supervising liquidity risk of 2008,[2] on 17 December 2009 the BCBS published a consultative

1 http://www.bis.org/publ/bcbs164.htm.
2 Principles for Sound Liquidity Risk Management and Supervision, http://www.bis.org/publ/bcbs144.htm.

document on a global set of monitoring metrics to prudentially measure and limit liquidity risk.[1] The new framework is intended to introduce quantitative minimum requirements at an international level for the first time. Specifically, institutions will be required to hold a minimum stock of high-quality liquid assets, calculated on the basis of a supervisory stress scenario (Liquidity Coverage Ratio or LCR). The exact definition of high-quality liquid assets will be determined once the consultation process has been concluded. The LCR will be supplemented by the Net Stable Funding Ratio that defines a minimum amount of "stable", ie longer-term, sources of funding, which is derived from the average liquidity profiles of the assets funded. The minimum standards will be rounded off with metrics with which to monitor, amongst other things, the concentration of certain funding sources and holdings of marketable or central bank-eligible assets. The liquidity rules are scheduled to be approved by the BCBS by the end of 2010 and will then be incorporated into the Banking Directive at the European level.

Minimum requirements and monitoring metrics

(c) Capital buffer

Mitigation of the procyclicality of risk-sensitive capital requirements through countercyclical capital buffers

In order to reduce the cyclicality inherent in banking business (ie more lending during an upturn, less credit during a downturn), the BCBS is examining the possibility of introducing a "countercyclical capital buffer". The capital buffer would be established at single bank level to act as a financial cushion during an economic downturn or other times of stress, thus stabilising the banking system as a whole. The objective is to prevent institutions from sharply curtailing lending (credit crunch) and to protect the banking system against systemic crises. At the same time, the buffer is intended to curb excessive lending during boom periods. The BCBS' concept will be finalised based on the results of the impact study being conducted in the first half of 2010. It is crucial to develop a buffer that adapts elastically to the cycle rather than merely establishing another capital charge on top of the existing minimum capital requirements.

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1 International framework for liquidity risk measurement, standards and monitoring, http://www.bis.org/publ/bcbs165.htm.

(d) Leverage ratio

Introduction of a leverage ratio as a non-risk-based metric

In order to prevent excessive credit growth without sufficient capital cover, the BCBS – as stipulated by the G20 leaders in Pittsburgh – has put forward proposals to introduce a leverage ratio in addition to the concept of the countercyclical capital buffer.[1] This metric is to be applied under Pillar 2 of the Basel Framework, ie the supervisory review process, although care will have to be taken to avoid competitive distortions as a result of different accounting standards and varying treatment of off-balance-sheet positions. The leverage ratio – unlike the Basel Framework – is designed to be a risk-insensitive, volume-based metric. It measures an institution's available tier 1 capital as a percentage of total balance-sheet assets (including off-balance-sheet exposures). The leverage ratio can, therefore, also be interpreted as a (modified) balance-sheet capital ratio. It has two main purposes: to limit the extent of leverage within the banking system, which includes preventing system-wide, destabilising deleveraging processes, and to safeguard against model risk, which can result from the use of model-based risk-weight functions under Basel II. The Bundesbank is currently involved in work being done at the international level on the details of the leverage ratio with a view to avoiding competitive distortions as a result of different accounting standards. However, a key part of the preparatory work will have to be carried out by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), which have been asked by the G20 to complete the convergence process for their approaches to accounting by June 2011.[2]

(e) Trading book

New rules for market risk ...

The BCBS' Trading Book Group refined the supervisory rules for market risk in the trading book in 2009. After consultation with the banking industry, the new rules were published in July 2009. Under these rules, a stressed value-at-risk capital charge will be introduced for all banks that use their own prudentially recognised risk model to determine their capital requirements for market risk in the trading book pursuant to the Solvency Regulation (*Solvabilitätsverordnung*). Furthermore, banks allowed to use internal models to measure specific risk in net interest positions must hold additional own funds to cover default and migration risk (Incremental Risk Charge or IRC). In addition, changes have been

1 See Progress Report on the Economic and Financial Actions of the London, Washington and Pittsburgh G20 Summits prepared by the UK chair of the G20, 7 November 2009, p 19 ff.
2 See Leaders' Statement: The Pittsburgh Summit, 24-25 September 2009, item 14.

made to the standardised approaches, for example, for the treatment of securitisations and resecuritisations.

... and their impact on capital requirements

According to the findings of the quantitative impact study conducted in the summer of 2009, the capital requirements for market risk will rise considerably; the new rules on stressed value-at-risk, the IRC and resecuritisations alone will raise them by a factor of around two to three. A further impact study on the rule changes for securitisations in the trading book has been under way since the end of 2009.

II European work on strengthening supervisory cooperation and crisis management

1 Creation of the European System of Financial Supervisors (ESFS)

Establishment of three European supervisory authorities: EBA, EIOPA and ESMA

On 2 December 2009, the EU finance ministers gave their general approval to a large-scale package of regulations to establish the European System of Financial Supervisors. At the heart of these measures lies the creation of three sector-based European supervisory authorities which will, in future, work together with national supervisors to improve cross-border financial supervision. This will implement a key proposal put forward on 25 February 2009 by the High Level Expert Group chaired by Jacques de Larosière on the future of European financial market regulation and supervision. The three supervisory authorities are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), which are scheduled to start work on 1 January 2011.

EBA's tasks will include developing technical standards, settling disagreements, ensuring compliance with EU law and taking action in emergency situations

In the banking sector, the EBA will not only take on CEBS' tasks (such as advising the European Commission or developing non-binding guidelines), but will also be able to issue binding decisions in various areas. These will include, *inter alia*, examining and, if necessary, correcting instances in which national supervisors fail to comply with Community legislation, powers vis-à-vis national supervisory authorities in emergency situations as well as powers to settle disagreements between national supervisors with binding effect. A safeguard clause will be introduced, which is intended to protect the member states against intervention by the European supervisory authorities that may impinge on their fiscal responsibility. In addition, the EBA has been tasked with developing "technical standards" that are to be applied directly in the member states. The European Parliament is to finish debating the proposals by mid-2010. The question of the Community law basis for issuing the package of regulations will also feature in this debate, with the division of powers outlined in the Lisbon Treaty, in particular the principle of limited conferred powers,[1] needing to be observed.

2 Crisis management

Implementation of SAF concluded in April 2009

In implementing the contents of the Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on Cross-Border Financial Stability of 1 June 2008, the Bundesbank has put into practice the recommendations relating to the common analytical framework (Systemic Assessment Framework or SAF). These recommendations state that all of the institutions involved should exchange the results of their analyses of the systemic impact of a financial crisis situation using a common analytical framework. The aim of the analytical framework is to structure communication between the central banks, supervisory authorities and finance ministries of the member states affected by a cross-border financial crisis. The Bundesbank had conducted such analyses even before the SAF was introduced.

Need to reform the regulation and supervision of financial markets

As regards the legal framework for crisis management, the European Commission believes that both an improvement in deposit insurance and a strengthening of the supervisory infrastructure are necessary. The reforms are intended to enable the authorities to stabilise ailing cross-border financial institutions and control the systemic impact of a collapse. The Commission has issued both a communication and a working document for public consultation on this matter.[2] It wants to take measures in three areas, which may overlap in some cases.

Early intervention

– Early intervention comprises measures taken by the supervisory authorities to restore the stability and financial soundness of ailing institutions and to transfer assets between solvent group entities for the purpose of financial support (avoidance of ring-fencing). The Commission believes that the EBA

1 The principle of limited conferred powers refers to the maxim that the Community is required to act only within the limits of the powers conferred upon it by the Treaty on European Union and the Treaty on the Functioning of the European Union.
2 http://ec.europa.eu/internal_market/bank/docs/crisis-management/091020_communication_en.pdf; http://www.parlament.gv.at/cgi-bin/eukp.pdf?P_EU=XXIV.pdf/EU/02/02/020271.pdf.

could help to coordinate early intervention measures within cross-border groups.

– Resolution comprises measures taken by the competent national authorities to manage crises at banks in order to contain their impact on financial stability and, where appropriate, to facilitate an orderly winding-up of the whole or parts of the institution.

Resolution

– The minimum solution proposed in the event of a bank insolvency is a co-operation framework to coordinate national measures; a more far-reaching idea under consideration is an integrated approach to the insolvency of banking groups.

Insolvency

3 Supervisory colleges

Intensified international cooperation

In 2009, progress was made in the creation of supervisory colleges, a key component of international cooperation in the supervision of EU cross-border banking groups. The colleges provide the competent national supervisory authorities with a common platform for debate and coordination; their flexible structure makes them suitable both for use in ongoing supervision and crisis prevention as well as to support decision-makers in times of crisis. Chaired by the parent institution's home supervisor (consolidating supervisor), a supervisory college generally brings together all of the host supervisors of a banking group's subsidiaries and significant branches, ie branches that are systemically important in a particular country (general college). However, the flexible framework also allows for meetings of supervisors from countries of particular relevance to the banking group (core college) or based on regional or thematic necessities (regional college). Details on how the colleges are set up and run are laid down in written cooperation and coordination agreements. In order to promote the convergence of the work carried out in these supervisory colleges, CEBS published its draft "Guidelines for the operational functioning of colleges" in December 2009. These measures will also implement the recommendations of the former Financial Stability Forum (FSF) made in April 2008 to set up supervisory colleges for the largest international banks, concepts which were taken up and reaffirmed at the G20 global financial summit in Washington in November 2008.

Ongoing banking supervision operations

At the end of 2009, 2,106 domestic credit institutions were registered as being subject to the German Banking Act (*Kreditwesengesetz*), down from 2,154 at the end of 2008.[1] The streamlining of the German banking network has therefore continued, with a total of 48 fewer credit institutions than in the previous year (the number of institutions fell by 37 in 2008). A total of 74 credit institutions closed down, owing predominantly to mergers in the credit cooperative sector (41) and the savings bank sector (7). These closures were partly offset by 26 new institutions, mainly regional banks, branches of foreign banks from the European Economic Area (EEA) and securities trading banks.

The range of financial services requiring authorisation was extended further to cover new aspects. With the entry into force of the Annual Tax Act 2009 (*Jahressteuergesetz 2009*), factoring and finance leasing became classified as financial services requiring authorisation, thereby newly rendering 623 institutions subject to supervision. Moreover, Article 2 of the Act to Further Develop German Pfandbrief Legislation (*Gesetz zur Fortentwicklung des Pfandbriefrechts*) extended the catalogue of financial services to include asset management activities. This raised the number of supervised financial services institutions to a total of 1,483 (compared with 876 in 2008). With the entry into force of the Payment Services Oversight Act (*Zahlungsdiensteaufsichtsgesetz*), financial services institutions providing money transmission services or conducting credit card business became classified as payment institutions pursuant to the Payment Services Oversight Act. This has affected 25 institutions, which are, however, still counted as financial services institutions and will continue to be supervised according to the Banking Act as a transitional arrangement will be in place until 30 April 2011.

Ongoing monitoring of institutions

Number of operations conducted

Item	2007	2008	2009
1 Reports, monthly and other returns			
Individual reports pursuant to sections 13 to 14 of the Banking Act	148,244	127,405	95,014
Single borrowers listed in the summary reports submitted pursuant to sections 13 to 14 of the Banking Act	2,042,756	2,080,237	2,146,240
Reports pursuant to sections 24 and 24a of the Banking Act	21,998	20,288	20,997
Monthly returns and other data pursuant to sections 25 and 25a of the Banking Act	33,558	32,425	30,291
Reports under Principle I or pursuant to the Solvency Regulation	27,523	27,013	[1] 8,684
Reports under Principle II or pursuant to the Liquidity Regulation	26,322	25,847	26,052
2 Audit reports and reports on activities	8,740	5,869	6,328
3 Meetings with senior management	2,314	2,465	3,051
4 Audits of banking operations	214	215	223

1 Since 2009, only quarterly reports.

1 Credit institutions pursuant to section 1 (1) of the German Banking Act (including institutions which are in liquidation or resolution). For the sake of systematic classification, all 46 securities trading banks are also included here although 42 of these institutions provide only financial services.

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Ongoing banking supervision operations (cont'd)

In 2009, the Bundesbank's Regional Offices were responsible for the ongoing supervision of credit institutions and financial services institutions pursuant to section 7 of the Banking Act. They applied a risk-oriented approach, including regular and extensive dialogue with the institutions. The key element in the assessment of credit institutions and for establishing the annual supervisory schedule is the "risk profile" drawn up by the Bundesbank. A risk profile is created by regularly and systematically pooling information from audit reports, other reports and returns as well as other sources with the knowledge obtained from direct contacts with the institutions and condensing all these data to create a "big picture" of each institution's risk situation.[2] The stepping-up of supervisory activities necessitated by the financial crisis, in particular the increased number of meetings with senior management and the requisite examinations, represented a major challenge for the Regional Offices given limited staff resources; to overcome these challenges, prioritisation was necessary. Amongst other things, the Bundesbank again conducted around 20 cross-institutional requests for information in 2009. This enabled supervisors to collect valuable up-to-date information from which they obtained insights into potential systemic risks. In addition, extensive analyses of risk-bearing capacity were conducted, in particular for systemically relevant institutions. Moreover, ongoing supervision provided assessments of the risk situation at important cross-border banks for inclusion in overall risk assessment at the European level. This risk assessment was conducted, for the first time, on a semi-annual basis and is to be continued in 2010.

In 2009, the Bundesbank performed 177 on-site inspections on the basis of the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement*) pursuant to section 44 (1) sentence 2 of the Banking Act. The on-site inspections were conducted as risk and process-oriented system audits, focusing on the organisation of risk management practices pursuant to section 25a (1) of the Banking Act. The majority of these on-site inspections related to the requirements for an adequate business organisation of credit business and trading activities as well as to the assessment of risk-bearing capacity. Supervisors also increasingly focused on examinations to assess the adequacy of institutions' liquidity risk management procedures.

Credit register of loans of €1.5 million or more

	Volume of loans of €1.5 million or more		Number of loans of €1.5 million or more reported		Number of reporting		
Third quarter	€ billion	Percentage change	Number	Percentage change	institutions[1]	financial enterprises	insurance corporations
2001	7,087	+ 9.2	525,020	+ 2.9	2,946	955	644
2002	7,161	+ 1.0	526,552	+ 0.3	2,777	1,075	621
2003	6,995	– 2.3	514,433	– 2.3	2,624	1,174	633
2004	7,118	+ 1.8	503,632	– 7.0	2,547	1,271	635
2005	7,843	+ 10.1	503,290	– 0.1	2,517	1,428	623
2006	8,069	+ 2.9	507,821	+ 0.7	2,489	1,362	615
2007	8,656	+ 7.3	504,052	– 0.7	2,405	981	618
2008	9,989	+ 15.9	518,331	+ 2.8	2,328	982	634
2009	9,375	– 6.2	517,339	– 0.2	2,322	959	622

1 Credit institutions and financial services institutions.

2 See Risikoorientierte Aufsicht nach Umsetzung der zweiten Säule von Basel II, publication under CEBS' Guidelines on Supervisory Disclosure (available only in German), http://ww2.bafin.de/sdtf/xls/Risikoorientierte_Aufsicht.pdf.

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Ongoing banking supervision operations (cont'd)

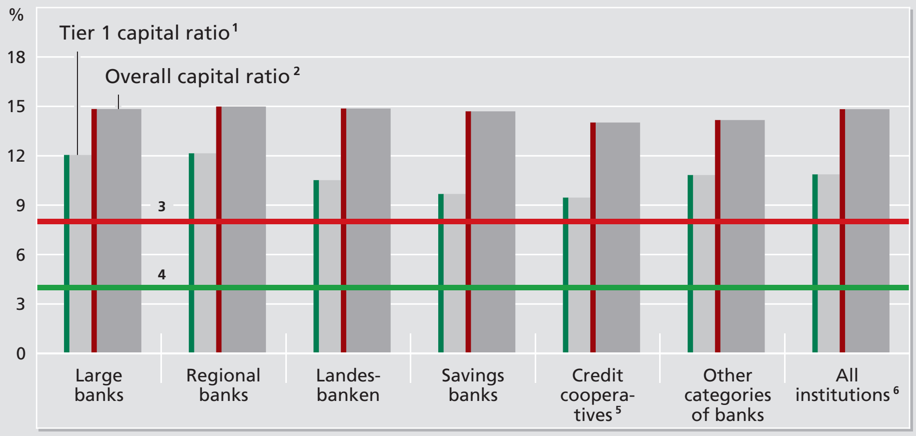
There was a slight decline in the Bundesbank's examination activities in connection with the approval and use of internal rating systems compared with 2008. The number of institutions that have received approval to use an Internal Ratings-Based Approach (IRBA) rose by two to 54. Of these, 20 institutions are permitted to apply an advanced approach.

In 2009, the Bundesbank conducted two initial and two follow-up examinations for approval of an Advanced Measurement Approach (AMA) for operational risk. One initial and one follow-up examination were conducted at the German subsidiaries of foreign institutions. Moreover, the loss data collection process and scenario analysis at an international level initiated in 2008 (BCBS Loss Data Collection Exercise) were evaluated and the results were presented to the participating German institutions.

In terms of internal market risk models, two follow-up examinations were carried out in 2009. Moreover, the Federal Financial Supervisory Authority (BaFin) commissioned the Bundesbank with conducting backtesting examinations at six institutions and with fact-finding at several other institutions, which was, however, carried out solely by evaluating bank documents. These examination mandates were assigned because virtually all model banks saw a rise in the occurrence of backtesting overshootings during the financial crisis, ie the valuation losses determined based on market prices exceeded the value-at-risk measure calculated using the model (see section 318 (1) of the Solvency Regulation (*Solvenzverordnung*)).

Overall capital ratio and tier 1 capital ratio of institutions submitting reports pursuant to the Solvency Regulation *

End-2009 levels



* Individual institution reports from credit and financial services institutions plus reports submitted by groups of institutions and financial holding groups that are parent-waiver institutions pursuant to section 2a (6) of the Banking Act less individual institution reports submitted by institutions that are subordinated to a parent-waiver institution (the aforementioned overall definition relates to the "whole banking sector" in aggregate form). — **1** Tier 1 capital ratio = (total tier 1 capital for solvency purposes ÷ capital charges for counterparty risk, market risk and operational risk pursuant to the Solvency Regulation) × 8. — **2** Overall capital ratio = (total own funds ÷ capital charges for counterparty risk, market risk and operational risk pursuant to the Solvency Regulation) × 8. — **3** The minimum overall capital ratio is 8% under the Solvency Regulation. — **4** The minimum tier 1 capital ratio is 4% pursuant to section 10 of the Banking Act. — **5** Excluding regional institutions of credit cooperatives. — **6** Including regional institutions of credit cooperatives.

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Ongoing banking supervision operations (cont'd)

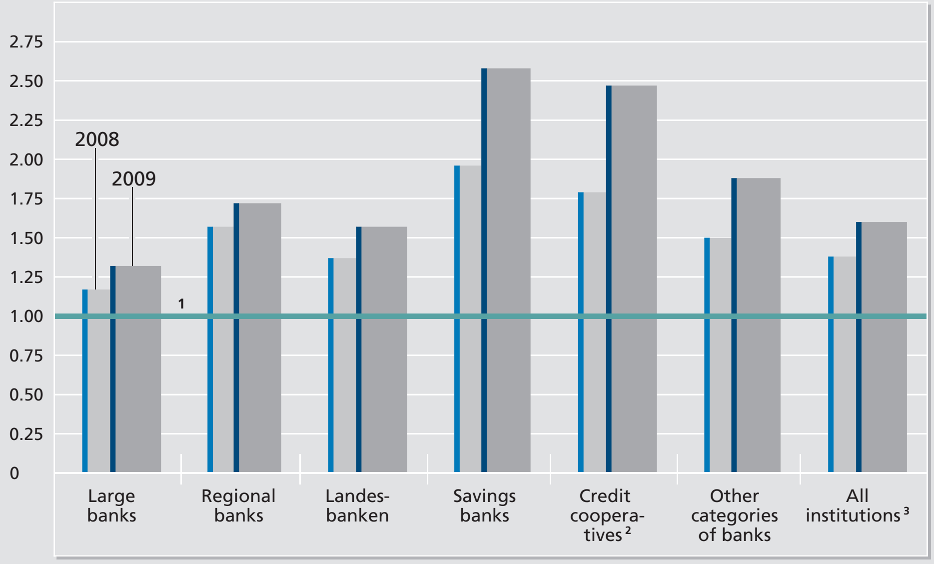
In 2009, the Bundesbank conducted several examinations for approval of liquidity risk models pursuant to section 10 of the Liquidity Regulation (*Liquiditätsverordnung*). However, only one liquidity risk model has been approved to date.

The capital adequacy levels of institutions required to submit reports pursuant to the Solvency Regulation[3] remained stable year-on-year, although this was, in part, the result of government support measures in 2009. On 31 December 2009, the average overall capital ratio, which gives the ratio of all risk positions that have to be backed by capital to own funds, was 14.83% for all institutions required to submit reports. The average tier 1 capital ratio, which gives the ratio of all risk positions that have to be backed by capital to tier 1 capital, was 10.87%.

Under the Liquidity Regulation, institutions must demonstrate that they have adequate liquidity for payment purposes at all times by maintaining a liquidity ratio of at least 1. On 31 December 2009, the average liquidity ratio was 1.60.

Liquidity ratio of individual institutions submitting reports pursuant to the Liquidity Regulation*

End-of-year levels



* Credit institutions and financial services institutions on a non-consolidated basis (Liquidity Regulation reporting format). Liquidity ratio = total payment assets ÷ total payment liabilities. — **1** Under the Liquidity Regulation, the required minimum liquidity ratio is 1.0. — **2** Excluding regional institutions of credit cooperatives. — **3** Including regional institutions of credit cooperatives.

3 This includes all institutions reporting on a non-consolidated basis – provided they are not partially exempt from supervision on a solo basis pursuant to section 2a of the Banking Act – and groups of institutions/financial holding groups whose superordinated enterprise is subject to section 2a of the Banking Act.

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III Development of the national prudential supervisory standards

1 The Act to Strengthen Financial Market and Insurance Supervision, the Consolidated Financial Statements Reconciliation Regulation and the Audit Report Regulation

Higher own funds and liquidity requirements

The financial crisis has demonstrated that financial market and insurance supervisors' powers of intervention have not always been sufficient to allow an early and appropriate response to critical developments at financial sector enterprises. Supervisors' powers of intervention were therefore extended under the Act to Strengthen Financial Market and Insurance Supervision (*Gesetz zur Stärkung der Finanzmarkt- und Versicherungsaufsicht*), in some cases in anticipation of rules that have yet to be agreed at the international level. A core provision in the field of banking supervision under this Act concerns higher own funds (section 10 (1b) of the German Banking Act (*Kreditwesengesetz*)) and liquidity requirements (section 11 (2) of the Banking Act) if, for example, the institution's risk-bearing capacity or long-term liquidity would otherwise be jeopardised.

Leverage ratio

In addition, the modified balance-sheet capital ratio (section 24 (1) number 16 and section 24 (1a) number 5 of the Banking Act) was introduced as a metric which must now be reported in order to allow the potential risk arising from an institution's balance-sheet growth to be identified at an earlier stage.

Trustworthiness and professional qualifications of members of supervisory bodies

The qualitative requirements demanded of members of supervisory bodies have been tightened (section 36 (3) of the Banking Act) with the aim of ensuring that members of these bodies have a better understanding of the business effected by their institution, are able to assess adequately the risks that this business entails for the enterprise and, if necessary, may bring about management changes, thus allowing them to better fulfil their oversight and control function. Finally, supervisory measures such as a prohibition on lending or profit distribution can be imposed even before the prudential capital or liquidity ratios fall below the required levels.

Non-distribution constraint

Similarly, the distribution of all types of disbursements on own funds instruments that are not fully covered by the profit for the financial year in question can be prohibited.

Mitigation of the cyclical effects of international accounting standards in the Consolidated Financial Statements Reconciliation Regulation

The Consolidated Financial Statements Reconciliation Regulation (*Konzernabschlussüberleitungsverordnung*) was amended in line with European and international regulations. The aim was to mitigate the cyclical effects of international accounting standards – resulting from the financial crisis-induced market turmoil – on credit institutions' capital adequacy levels. As a consequence, changes in the value of debt instruments that have no impact on the profit and loss account need no longer be taken into consideration from a prudential point of view.

Greater risk orientation in the Audit Report Regulation

The Audit Report Regulation (*Prüfungsberichtsverordnung*), which lays down the areas to be covered by the audit of banks' annual accounts and the contents of audit reports, was also revised. Besides bringing the Regulation into line with the latest supervisory legislation, the most recent revision was intended to ensure that, in future, audit activities and reports are more focused on key risks and institutions' risk management processes.

2 Changes to the Minimum Requirements for Risk Management

Changes resulting from shortcomings in banks' risk management systems

Banking supervisors have amended the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* or MaRisk) in response to shortcomings in credit institutions' risk management systems which were revealed during the financial crisis. The review took account of European and international regulatory initiatives, particularly the recommendations put forward by the Financial Stability Board (FSB, formerly the FSF). These stress that, apart from ensuring that risk-bearing capacity is adequate, risk concentrations and risks arising from special-purpose vehicles should also be taken into appropriate consideration. In addition, the liquidity risk management requirements were outlined more precisely and extended, as the financial crisis yet again demonstrated the importance of appropriate liquidity risk management procedures. Furthermore, the requirements for developing and conducting meaningful individual stress tests were tightened. The revised MaRisk also no longer permit the exclusive use of external credit assessments to determine counterparty credit risk. Finally, the lessons learned from instances of manipulation at several banks resulted in the organisational requirements for trading activities being amended. The new MaRisk provisions on incentive and compensation systems introduced with the review were replaced shortly afterwards[1] by a separate circular from the Federal Financial Supervisory Authority (BaFin) de-

Requirements for remuneration systems detailed in separate circular

1 Based on the publication of the FSB Principles for Sound Compensation Practices – Implementation Standards, 25 September 2009.

tailing the requirements for banks' remuneration systems, which are not to offer any incentives to take on excessive risk. In December 2009, moreover, eight large German banks and the three largest German insurers voluntarily undertook to focus their compensation systems on long-term business success. In signing a code of conduct, the institutions expressly committed to implementing as quickly as possible the standards for sustainable compensation systems that were agreed by the G20, as well as the FSB principles based on these standards.

Cash management

The Bundesbank study on "Payment behaviour in Germany", which was published in July 2009, shows that cash is the most commonly used means of payment for purchases in Germany and that it is likely to remain so in the future. This finding, together with the Bundesbank's statutory mandate in the area of cash payments, still requires cash processing logistics and an infrastructure which are efficient and independent of private cash handlers. Irrespective of this, the new legal framework for cash payments can help to promote private banknote recycling. The CashEDI procedure, which was launched in December 2006, was enhanced with a number of advanced functions. The collective effort in the development of the new series of euro banknotes will continue in 2010. Furthermore, economic analyses in the area of cash operations are to be intensified.

Euro currency in circulation in the Euro-system

The volume of banknotes in circulation issued by the Eurosystem went up by 5.7% to €806.4 billion in 2009; the increase was therefore less dynamic than in previous years. The volume of coins in circulation rose by 4.5% to €21.3 billion.

Euro currency in circulation in the Eurosystem

Table 8

Trend

€ million

End of	Currency in circulation	Banknotes in circulation	Coins in circulation 1
2007	695,860	676,621	19,239
2008	783,179	762,775	20,404
2009	827,728	806,412	21,316

Breakdown at year-end 2009

Banknotes in circulation			Coins in circulation		
Banknotes of €	€ million	Percentage of total	Coins of €	€ million	Percentage of total
500	281,892	35.0	2	8,529	40.0
200	35,647	4.4	1	6,184	29.0
100	147,186	18.3	0.5	2,502	11.8
50	259,972	32.2	0.2	1,733	8.1
20	53,804	6.7	0.1	1,106	5.2
10	20,423	2.5	0.05	711	3.3
5	7,488	0.9	0.02	340	1.6
			0.01	211	1.0
Total	806,412	100.0	Total	21,316	100.0

1 Circulation of euro coins excluding commemorative coins.

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Besides the regular coins in circulation, euro collector coins were issued in all euro-area countries; these are legal tender only in their country of issue. In Germany, issues of German euro collector coins in 2009 had a total value of €141.6 million.

In the financial year 2009, the Bundesbank paid out 15.2 billion euro banknotes with a value of €488.4 billion. During the same period, the Bundesbank received lodgements from its customers of 14.8 billion euro banknotes with a value of €464.6 billion.

Euro counterfeits

The number of counterfeit euro banknotes detained in German payments and recorded by the Bundesbank increased in comparison with the previous year. By contrast, a slight decline in the number of counterfeit euro coins was recorded.

The share of counterfeit €50 notes among all counterfeit banknotes went up from 31% to 44%. The €50 note therefore remained the most frequently counterfeited banknote denomination. There was a sharp decline in the number of counterfeit €100 and €200 banknotes with the result that the loss fell slightly. In relative terms, the incidence of counterfeit banknotes detected is exceptionally

Number of counterfeit euro banknotes and coins detained in German payments and recorded by the Bundesbank

Table 9

Year	Banknotes		Coins	
	Number (thousand)	€ thousand	Number (thousand)	€ thousand
2007	40	3,769	82	157
2008	41	3,477	80	147
2009	53	3,134	79	142

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low in Germany at around six counterfeits per 10,000 inhabitants per year. The €2 coin accounted for the majority of counterfeit coins (81%). The share of counterfeit €1 coins continued to rise.

Counterfeit prevention

The training courses offered free of charge by the Bundesbank on how to recognise counterfeit money were again very well attended by the banking industry, the retail sector and other interested parties in 2009. A total of around 1,200 training courses were organised across Germany, attracting over 25,000 participants.

Damaged and mutilated banknotes and coins

In the financial year 2009, the National Analysis Centre for damaged banknotes and coins received around 20,800 applications (2008: 19,900) for the reimbursement of damaged Deutsche Mark and euro banknotes and coins.

Deutsche Mark and euro banknotes and coins submitted to the Bundesbank's National Analysis Centre for reimbursement

Table 10

Year	Banknotes		Coins	
	Number (thousand)	€ million	Number (thousand)	€ million
2007	452	16.6	192	0.05
2008	511	19.3	133	0.05
2009	571	22.0	160	0.05

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Deutsche Mark currency in circulation

The volume of Deutsche Mark currency in circulation had declined to DM13.6 billion by the end of 2009. Banknotes accounted for around DM6.6 billion of this amount and coins for roughly DM7 billion.

Deutsche Mark currency in circulation

Table 11

DM million

End of	Currency in circulation	Banknotes in circulation	Coins in circulation
2007	14,086	6,990	7,096
2008	13,835	6,801	7,034
2009	13,608	6,635	6,973

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Second series of euro banknotes

The new series of euro banknotes, which has been approved by the Governing Council of the ECB, will replace the current banknote series in a few years' time. It is envisaged that the individual banknote denominations will be introduced in stages. In order to maintain continuity, the key design elements of the first series of euro banknotes, such as the colour scheme and the main motifs, will largely be adopted for the second series as well. However, new and improved security features will be integrated into the upgraded designs in order to protect the general public better against counterfeits.

New legal framework for cash payments

On 23 January 2009, the amended Council Regulation (EC) No 1338/2001 laying down measures for the protection of the euro against counterfeiting came into force. This amendment has resulted in the regulation applying to a larger target group and in an additional obligation to check notes and coins for authenticity besides that of detaining counterfeit cash. As a result, credit institutions and other economic agents – whose task is to process and re-circulate banknotes and coins – are obliged to ensure that the cash which they have received and wish to reintroduce into circulation is checked for authenticity. These players are also responsible for ensuring that any counterfeits are taken out of circulation. When checking the authenticity of euro banknotes, the procedure laid down in the "Framework for the detection of counterfeits and fitness sorting ..." are to be used. The Eurosystem is using the opportunity provided by the amended Regulation 1338/2001 to establish a new legal basis for this framework. Furthermore, the Payment Services Oversight Act *(Zahlungsdiensteaufsichtsgesetz)* came into force on 31 October 2009. This Act stipulates that cash-in-transit (CIT) companies which undertake activities that go beyond the pure transportation of cash now require a licence from the German Federal Financial Supervisory Authority *(Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin)*. The conditions for the granting of authorisation include *inter alia* adequate capital, the safeguarding of customer funds, and the obligation for senior management and the business organisation to comply with special requirements. CIT companies which have been granted a licence are allowed to offer and carry out cash recycling on their own behalf.

Private banknote recycling

So far, private cash recycling has been carried out primarily via customer-operated cash-recycling machines. Although the volume of banknotes recycled by commercial banks has doubled since statistics were first collected in 2008, the share of private banknote recycling is still low. The monitoring tests carried out on the basis of the "Agreement for the national implementation of the framework for the detection of counterfeits and fitness sorting of euro banknotes" were stepped up considerably compared with the previous year and were extended from customer-operated machines to staff-operated machines.

Bundesbank publishes study on "Payment behaviour in Germany"

In July 2009, the Bundesbank published a study on "Payment behaviour in Germany", which was based on a representative survey of over 2,000 persons. The study confirmed that cash is the most commonly used means of payment for purchases in Germany, accounting for 82.5% of all payment transactions. The share of cash payments is above average in the case of purchases up to €50, purchases made by very young or by elderly persons, and purchases made in cafés, for example. People carry an average of €118 with them in cash, €6.70 of which are coins. When deciding on the method of payment to be used, members of the general public in Germany attach the greatest importance to protection against financial loss, acceptance in retails outlets and low costs. The study concludes that cash is likely to remain the most frequently used means of payment in the future as well.

CashEDI project successfully completed; international interest

The CashEDI (Cash Electronic Data Interchange) project was successfully completed in July 2009. Besides a sharp increase in the use of the electronically supported cash management service at the national level, CashEDI has also met with approval internationally and is to be adopted in other euro-area countries.

Cashless payment and securities settlement systems

With respect to cashless payments and securities settlement, the Bundesbank strives to fulfil its statutory mandate and strategic objectives by making payment and settlement systems as secure and efficient as possible as well as by promoting innovation. The Bundesbank works towards achieving these goals by helping to shape payment policy at the national, European and international level (catalyst function) and by providing its own settlement systems as well as through its involvement in the oversight of payment and securities settlement systems. In 2009, the Bundesbank focused on activities relating to the further development of SEPA – in particular with regard to the launch of the SEPA direct debit scheme – and its contributions to the TARGET2-Securities project. In spite of the difficult underlying conditions in the aftermath of the financial crisis, the Bundesbank's own payment systems saw satisfactory development. The Bundesbank expanded its activities in the area of payment instruments oversight. In particular, the problems with German card payments that occurred towards the turn of the year 2009/2010 have demonstrated the significant economic and societal importance of cashless payments along with the need to ensure that such transactions are effected in a secure and efficient manner.

Single market for cashless payments

In the reporting year, the Bundesbank actively supported European and national efforts to create a Single Euro Payments Area (SEPA), both in its collaborative work with the other Eurosystem central banks and through close consultation with the German banking industry. The launch of the SEPA direct debit scheme for private and business customers represents an important milestone inasmuch as the SEPA credit transfer has been supplemented by a further pan-European payment instrument that can be used for both national and cross-border euro payments. The introduction of the SEPA direct debit scheme depended to a large extent on establishing a common legal framework on the basis of the European Payment Services Directive (PSD), which was transposed into German law on schedule with effect from 1 November 2009.

Progress of SEPA credit transfers ...

Even though use of the SEPA credit transfer in the euro area increased in 2009 it remained at a very low level, accounting for just over 6% of all credit transfers. In fact, in Germany, its use has been markedly less widespread. For this reason, the banking industry will have to step up its efforts even further to increase SEPA acceptance. At the same time, users' demand behaviour should take into account the medium-term advantages that SEPA has to offer in the form of additional cost and product competitiveness with respect to payment transactions.

... and SEPA direct debits

As expected, use of the SEPA direct debit has thus far been extremely limited, as euro-area banks do not have to accept such direct debits until November 2010. However, more widespread use for national German payments is predicated on the possibility of utilising pre-existing collection authorisations in the SEPA direct debit scheme. The Bundesbank therefore strongly supports the solution jointly developed by itself and the Central Credit Committee to convert collection authorisations that have already been granted into SEPA direct debit mandates.

Setting an end date for SEPA migration

From the Bundesbank's point of view, SEPA cannot be fully realised until there is clarity regarding how long national payment schemes will be allowed to remain in existence. Only then will banks and enterprises enjoy the requisite planning certainty for them to invest in payment technology. This strategy also makes it possible to avoid a sustained and expensive parallel existence of legacy payment procedures and the SEPA schemes. Such an approach also encourages efforts to further extend the scope of SEPA – for instance, with respect to innovative internet-based payment schemes and the use of mobile telephones for making payments. Hence, the Bundesbank, in line with a host of other European market participants, is in favour of EU legislators setting an end date for the SEPA migration.

Promotion of SEPA through own range of services

Since implementing the SEPA direct debit scheme on 2 November 2009 the Bundesbank has, in addition to its facility for clearing and settling SEPA credit transfers, been offering banks and public administrations the opportunity to process SEPA direct debits using its SEPA-Clearer. Following a modest start, the settlement volume for the SEPA credit transfer, which was introduced in January 2008, has risen sharply, owing to, among other factors, the migration to SEPA by public administrations. By the end of the year, around 48,000 SEPA credit transfers were being processed by the Bundesbank every working day. The Bundesbank provides its customers with advice relating to SEPA migration. Public administrations play a key role in this connection on account of the large volume of payments for which they are responsible.

TARGET2 ...

As a constituent member of the joint development and operating community which also comprises Banque de France and Banca d'Italia, the Bundesbank made a major contribution to the high performance quality and stability offered by TARGET2 in 2009. Moreover, in its capacity as the largest user central bank and in close consultation with the market participants for whom it acts the Bundesbank has been actively involved in improving TARGET2 to meet customers' requirements. The ECB Governing Council Decision on the introduction of TARGET2 stipulates that Eurosystem central banks are required to settle certain payment transactions via TARGET2 within a strict four-year transition period. In the main, this relates to bank-to-bank payments in euro in the European Economic Area (EEA), euro-denominated payments between credit institutions and ancillary systems (eg securities settlement systems, retail payment systems) as well as payments relating to Eurosystem open market operations. While all securities clearing activities of Clearstream Banking Frankfurt have already been carried out using TARGET2 since 17 November 2008, the additional requirements shall be fulfilled in stages. As a next step, banks will no longer be offered the option of indirect participation in TARGET2 via the Bundesbank, probably as from January 2011.

... and greater efficiency in the area of payment systems and account management

The Bundesbank remains unwavering in its pursuit of its policy of reducing the volume of vouchers generated and ensuring the efficient processing of those vouchers that remain. For Prior1 credit transfers by non-banks, electronic participation will be mandatory as of 1 March 2010. Retail payment orders still submitted in paper form will in future be automatically truncated at a central location. Furthermore, at the end of 2009, the processing of data media relating to retail payments was discontinued.

Cashless payment systems

In 2009, an average of around 345,000 payments with a value of €2,205 billion were processed each working day by the TARGET2 individual payment system, which is jointly operated by the Deutsche Bundesbank, Banca d'Italia and Banque de France on behalf of the Eurosystem. Using TARGET2 it is possible to make payments to a total of 900 direct participants and to access some 72,000 additional financial institutions or correspondent banks. Like comparable systems in other countries, TARGET2 also saw a year-on-year decrease in the transaction volume (-6.9%) and value (-17%) of settled payments as a consequence of the financial crisis. The decline in the value is also attributable to changes to the statistical methodology.

In total, 138 institutions in Germany and the EEA are directly connected to TARGET2 while 2,603 institutions are linked to it indirectly via the German component, TARGET2-Bundesbank. Both in terms of transaction volume (around 50%) and value (around 30%), TARGET2-Bundesbank remains the largest component of the TARGET2 Single Shared Platform (SSP). TARGET2-Bundesbank's year-on-year growth pattern resembled that of the TARGET2 system as a whole.

In addition, the Bundesbank is actively involved in German interbank clearing by offering its Retail Payment System (RPS) for the clearing and settlement of retail payments in the national DTA format and the SEPA-Clearer for retail payments in the SEPA format as a complement to other providers' services. The RPS numbers 222 active participants while 128 credit institutions use the SEPA-Clearer. The table below shows how payments within these Bundesbank systems have developed.

Cashless payments of the Deutsche Bundesbank

Item	2008		2009			
	Volume (million)	Value (€ billion)	Volume (million)	Percentage change	Value (€ billion)	Percentage change
Individual payments	47.1	250,446	45.3	– 3.9	173,685	– 30.6
TARGET2-BBk[1]	46.5	248,816	44.7	– 3.9	171,299	– 31.2
National	36.2	184,358	34.3	– 5.3	114,905	– 37.7
Cross-border	10.3	64,458	10.4	1.2	56,394	– 12.5
Other[2]	0.6	1,630	0.6	– 3.0	2,385	46.3
Retail payments	2,468.9	2,359	2,589.1	4.9	2,297	– 2.6
RPS	2,465.4	2,357	2,585.5	4.9	2,295	– 2.6
National	2,459.3	2,338	2,575.0	4.7	2,261	– 3.3
Cross-border	3.6	6	3.6	0.2	5	– 11.1
SEPA credit transfers[3]	2.6	13	7.0	175.1	29	125.7
SEPA direct debits[3]	.	.	0.0	.	0	.
Other[4]	3.5	1.8	3.5	2.1	1.9	10.0
Total	2,516.0	252,805	2,634.4	4.7	175,982	– 30.4

1 Since 2009, a new common statistical methodology has applied (eg changes with regard to the inclusion of intrasystem liquidity transfers). — **2** CAM: Customer Access Mechanism (access to TARGET2, correspondent banking), in specific. — **3** National and cross-border payments. — **4** Exclusively MASSE: Procedure for cross-border retail payments effected by public authorities.

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TARGET2-Securities

The planned European central platform for settling securities transactions using central bank money, TARGET2-Securities (T2S), took on much more concrete shape over the course of 2009. Building on the user requirements, the T2S General Functional Specifications and the General Technical Design were broadly finalised and work on the detailed specifications was commenced. These activities have demonstrated the success of the collaboration between the Bundesbank, Banque de France, Banca d'Italia and Banco de España, which were entrusted by the Governing Council of the ECB with the task of developing and operating T2S. A further important milestone in the T2S project was the 19 March 2009 decision by the Governing Council to establish a T2S Programme Board. This steering committee is responsible for ensuring the successful completion of the T2S programme in line with the user requirements, both on time and within budget. Moreover, the Memorandum of Understanding that was signed by the Eurosystem and 27 central securities depositories (CSDs) on 16 July 2009 underscores the broad-based support within the European market – including non-euro-area countries – for this joint project. An important factor here was close cooperation between the Eurosystem, CSDs and end users, which was achieved not just by means of a European Advisory Group but also through National User Groups. At present, the legal frameworks for the remaining project and operational phases are in the process of being drawn up, both within the Eurosystem and between the Eurosystem and CSDs. Completion is expected by mid-2010.

Need to strengthen further areas of post-trade structure

The financial market turmoil has demonstrated that there is room for further improvement in other areas of the post-trade structure, especially in the light of the systemic relevance of over-the-counter (OTC) derivatives, such as credit default swaps. The reforms that have been initiated and promoted by the Bundesbank in this context with a view to enhancing the post-trade structure of OTC derivatives place particular emphasis on the establishment and utilisation of central counterparties (CCPs). In their capacity as central risk bearers these need to meet particularly high safety standards.

Finalisation of ESCB/CESR recommendations for securities settlement systems and central counterparties

At the European level, the Committee of European Securities Regulators (CESR) and the ESCB jointly concluded their work on recommendations for securities settlement systems and central counterparties in June 2009. The aims of these ESCB/CESR recommendations are to ensure safety, reliability and efficiency in the area of clearing and settlement and to guarantee the harmonised Europe-wide implementation of the recommendations adopted at the global level by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO). Additionally, the Bundesbank is involved in revising these recommendations for CCPs which clear OTC derivatives.

Analysing the structure of the repo market and the post-trading sector

Within the CPSS framework, the Bundesbank continued to collaborate on studies focused on repo market infrastructure as well as on post-trade service infrastructure. The aim is to acquire a better understanding of the determinants of change and of any systemic risks that may exist in this rapidly evolving sector.

Participation in oversight of TARGET2, ...

With respect to payment systems oversight, in 2009 the Bundesbank was involved in, among other things, the first comprehensive assessment of the TARGET2 system for compliance with the "Core Principles for Systemically Important Payment Systems", oversight standards developed by the CPSS and used by the Eurosystem. Ultimately, TARGET2 fulfils all the necessary requirements. In addition to this, a start has been made on the assessment of systemically important payment systems against the more stringent "Business Continuity Oversight Expectations for Systemically Important Payment Systems" to ensure business continuity in a crisis.

... CLS and SWIFT

Under the cooperative oversight arrangement (lead-managed by the Federal Reserve) for the Continuous Linked Settlement (CLS) system for international foreign exchange transactions, the Bundesbank was involved in the general risk assessment of the system and took part in discussions on new CLS business activities. The main focus of the cooperative oversight of SWIFT was on the regional division of its transaction processing service into a European and a transatlantic zone and activities geared to enhancing its own cost efficiency.

Payment instruments oversight

In February 2009, the Eurosystem adopted general standards for the assessment of payment instruments, on the basis of which it drew up draft oversight frameworks for credit transfer and direct debit schemes. During 2009 the Bundesbank continued, both on an independent basis and as a contributing party, to carry out assessments of the German debit card scheme "girocard" and the international card schemes Visa Europe, MasterCard Europe and American Express for compliance with the oversight standards for card schemes that have already been in force since January 2008. Due to a defect in the operating system for the chips in the cards at the turn of 2009/2010 some 30 million debit and credit cards were temporarily unavailable for use at automated teller machines and POS terminals. Although the German banking industry's rapid response prevented the impact of the disruption from getting worse, further problems of this magnitude could cause sustained damage to users' confidence in the reliability of card payments. Not only do quality control and test procedures need to be adjusted, it is also particularly important to check whether communication strategies and business continuity planning need improving.

TARGET2 as key topic of research

In the year under review, the Bundesbank also expanded its activities in the area of payment research and analysis. This research was centred on the liquidity efficiency of TARGET2 and discussion of the strongly institution-specific results with its users. The Bundesbank also carried out preparatory work for a simulation-based analysis of TARGET2 which, among other things, can yield important findings about the robustness of the system to changes in participants' behaviour or composition. Moreover, the Bundesbank is currently taking part in an ECB study which sets out to calculate the social costs of individual payment instruments in a methodologically similar manner for the bulk of EU member states. Data collection will commence in 2010.

Organisation and staff

I Strategy

Strategic cycle 2008-2012

The annual strategy review carried out in the reporting year shows that, following its successful launch, the implementation of the strategic cycle from 2008 to 2012 progressed smoothly in 2009.

Core business area: monetary policy

Work in the core business area of monetary policy was chiefly focused on learning and digesting the lessons from the financial crisis. The conclusions drawn from these evaluations are feeding into plans to expand the range of tools for economic and monetary analysis. In 2010, the Bundesbank will continue to intensify its application-oriented analysis and research in the area of monetary policy.

Core business area: financial and monetary system

Last year, the Bundesbank leveraged its expertise in the field of financial stability in a new Financial Stability Department, whose work focuses primarily on the stability of the domestic and international financial and monetary system. The macroprudential analyses that form the basis of the Bundesbank's *Financial Stability Review,* which is drawn up by this department, play a central role in this respect. Further key areas of work for the department include the Bundesbank's participation in international forums working to implement the reform agenda of the G20 and the Financial Stability Board (FSB) as well as its work in helping to create the European Systemic Risk Board and extensively reform international financial institutions, notably the International Monetary Fund.

Core business area: banking supervision

The Bundesbank has constructively contributed to the ongoing reform of the regulatory framework at the international, European and national level in the wake of the financial crisis. Furthermore, it has intensified both its on-site auditing activities and its prudential fact-finding and evaluation work, including in the context of meetings with senior management and cross-institutional requests for information.

Core business area: cash management

After completion of the 2009 branch structure evaluation, the Executive Board approved further steps in December to consolidate the branch network. In 2012 and 2015, the number of branches is to be reduced from the current figure of 47 to 35. Moreover, the Board is currently assessing whether, given the high density of branches in the Rhine-Ruhr area, replacing the existing branches with a single new branch in this region from 2015 onwards could lead to more cost-efficient operations.

Regional Offices and branches of the Deutsche Bundesbank on 1 April 2010

Locality number	Bank location	Regional Office [1]
390	Aachen	D
720	Augsburg	M
773	Bayreuth	M
100	Berlin	B
480	Bielefeld	D
430	Bochum	D
290	Bremen	H
870	Chemnitz	L
570	Coblenz	MZ
370	Cologne	D
180	Cottbus	B
440	Dortmund	D
850	Dresden	L
300	Düsseldorf	D
350	Duisburg	D
820	Erfurt	L
360	Essen	D
215	Flensburg	HH
500	Frankfurt/Main	F
680	Freiburg	S
	Lörrach [2]	
513	Giessen	F
260	Göttingen	H
450	Hagen	D
200	Hamburg	HH
250	Hanover	H
660	Karlsruhe	S
520	Kassel	F
210	Kiel	HH
860	Leipzig	L
545	Ludwigshafen	MZ
230	Lübeck	HH
810	Magdeburg	H
550	Mainz	MZ
840	Meiningen	L
700	Munich	M
150	Neubrandenburg	HH
760	Nuremberg	M
280	Oldenburg	H
265	Osnabrück	H
750	Regensburg	M
640	Reutlingen	S
130	Rostock	HH
590	Saarbrücken	MZ
600	Stuttgart	S
630	Ulm	S
694	Villingen-Schwenningen	S
790	Würzburg	M

1 Abbreviations: B = Berlin; D = Düsseldorf; F = Frankfurt am Main; H = Hanover; HH = Hamburg; L = Leipzig; M = Munich; MZ = Mainz; S = Stuttgart. — **2** Operating unit.

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Since 31 October 2009, when the Payment Services Oversight Act *(Zahlungsdiensteaufsichtsgesetz)* came into force, cash-in-transit (CIT) companies providing supplementary cash logistics services in addition to transportation have been subject to government supervision. The act also contains confidence-building provisions applicable to such CIT companies aimed at safeguarding the protection of customer funds. One important prerequisite for achieving the Bundesbank's strategic aim of promoting banknote recycling among CIT companies has thus been fulfilled. On 1 November 2009, the Bundesbank adjusted its cash payment service profile in line with this objective and with the regulations agreed within the Eurosystem. In 2009, the number of banknotes processed at the Bundesbank was slightly below the previous year's figure.

Core business area: cashless payments

In July 2009, the Eurosystem and 27 central securities depositories (CSDs) signed a Memorandum of Understanding regarding the involvement of the CSDs in TARGET2-Securities. It stipulates the respective obligations and responsibilities of the Eurosystem and the CSDs for the next project phase and is intended to pave the way for the contract conclusion planned for mid-2010.

Together with Banque de France and Banca d'Italia, the Bundesbank is implementing new customer requirements as part of a qualitative update of TARGET2. To this end, functional improvements were provided in 2009.

The launch of the SEPA direct debit on 2 November 2009 ran smoothly. The use of SEPA instruments is not very widespread at present. Setting a closedown date for the national payment schemes and introducing legislation governing the migration of existing direct debit mandates to the mandates required for the SEPA Direct Debit Scheme would substantially accelerate the migration of national legacy instruments to SEPA instruments.

II Staff

A top employer in Germany

In 2009, the Bundesbank was again ranked as a top employer in the Trendence institute studies "Deutsches Absolventenbarometer 2009/2010" (German Graduate Barometer 2009/10) and "Deutsches Schülerbarometer 2009/2010" (German Secondary School Student Barometer 2009/10). Furthermore, in the

"Universum Graduate Survey 2009", it was rated as one of the most popular employers in Germany.

Steady reduction in staff numbers

Despite the new challenges and tasks in the wake of the financial crisis, the number of core staff fell by a further 2.1% overall, reaching 10,575 on 31 December 2009. The downward trend is still mainly attributable to staff cuts at the Bundesbank's branches owing to the progressive automation of cash processing and payment systems. Measured by contractual working hours, the Bundesbank had a weighted core headcount of 9,822 full-time equivalent (FTE) employees (a decline of 2.1%).

At the end of 2009, 1,066 staff members were participating in the partial retirement scheme, compared with 856 a year earlier. This constitutes a year-on-year rise of 24.5%, which was due mainly to the fact that admission to the partial retirement scheme was only possible until the end of 2009. The majority of these employees have contracts based on the "phase model", which means that a phase in which the employee works the same hours as previously but with reduced remuneration is followed by a second pre-retirement phase in which he or she does not work but receives the same (reduced) remuneration as in the first phase. In addition, 155 salaried employees (166 in 2008) took up the option of early retirement (only available to those aged 55 or over) in the reporting year.

Recruitment policy geared to demographic developments

Through its recruitment policy, the Bundesbank is responding to changing business requirements and its own age structure. In view of the demographic trend in the labour market, the Bank is thus ensuring at an early stage that it will have highly qualified staff for its specific functions at the national, European and international level.

In 2009, the Bundesbank again offered significantly more commercial trainee vacancies than required to cover its own needs. At the end of the year, a total of 556 employees were in salaried or civil service trainee positions, compared with 518 a year earlier.

Staff exchange within the European System of Central Banks

In the 11th year of European Monetary Union, 45 members of the Bundesbank's staff were on secondment to the European Central Bank. In addition, 15 employees temporarily worked at the ECB or another ESCB central bank. In total, four employees of other central banks in Europe worked for a limited term at the Bundesbank.

Bundesbank staff on 31 December 2009 *

Table 12

Item	Staff numbers [1]				Year-on-year changes			
	Total	Regional Offices	Branches	Central Office	Total	Regional Offices	Branches	Central Office
Civil servants	5,484	1,636	1,708	2,140	– 82	– 7	– 118	43
Salaried staff	5,647	1,564	2,178	1,905	– 106	– 5	– 141	40
Total	11,131	3,200	3,886	4,045	– 188	– 12	– 259	83
of which Trainees	556	227	18	311	38	21	– 9	26
Remainder Core staff	10,575	2,973	3,868	3,734	– 226	– 33	– 250	57
of which Staff with permanent contracts	10,453	2,939	3,851	3,663	– 258	– 46	– 256	44
Staff with temporary contracts	122	34	17	71	32	13	6	13
Memo item Core staff *pro rata* (full-time equivalent)	9,822.3	2,720.4	3,585.4	3,516.5	– 215.4	– 31.1	– 226.8	42.5

	End-2009	End-2008
* Not included:		
Members of staff on secondment	170	215
Members of staff on unpaid leave	394	420
Members of staff in the second phase of the partial retirement scheme	359	362
1 *Of which*: part-time employees	1,968	1,964

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Modern, family-friendly employer

In view of its long-term family-friendly staff policy, the Bundesbank obtained the "Audit berufundfamilie" (Work and Family Audit) certificate from the Hertie Foundation (a non-profit making organisation) to reflect its commitment as a socially responsible employer. The Bundesbank regards the promotion of improvements in the compatibility of family and working life as an important issue both for staff policy and for society as a whole. It therefore provides its employees with access to a number of forms of flexible working. On 31 December 2009, there were 1,964 part-time staff members and 252 teleworkers. The Bundesbank also further enhanced its health management system in order to ensure that its working conditions promote both long-term health and higher productivity.

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

At its meeting on 14 July 2004, the Executive Board of the Deutsche Bundesbank, in consultation with the Corporate Governance Compliance Adviser, approved a Code of Conduct for the members of the Executive Board of the Deutsche Bundesbank. This code states, *inter alia*, that details of offices held by Board members on supervisory boards or similar inspection bodies of business enterprises shall be disclosed in the Annual Report.

The Board members hold the offices indicated below.

– Professor Axel A Weber, President:
  Member of the Board of Directors, BIS[1]

– Professor Franz-Christoph Zeitler, Vice-President:
  Member of the Administrative Council, LIKO-Bank;[2]
  Member of the Board of Trustees, Monetary Stability Foundation (until 31 December 2009);
  Alternate, Board of Trustees, Monetary Stability Foundation (from 1 January 2010)

– Dr hc Rudolf Böhmler:
  Member of the Supervisory Board of ARADEX AG, Lorch;[3]
  Member of the Board of Trustees, Monetary Stability Foundation (from 1 January 2010)

– Dr Hans Georg Fabritius:
  Alternate, Administrative Council, LIKO-Bank;[2]
  Alternate, Credit Committee, LIKO-Bank;[2]
  Member of the Administrative Council, Rhineland-Westphalian Institute for Economic Research;
  Alternate, Board of Trustees, Monetary Stability Foundation (from 1 January 2010)

1 Ex officio.
2 Partnership agreement.
3 Membership will cease upon expiry of the current mandate, which was accepted before Dr hc Böhmler joined the Deutsche Bundesbank's Executive Board.

– Professor Hans-Helmut Kotz:
Member of the Administrative Council, LIKO-Bank;[1]
Member of the Credit Committee, LIKO-Bank;[1]
Alternate, Board of Directors, BIS;[2]
Standing guest on the Central Capital Market Committee;
Member of the Stock Exchange Expert Commission of the Federal Ministry of Finance

– Dr Hans Reckers, Member of the Executive Board until 30 April 2009:[3]
Alternate, Administrative Council, LIKO-Bank;[1]
Member of the Stock Exchange Expert Commission of the Federal Ministry of Finance

– Professor Hermann Remsperger, Member of the Executive Board until 30 April 2009:[3]
Alternate, Board of Directors, BIS;[2]
Chairman of the Board of Trustees, Monetary Stability Foundation

– Dr Thilo Sarrazin, Member of the Executive Board since 1 May 2009:
Member of the Board of Trustees, Monetary Stability Foundation
(since 1 January 2010)

1 Partnership agreement.
2 Ex officio.
3 Offices held when he stepped down from the Executive Board on 30 April 2009.

Other activities

I Conferences and workshops

Academic conferences and workshops

In 2009, the Bundesbank – largely in cooperation with other central banks, international organisations or universities and research institutes – organised several academic conferences and workshops primarily devoted to topics associated with the financial crisis. The primary aim of the Spring Conference, entitled "The macroeconomy and financial systems in normal times and in times of stress", was to cast light on which mechanisms facilitated and caused the financial crisis. Misincentives in the financial system and regulatory countermeasures were also discussed, as well as our current level of knowledge of the future and economic policy strategies for alleviating the resulting problems. Possible consequences of the high level of public debt worldwide caused by the financial crisis were also discussed. Other conferences and workshops focused on drawing initial lessons for the future from the crisis. These events included the Autumn Conference on the topic "The future of banking regulation" as well as workshops entitled "Advanced techniques in stress testing" and "Monetary policy and the business cycle – Lessons for (from) the crisis". A conference on "Forecasting and monetary policy" highlighted the progress made in recent years with respect to improving macroeconomic forecasting, which is important for forward-looking monetary policy. For the first time, the Bundesbank also organised a workshop on "Money, finance and banking in Asia", which focused on Asia, an area of the international financial system which is attracting an increasing amount of attention.

Workshops on the implementation of the G8 action plan

As part of the G8 initiative to develop local currency bond markets in emerging market economies and developing countries[1] the Bundesbank, in cooperation with the International Monetary Fund (IMF) and the World Bank group, organised the workshop "Lessons from the crisis and progress made in developing local currency bond markets in Emerging Market Economies and developing countries". As was the case in the previous year, the workshop focused on the implementation of the recommendations contained in an action plan approved by G8 finance ministers in 2007. The workshop looked, in particular, at how local currency bond markets in these countries had coped with the financial crisis and which new challenges they face. The results of these workshops are included in annual progress reports.

1 See Deutsche Bundesbank, Bond markets in emerging market economies, Financial Stability Review 2007, November 2007, pp 113-131.

II Research Centre

Research priorities

In the past year, Research Centre staff worked on and completed many projects. These were concentrated on the fields of monetary and fiscal policy, international macroeconomics, econometric forecasting methods, financial markets and bank behaviour as well as banking supervision and financial stability. The studies emphasised the connections with the financial crisis. In 2009, many visiting researchers spent time at the Centre in order to use the Bundesbank's statistical data for their own research or to work on joint projects with Bundesbank staff members.

International research networks

The Research Centre was involved in a number of research networks in 2009, some of which were organised in an ESCB context. They encourage interaction between researchers at the various European central banks and ensure problems are looked at from a European perspective. One network was dedicated to research on wage dynamics in Europe. Its aims were to study links between wage-setting and the situation in the labour markets, to better understand the influence of institutional regulations and to investigate the interaction between wage-setting and price-setting. This network produced a large number of publications and contributed to an improved understanding of cause-and-effect relationships in the labour markets in Europe and of the differences between European countries. This network was disbanded at the end of 2009. Another network is seeking to improve understanding of European households' wealth situation and consumption decisions. Until now, in most euro-area countries only very incomplete information was available regarding the distribution and composition of households' assets and debt. In 2009, alongside initial research on the basis of existing data, extensive preparations were made for a survey on households' financial situation. A survey of 4,000 German households, chosen at random, on this set of issues is planned for the first time in spring 2010. The data collected in this survey can then be used to analyse important questions concerning households' consumption and savings decisions, the distribution of wealth, the effects of monetary policy and also the stability of the financial system.

Other international working groups in which the Research Centre was active looked at the design and application of econometric models and methods in the euro area, be it in connection with forecasting or simulating alternative economic policy measures. The focus of the research, which was carried out under the auspices of the Research Task Force of the Basel Committee on Banking Supervision, was the analysis of the significance of a stable banking system for the real economy as well as the investigation of credit risk modelling. The Research Centre is also a partner in Europe-wide academic research networks. As part of the Marie Curie project on "Risk", the Bundesbank has taken charge of the research theme of "Risk Modelling", in which the measurement of, and interaction between, financial risks in banks are studied from a risk management and regulatory perspective. The aim of the network is to improve understanding of risks in the financial system and to develop methods which can be used to better deal with these risks. Another network is investigating the different aspects of the internationalisation of enterprises in Europe with a particular focus on the causes and consequences of this development.

Discussion papers and publications

The Research Centre publishes two series of discussion papers. In 2009, it published 36 papers in series 1 (Economic Studies) and 15 papers in series 2 (Banking and Financial Studies). Many of these discussion papers are also published in academic journals or books. In 2009, more than 50 articles were published or accepted for publication.

Research Council

In 2009, Professor Dale Henderson was appointed to the Bundesbank Research Council. The contracts of Professors Richard Clarida, Jürgen von Hagen and William Perraudin were extended by three years.

III Centre for Education, Training and Central Bank Cooperation

The Bundesbank has merged its wide range of education and training options for its own staff and its consultancy services for foreign central banks into the Centre for Education, Training and Central Bank Cooperation.

Foundations laid for project management qualification programme

In 2009, around 70% of Bundesbank employees took part in one of some 2,000 internal training measures. Alongside training in the core areas of the Bundesbank's business, languages and management training also played a prominent role. Additionally, as part of joint Eurosystem seminars, around 300 members of staff from European central banks took part in courses at the Bundesbank's training centre in Eltville. These seminars are generally designed by the ESCB Task Force on Training and Development, of which the Bundesbank is a member. In the reporting year, the task force laid the foundations for a very demanding qualification programme in the area of project management, which will start in 2010.

European supervisor education according to uniform standards

In summer 2009 the Bundesbank, together with the Federal Financial Supervisory Authority (BaFin), the Oesterreichische Nationalbank and the University of Frankfurt's Goethe Business School, founded the European Supervisor Education Initiative (ESE). The aim of the initiative is to offer financial market supervisors in Europe a demanding qualification programme according to uniform standards while also forging a link between academic theory and practical supervisory experience. It was developed from the long-running cooperation between the Bundesbank and the Oesterreichische Nationalbank with respect to the training of supervisors (Advanced Basel II Seminars). The 25 seminars were attended by around 500 supervisors from 27 countries.

Fast-track trainee programme gains in importance

The Bundesbank is training new staff for the higher, upper intermediate and, with the reintroduction of training for the Banking Operations Service, also for the lower intermediate service. In 2009, there were 556 Bundesbank employees and 29 guest students from BaFin in training, 7% more than in the previous year, meaning that the fast-track trainee programme for training future managerial staff has been gaining in importance.

Central banking studies at the Bundesbank's University of Applied Sciences

The Bundesbank is the only central bank in the Eurosystem to have its own university. Since 1980, future members of the upper intermediate service of the Bundesbank and BaFin have completed a three-year course of studies. By closely interlinking theory and practice, the qualification in business management with an emphasis on central banking ensures that students gain a detailed understanding of monetary and foreign exchange policy, banking supervision and financial markets. The 12 full-time and 75 guest lecturers cover a broad range of economic and methodological topics from the Bundesbank's five core business areas. There are currently 135 students at the Bundesbank's University of Applied Sciences in the town of Hachenburg, in the state of Rhineland-Palatinate, while 101 students are completing practical work experience in various departments at the Bundesbank and BaFin. In 2009, 69 students graduated with the academic title "Diploma in Business Management (University of Applied Sciences)". The conversion of the diploma course to a Bachelor degree course is planned for 2011.

Globalisation and development cooperation

Development cooperation in general, and technical central bank cooperation as a part of it, are becoming more and more important throughout the world as a result of globalisation. The realisation that mutual influences and dependencies between virtually all states are tending to increase rather than decrease is of particular relevance to the financial and central banking systems, as has recently been demonstrated by the global financial crisis and its effects. Conscious of its responsibility in the area of stability policy, in 2009 the Bundesbank again advised a significant number of foreign central banks, thus concentrating its strategic focus on its core competences.

Demand for bilateral cooperation remained high

The external demand for technical central bank cooperation has remained high. More than 300 activities were organised either in Germany or abroad for more than 90 central banks. These were attended by more than 3,500 central bankers from across the world. The interests of the foreign partner institutions were focused primarily on the five core business areas of the Bundesbank – cash, the financial and monetary system, monetary policy, banking supervision and cashless payments – as well as on issues of good governance. Demand for support in the areas of financial stability, banking supervision and risk management has increased markedly in the wake of the financial crisis. Demand primarily came from EU accession countries and EU candidate countries as well as the states of the former Soviet Union and China.

Central bank cooperation becoming more multilateral

The trend towards multilateralisation of cooperation which has emerged in recent years continued as part of European partnership projects (EU twinning projects and ESCB programmes). The Bundesbank is currently running EU twinning projects for the central bank of Bosnia-Herzegovina and the Ukrainian national bank, which are being carried out in cooperation with the Czech and Polish central banks respectively. At the ESCB level, the Bundesbank is involved in programmes for the Russian and Egyptian central banks.

IV Services the Deutsche Bundesbank provides for the Federal Government

Involvement in the issuance of Federal securities

The Bundesbank conducts the auctions of one-off issues of Federal securities and carries out market management operations for listed Federal securities on the German stock exchanges on behalf of the Federal Republic of Germany –

Finance Agency. One-off issues of Federal securities are sold by auction through the Bund Issues Auction Group. The auction procedure is carried out using the Bund Bidding System electronic primary market platform provided by the Bundesbank. In 2009, 60 auctions were carried out (2008: 37 auctions) which included two auctions of inflation-linked instruments. The allotment volume was €262.5 billion (2008: €170.1 billion). The increased issuing activity and additional borrowing was primarily to finance the Federal Government's financial market stabilisation measures as well as the Investment and Relayment Fund. In the reporting year, the Bundesbank continued to be involved, through credit institutions, in selling tap issues of Federal Treasury financing paper and Federal savings notes.

Asset management ...

In its role as fiscal agent, the Bundesbank also performs asset management services on behalf of the Federal and state governments. It manages these assets under a passive strategy.

... for the Federal Government ...

Asset management services for the Federal Government cover several pension fund portfolios and the portfolio of the Monetary Stability Foundation. The Bundesbank was given the responsibility for managing this portfolio after the Act on a Federal Government Pension Reserve *(Versorgungsrücklagegesetz des Bundes)* came into force in 1999. The reserve is partially funded by wage increases and serves to balance out the Federal Government's increased pension burden in the years 2018 to 2032. In 2007, the Bundesbank was also given the task of managing the Federal Government's newly established pension fund. The purpose of this pension fund is to finance the pension claims of all Federal civil servants, judges and professional soldiers newly hired from 2007 onwards. The spectrum of investment instruments permitted by the Federal Government includes Federal securities as well as other investment-grade euro-denominated debt securities. For the pension fund, Parliament also created the possibility of an index-linked investment of up to 10% of the assets in shares.

... for the Federal Employment Agency ...

At the beginning of 2008, the Federal Employment Agency's pension scheme was separated from that of the Federal Government and redesigned. The Bundesbank was appointed asset manager by law. This portfolio is also subject to the investment rules of the Federal Government's reserve fund.

... for the Federal Financial Supervisory Authority ...

The funded pension scheme for civil servants employed at the Federal Financial Supervisory Authority is also regulated outside the scope of the aforementioned Act on a Federal Government Pension Reserve. Nevertheless, the portfolio managed by the Bundesbank for this scheme has a similar structure to the portfolio of the Federal Government's pension fund.

... and for the Federal states

The Bundesbank also provides varying levels of securities management services for several state government pension reserves and funds. The number of states that have requested such services from the Bundesbank increased further in 2009.

V Own portfolios and management of the foreign reserves

Euro-denominated own portfolios

The Bundesbank manages three own euro-denominated portfolios. One portfolio is the balance sheet counterpart to the pension reserves for Bundesbank civil servants, the capital base and the statutory reserves and provisions for general risks. Another portfolio is invested in euro-denominated covered bonds. These portfolios are managed using a buy-and-hold strategy. Additionally, in July 2009 the Bundesbank began building up the covered bond portfolio of the Eurosystem. This portfolio is held for monetary policy purposes and is intended to support the European covered bond market.

Management of foreign reserves ...

The management of the Bundesbank's foreign reserves includes the investment of foreign currency reserves, stewardship of the IMF reserve position as well as management of gold reserves. Along with its own foreign reserve assets, the Bundesbank also manages some of the ECB's foreign reserves.

... on the basis of benchmark portfolios ...

The framework for managing the foreign currency reserves of the Bundesbank and the ECB is defined by benchmark portfolios for each currency (US dollar and yen). These benchmark portfolios reflect the desired long-term risk level and serve as a yardstick. The benchmarks for the Bundesbank's own reserves are specified by the Executive Board each year. The Bundesbank manages the ECB reserves for which it is responsible using benchmarks set by the Governing Council and Executive Board of the ECB. Reserve management decisions may deviate from the benchmark within a narrow margin in order to outperform the benchmark through duration and yield curve management and the choice of instruments.

… and eligible investment instruments and limits

In addition to US and Japanese government bonds, a very limited volume of fixed-income securities of other investment-grade issuers represent eligible investment instruments. Furthermore, investments can be made in the money market, in particular in the form of repo transactions. Business activities with individual counterparties in the different business lines are regulated by a differentiated limit system.

Annual accounts of the Deutsche Bundesbank for 2009

I Balance sheet of the Deutsche Bundesbank as at 31 December 2009

Assets

				31.12.2008
			€ million	€ million
1	Gold and gold receivables		83,939	68,194
2	Claims on non-euro-area residents denominated in foreign currency			
2.1	Receivables from the IMF	15,969		(3,285)
2.2	Balances with banks, portfolio investment, external loans and other external assets	25,634		(27,705)
			41,602	30,991
3	Claims on euro-area residents denominated in foreign currency		4,412	63,263
4	Claims on non-euro-area residents denominated in euro		300	300
5	Lending to euro-area credit institutions related to monetary policy operations denominated in euro			
5.1	Main refinancing operations	53,605		(75,291)
5.2	Longer-term refinancing operations	170,004		(201,383)
5.3	Fine-tuning reverse operations	—		(—)
5.4	Structural reverse operations	—		(—)
5.5	Marginal lending facility	1		(750)
			223,610	277,425
6	Other claims on euro-area credit institutions denominated in euro		7,136	22,031
7	Securities of euro-area residents denominated in euro			
7.1	Securities held for monetary policy purposes	7,892		(—)
7.2	Other securities	5,276		(—)
			13,168	—
8	Claims on the Federal Government		4,440	4,440
9	Intra-Eurosystem claims			
9.1	Participating interest in the ECB	1,091		(1,196)
9.2	Claims arising from the transfer of foreign reserves to the ECB	10,909		(11,821)
9.3	Claims related to the allocation of euro banknotes within the Eurosystem (net)	—		(—)
9.4	Other claims within the Eurosystem (net)	177,706		(115,537)
			189,706	128,555
10	Items in course of settlement		2	2
11	Other assets			
11.1	Coins	721		(665)
11.2	Tangible and intangible fixed assets	1,038		(1,253)
11.3	Other financial assets	10,227		(10,011)
11.4	Off-balance-sheet instruments revaluation differences	24		(2,813)
11.5	Accruals and prepaid expenses	1,703		(2,330)
11.6	Sundry items	6,017		(289)
			19,729	17,362
			588,043	612,563

Liabilities

				31.12.2008
			€ million	€ million
1	Banknotes in circulation		201,304	206,620
2	Liabilities to euro-area credit institutions related to monetary policy operations denominated in euro			
	2.1 Current accounts	76,665		(100,678)
	2.2 Deposit facility	35,498		(66,261)
	2.3 Fixed-term deposits	—		(—)
	2.4 Fine-tuning reverse operations	—		(—)
			112,163	166,938
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	9,987		(170)
	4.2 Other liabilities	363		(646)
			10,350	816
5	Liabilities to non-euro-area residents denominated in euro		9,124	9,226
6	Liabilities to euro-area residents denominated in foreign currency		36	18,401
7	Liabilities to non-euro-area residents denominated in foreign currency		—	2,540
8	Counterpart of special drawing rights allocated by the IMF		13,127	1,338
9	Intra-Eurosystem liabilities			
	9.1 Liabilities to the ECB arising from promissory notes	—		(—)
	9.2 Liabilities related to the allocation of euro banknotes within the Eurosystem (net)	146,806		(121,759)
	9.3 Other liabilities within the Eurosystem (net)	—		(—)
			146,806	121,759
10	Items in course of settlement		6	4
11	Other liabilities			
	11.1 Off-balance-sheet instruments revaluation differences	—		(—)
	11.2 Accruals and income collected in advance	414		(1,206)
	11.3 Sundry items	2,225		(2,333)
			2,639	3,540
12	Provisions		6,562	7,011
13	Revaluation accounts		76,778	63,108
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		4,147	6,261
			588,043	612,563

II Profit and loss account of the Deutsche Bundesbank for the year 2009

				2008
			€ million	€ million
	– Interest income	7,624		(16,880)
	– Interest expense	– 3,468		(– 8,451)
1	Net interest income		4,156	8,429
	– Realised gains/losses arising from financial operations	673		(623)
	– Write-downs on financial assets and positions	– 142		(– 0)
	– Transfers to/from provisions for general risks, foreign exchange risks and price risks	– 49		(– 40)
2	Net result of financial operations, write-downs and risk provisions		482	583
	– Income from fees and commissions	64		(62)
	– Expense relating to fees and commissions	– 15		(– 13)
3	Net income from fees and commissions		49	49
4	Income from participating interests		564	371
5	Net result arising from allocation of monetary income		278	– 1,802
6	Other income		90	143
7	**Total net income**		5,619	7,772
8	Staff costs		857	954
9	Other administrative expenses		250	237
10	Depreciation on tangible and intangible fixed assets		193	141
11	Banknote printing		154	157
12	Other expenses		19	23
13	**Profit for the year**		4,147	6,261

Frankfurt am Main, 16 February 2010

DEUTSCHE BUNDESBANK
Executive Board

Professor Axel A Weber   Professor Franz-Christoph Zeitler

Dr hc Rudolf Böhmler   Dr Hans Georg Fabritius   Professor Hans-Helmut Kotz   Dr Thilo Sarrazin

III 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 2009 to 31 December 2009. 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, 2 March 2010

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Havas Wirtschaftsprüfer	Müller-Tronnier Wirtschaftsprüfer

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 of assets 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 direct 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, currencies 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 either the straight-line method or the implicit rate of return method. The implicit rate of return method shall be used in the case of zero-coupon bonds with a residual maturity of more than one year at the time of acquisition.

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 assets. 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 provision for Eurosystem monetary policy operations, the regulations set forth in the Commercial Code continue to apply to the reporting of provisions in the balance sheet. Pursuant to section 26 (2) of the Bundesbank Act, 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.

IV General information on annual accounts

Legal basis

Sections 26 and 27 of the Bundesbank Act 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 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.

Notes on balance sheet entry of euro banknotes and associated intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem

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 key for allocating euro banknotes. The ECB has been allocated an 8% share of the total value of the euro banknotes in circulation, whereas the remaining 92% has been allocated to the national central banks in proportion to their respective paid-up shares in the capital of the ECB. In the year under review, the Bundesbank had a 27.1% share in the fully paid-up capital of the ECB and therefore a 25.0% 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.

The difference between the value of the euro banknotes allocated to each Eurosystem central bank in accordance with the banknote allocation key and the value of the euro banknotes that this national central bank actually puts into circulation gives rise to remunerated intra-Eurosystem balances.[3] If the value of

1 Published as a revised edition in Bundesbank Notice No 10001/2010 of 28 January 2010.
2 Decision of the European Central Bank of 6 December 2001 on the issue of euro banknotes (ECB/2001/15).
3 Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the national central banks of participating member states from the financial year 2002 (ECB/2001/16) and amended by its decisions of 19 May 2006 (ECB/2006/7), 22 November 2007 (ECB/2007/15) and 14 December 2009 (ECB/2009/27).

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 latest available 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 in NCBs' relevant income positions from those in previous years. The adjustments are made by taking into account the differences between the average value of the banknotes which each national central bank had in circulation in the reference period and the average value of the banknotes which would have been allocated to them during that period in accordance 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, when income from euro banknotes is allocated fully in proportion to the NCBs' paid-up shares in the ECB's capital. In the year under review, the adjustments resulted from the accession of the central bank of Slovenia in 2007, the Maltese and the Cypriot central banks in 2008 and the Slovakian central bank in 2009. Accordingly, the adjustments will be phased out by 31 December 2012, 2013 and 2014. 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".

Furthermore, the ECB's seigniorage income from the transfer of 8% of the euro banknotes in circulation to the ECB 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 the income earned on the euro banknotes allocated to it or, as a result of a decision by the Governing Council of the ECB, the amount is retained for allocation to a risk provision.[1] For the financial year 2009, the ECB's income from the banknotes allocated to it amounting to €787 million was distributed among the

1 Decision of the European Central Bank of 17 November 2005 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the national central banks of the participating member states (ECB/2005/11).

national central banks as interim profit for 2009 on 5 January 2010. The Bundesbank's share of €214 million (2008: €355 million) is shown in item 4 "Income from participating interests" in its profit and loss account.

Change to ECB capital key on 1 January 2009

Pursuant to the provisions laid down in Article 29.3 of the ESCB Statute, the key establishing the respective subscriptions of the ESCB national central banks to the ECB's capital is to be adjusted every five years. At the beginning of 2009, such an adjustment was made on the basis of the EU Council Decision of 15 July 2003 on the statistical data to be used for determining the key for subscription to the capital of the European Central Bank. The Bundesbank's share of the ECB's subscribed capital changed on 1 January 2009 from 20.5% to 18.9%. The Bundesbank's participating interest in the ECB decreased from €1,182 million to €1,091 million as a result. The Bundesbank receives compensation for its smaller share of the accumulated net assets of the ECB due to the reduction of its participating interest. The resulting income totalling €299 million is shown in item 4 "Income from participating interests" of its profit and loss account. Furthermore, the Slovakian central bank joined the Eurosystem on 1 January 2009 and paid up its capital share to the ECB in full. As a result, the Bundesbank's share in the fully paid-up capital of the ECB dropped from 29.4% to 27.1% on 1 January 2009.

Preparation and auditing of financial statements

The Executive Board drew up the Bundesbank's financial statements for the financial year 2009 on 16 February 2010. 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 2 March 2010 that the Bundesbank's financial statements for 2009 – consisting of the balance sheet and the profit and loss account – comply 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 9 March 2010.

V Notes on the individual balance sheet items

1 Assets

Gold and gold receivables

As of 31 December 2009, the Bundesbank's holdings of fine gold (ozf) amounted to 3,406,789 kg or 110 million ounces. The gold was valued at market prices at the end of the year (1 kg = €24,638.63 or 1 ozf = €766.347). In the year under review, the gold holdings declined by 5,809 kg or 0.2 million ounces. This was due to the sale of gold to the Federal Government at market prices for the purpose of minting gold coins.

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

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 are shown in this item.

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 the Federal Republic of Germany's membership of the IMF. The claims, which total SDR 14,669 million (€15,969 million), consist of drawing rights within the reserve tranche, special drawing rights and bilateral loans.

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 unchanged German quota of SDR 13,008 million (€14,160 million) and the euro balances amounting to €11,798 million (SDR 10,838 million) at the disposal of the IMF at the end of the year. In 2009, there was a net increase of SDR 623 million (€654 million) to SDR 2,170 million (€2,362 million) in the holdings of drawing rights.

Special drawing rights, by means of which convertible currencies can be obtained at any time, increased in the reporting year as a result of two free-of-charge allocations with a volume of SDR 10,848 million. A corresponding counterpart is shown as liability item 8 "Counterpart of special drawing rights allocated by the IMF". Without taking into account the free-of-charge allocations, the level of special drawing rights fell by SDR 91 million (€101 million) in 2009.

Credit due to a bilateral loan agreement amounted to SDR 315 million (€343 million). The Bundesbank's credit line with the IMF, which has been in place since September 2009, has an equivalent value of €15 billion.

If all items on the assets side and the liabilities side of the balance sheet are taken into account, the net SDR item amounted to SDR 2,611 million compared with SDR 1,765 million in 2008. The year-end revaluation is based on the reference rate of SDR 1 = €1.0886 (2008: SDR 1 = €1.1048) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem.

Receivables from the IMF Table 13

	31.12.2009		31.12.2008		Year-on-year change			
Item	SDR million	€ million	SDR million	€ million	SDR million	%	€ million	%
German quota	13,008	14,160	13,008	14,371	–	–	– 211	– 1.5
less euro balances	10,838	11,798	11,461	12,663	– 623	– 5.4	– 865	– 6.8
Drawing rights within the reserve tranche	2,170	2,362	1,547	1,709	623	40.3	654	38.2
Special drawing rights	12,184	13,263	1,427	1,576	10,757	753.9	11,687	741.3
Bilateral loans	315	343	–	–	315	.	343	.
Total	14,669	15,969	2,974	3,285	11,696	393.3	12,683	386.1

Deutsche Bundesbank

Balances with banks and 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 €25,634 million at the end of 2009 compared with €27,705 million on 31 December 2008. These are almost exclusively US dollar holdings amounting to US$35,999 million (€24,989 million), representing a decline of US$1,632 million from the previous year. This sub-item also contains holdings in yen (¥83,812 million = €629 million) and a very small amount in other currencies. The holdings are interest-bearing. If all US dollar 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$36,097 million compared with US$38,031 million in 2008 and the net yen item valued at market prices amounted to ¥83,934 million compared with ¥83,306 million in 2008. The foreign currency items were valued at the end-of-year market rate; in the case of the US dollar item, this amounted to €1 = US$1.4406 (2008: €1 = US$1.3917) and for the yen item €1 = ¥133.16 (2008: €1 = ¥126.14).

Claims on euro-area residents denominated in foreign currency

As of 31 December 2009, this item contained €4,412 million of US dollar claims on credit institutions resulting from refinancing operations within the context of the Federal Reserve's Term Auction Facility. In order to carry out these oper-

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

Table 14

Item	31.12.2009 € million	31.12.2008 € million	Year-on-year change € million	%
Current account holdings and overnight deposits	596	1,576	– 980	– 62.2
Claims arising from reverse repurchase agreements	–	1,478	– 1,478	– 100.0
Fixed-term deposits and deposits at notice	6,928	–	6,928	.
Marketable securities	18,004	24,535	– 6,532	– 26.6
Other	106	115	– 9	– 7.9
Total	25,634	27,705	– 2,072	– 7.5

Deutsche Bundesbank

ations, the ECB receives US dollars from the Fed 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 balances resulting from swap transactions between the ECB and the Bundesbank are shown in asset sub-item 9.4 "Other claims within the Eurosystem (net)".

Claims on non-euro-area residents denominated in euro

A long-term interest-free loan amounting to €300 million which the Bundesbank made available to the IMF in agreement with the Federal Government in 2000 is shown in this item. The loan is in connection with the financing of debt relief which the IMF grants to the heavily indebted poor countries (Heavily Indebted Poor Countries Initiative or HIPC Initiative). The interest income from the investment of this money is at the disposal of a trust fund which is administered by the IMF and from which the debt relief granted by the IMF is financed. The loan has a maturity of ten years.

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 balances amounted to €749,906 million (2008: €860,611 million), of which the Bundesbank holds €223,610 million (2008: €277,425 million). Pursuant to Article 32.4 of the ESCB Statute, all risks from these operations, provided they materialise, are shared among the Eurosystem central banks in proportion to the prevailing ECB capital key shares.

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 a fixed interest rate. At the end of the year, the main refinancing operations amounted to €53,605 million, which was €21,686 million less than the level on 31 December 2008. On a daily average, the main refinancing operations amounted to €60,790 million (2008: €78,052 million).

Longer-term refinancing operations with a maturity of between one month and one year were carried out in the period under review with the purpose of providing longer-term liquidity. The operations were conducted as fixed-rate tenders with full allotment. The volume of these transactions amounted to €170,004 million at the end of 2009 and was therefore €31,380 million lower than the volume of the previous year. On a daily average, the volume of longer-term refinancing operations amounted to €158,141 million (2008: €131,585 million).

The marginal lending facility is available at a predetermined interest rate (standing facility). By 31 December 2009, recourse to the marginal lending facility had declined by €749 million on the year to €1 million. The extent to which it was being used on a daily average amounted to €602 million (2008: €627 million).

Other claims on euro-area credit institutions denominated in euro

These are, in particular, 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").

Securities of euro-area residents denominated in euro

This item contains covered bonds denominated in euro which are held to maturity and valued at amortised cost. Purchases as part of the Eurosystem's "Covered Bond Purchase Programme", which the Governing Council approved on 7 May 2009, are shown under sub-item 7.1 "Securities held for monetary policy purposes"; other purchases are shown under sub-item 7.2 "Other securities".

Claims on the Federal Government

This item shows the equalisation claims on the Federal Government and the non-interest-bearing debt register claims in respect of Berlin; both 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 Union (Lisbon Treaty), it has been stipulated that equalisation claims and the debt register claims are to be redeemed in ten annual instalments, starting in the year 2024.

Intra-Eurosystem claims

The Bundesbank's claims on the ECB and on the other 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 accordance with rules laid down in Article 29.3 of this statute, the key for subscription to the ECB's capital was adjusted with effect from 1 January 2009 (see General information on annual accounts). As of 31 December 2009, the Bundesbank had an 18.9% share of the ECB's subscribed capital; this share amounts to €1,091 million.

Sub-item 9.2 contains the Bundesbank's euro-denominated claims arising from the transfer of foreign reserves to the ECB. In accordance with Article 30 of the ESCB Statute, the central banks participating in the Eurosystem transferred foreign reserves (15% in gold and 85% in foreign currency) to the ECB at the beginning of 1999. 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 2009, these claims amounted to €10,909 million. As the transferred gold does not earn interest, the claims are remunerated at 85% of the latest available interest rate for the main refinancing operations.

Sub-item 9.3 "Claims related to the allocation of euro banknotes within the Eurosystem" shows the claims which arise from applying the banknote allocation key. As at the end of 2008, the Bundesbank again had no claims at the end of 2009 but, instead, 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 the TARGET2 settlement balances between the central banks of the ESCB. At the end of the year, the Bundesbank had net claims amounting to €177,723 million (2008: €115,295 million), which are shown under sub-item 9.4 "Other claims within the Eurosystem (net)". These claims, with the exception of unremunerated intra-Eurosystem balances resulting from the swap transactions between the ECB and the Bundesbank, are remunerated at the latest available interest rate for main refinancing operations (see asset item 3 "Claims on euro-area residents denominated in foreign currency"). On a daily average, the interest-bearing net claims arising from TARGET2 settlement balances amounted to €177,498 million (2008: €111,172 million). This item also contains the liabilities amounting to €230 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 claim on the ECB of €214 million arising from the distribution of ECB income from banknotes allocated to it (see General information on annual accounts).

Items in course of settlement

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

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 €1,037 million compared with €1,253 million in 2008; it comprises land and buildings, furniture and equipment and computer software.

Tangible and intangible fixed assets Table 15

€ million

Item	Purchase/ production costs 31.12.2008	Additions	Disposals	Accumulated depreciations	Book value 31.12.2009	Book value 31.12.2008	Depreciation in 2009
Land and buildings	2,519	27	– 147	– 1,509	890	1,082	– 130
Furniture and equipment	695	39	– 31	– 562	142	163	– 58
Computer software	118	4	– 2	– 114	6	8	– 6
Total	3,332	70	– 179	– 2,185	1,037	1,253	– 193

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Sub-item 11.3 "Other financial assets" amounted to €10,227 million compared with €10,011 million in 2008. It contains fixed-interest euro assets of €10,138 million as a counterpart to the capital, statutory reserves, provisions for general risks and provisions for pensions and healthcare assistance. The euro assets are held until maturity and valued at amortised cost. This item also includes €89 million in participating interests of the Bundesbank. The participating interest in the BIS, Basel, was unchanged at €50 million at the end of 2009. The Bundesbank holds 50,100 shares. As in the previous year, the balance sheet value of the 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. The participating interest in the cooperative society SWIFT, La Hulpe (Belgium), fell to €1 million in 2009 owing to the statutory redistribution of shares (2008: €2 million).

Sub-item 11.4 "Off-balance-sheet instruments revaluation differences" essentially comprises €24 million for the year-end valuation of the US dollar forward liabilities to the ECB arising from the US dollar Term Auction Facility established by the Fed compared with €2,813 million in the previous year (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 identified at 31 December 2009. These chiefly consist of interest income which is due in the new financial year from refinancing operations and securities which were acquired or transacted in the financial year just ended.

As of 31 December 2009, sub-item 11.6 "Other" essentially contains the nominal value of claims against one counterparty that defaulted from monetary policy operations undertaken by the Eurosystem. In 2008, these claims were reported under asset item 5.2 "Longer-term refinancing operations".

2 Liabilities

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). In accordance with the banknote allocation key applying on 31 December 2009, the Bundesbank has a 25.0% share of the value of all euro banknotes in circulation (2008: 27.1%). During the year under review, the total value of banknotes in circulation within the Eurosystem rose from €762,775 million to €806,411 million, or 5.7%. Owing to the lower allocation key, the Bundesbank had euro banknotes in circulation worth €201,304 million at the end of the year compared with €206,620 million at the end of 2008. The value of the euro banknotes actually issued by the Bundesbank in the year under review increased by 6% from €328,380 million to €348,110 million. As this was more than the allocated amount, the difference of €146,806 million (2008: €121,759 million) is shown in liability sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)".

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

Sub-item 2.1 "Current accounts" contains the deposits of the credit institutions, amounting to €76,665 million (2008: €100,678 million), which are used to meet the minimum reserve requirement and 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 minimum reserve regulations in the Eurosystem. Minimum reserve balances are remunerated at the average interest rate for main refinancing operations in the maintenance period. On a daily average, the current account deposits amounted to €52,232 million (2008: €49,852 million).

Sub-item 2.2 "Deposit facility", amounting to €35,498 million (2008: €66,261 million), contains overnight deposits at a predetermined interest rate (standing facility). On a daily average, the deposit facility amounted to €46,147 million (2008: €21,262 million).

The sub-item 2.3 "Fixed-term deposits" contains liquidity-absorbing fine-tuning operations. In the year under review, they were conducted as variable-rate tenders with a maximum bid rate. As in the previous year, no operations were reported under this item at the end of 2009. On a daily average, the fixed-term deposits amounted to €2,246 million (2008: €1,463 million).

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 2009, general government deposits amounted to €9,987 million in all (2008: €170 million). This increase results, in particular, from increased deposits of the Financial Market Stabilisation Fund as a Federal special fund.

Sub-item 4.2 "Other liabilities" amounted to €363 million compared with €646 million on 31 December 2008. The deposits of enterprises and individuals are the main items shown here.

This balance sheet item, amounting to €9,124 million (2008: €9,226 million), contains primarily the fixed-term deposits of central banks and the working bal-

Liabilities to non-euro-area residents denominated in euro

ances of central banks, monetary authorities, commercial banks and international organisations held for settling the payments and other services provided by the Bundesbank. These deposits are accepted mainly as part of the Bundesbank's central bank services; the proceeds are invested in the money market (see asset item 6 "Other claims on euro-area credit institutions denominated in euro").

Liabilities to euro-area residents denominated in foreign currency

This item contains mostly the US dollar deposits of banks domiciled in the euro area and of euro-area branches of banks domiciled outside the euro area.

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

The foreign-currency-denominated liabilities to banks outside the euro area are recorded in this item. These are mainly liabilities in US dollars which have arisen from securities repurchase agreements (repos). At the end of 2009, no operations were reported under this sub-item (2008: €2,540 million).

Counterpart of special drawing rights allocated by the IMF

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

Intra-Eurosystem liabilities

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

The "Liabilities to the ECB arising from promissory notes" shown as sub-item 9.1 arise in connection with the issue of ECB debt certificates. The ECB did not issue such paper during the year under review.

Sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem" contains the liabilities arising from the application of the banknote allocation key (see liability item 1 "Banknotes in circulation"). At the end of the year, these liabilities amounted to €146,806 million (2008: €121,759 million).

The net liabilities balance 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 2009, the Bundesbank had a net claim, and this is shown on the asset side under sub-item 9.4 "Other claims within the Eurosystem (net)" and explained in the explanatory notes above.

Items in course of settlement

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

Other liabilities

Sub-item 11.2 "Accruals and income collected in advance" contains the accrued income identified on 31 December 2009. This consists essentially of interest expenditure which is due in the new financial year but was incurred in the financial year just ended and which arose in connection with the allocation of banknotes within the Eurosystem.

Sub-item 11.3 "Sundry items" essentially consists of 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 2009, amounted to a total of €3,392 million. The banknote series BBk I/Ia accounted for €1,273 million of this sum (2008: €1,288 million) and the banknote series BBk III/IIIa for €2,119 million (2008: €2,189 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 were taken off the books and reported as income as it is highly unlikely that this part of the banknote stock will now be exchanged for euro. As a result of this partial write-off, the liabilities arising from Deutsche Mark banknotes still in circulation on 31 December 2009 amounted to €2,155 million.

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. They are established against foreign exchange risks in the bank's US dollar, SDR and yen positions not already covered by existing revaluation items. The level of funds to be allocated to risk provisions is reviewed annually using value-at-risk methods amongst others. In doing so, bank holdings of risk-weighted assets, the financial situation expected for the coming year and the statutory reserves (currently €2.5 billion) are taken into account. Taking the aforementioned factors into consideration and the fact that currency reserves increased on the year, provisions of €1,937 million were deemed appropriate (see asset item 2 "Claims on non-euro-area residents denominated in foreign currency").

In accordance with Article 32.4 of the ESCB Statute, the provision for monetary policy operations will be funded by all national central banks of participating member states in proportion to their subscribed capital key shares in the ECB prevailing 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 has reviewed the appropriateness of this provision and decided to reduce the total amount from €5,736 million on 31 December 2008 to €4,011 million on 31 December 2009. The Bundesbank's share of this provision is €1,181 million (2008: €1,689 million). The respective adjustments are reflected in the profit and loss accounts of the national central banks. This resulted in income of €508 million for the Bundesbank in 2009 (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 based on an actuarial expert opinion pursuant to the entry age normal method *(Teilwertverfahren)*, with a discount rate of 5.2% used in the reporting year (2008: 5.4%). The adjustment of these provisions is reflected in profit and loss item 8 "Staff costs".

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 3.8% (2008: 4.1%) based on an actuarial expert opinion pursuant to the present value method *(Barwertverfahren)*. The adjustment of these provisions is reflected in profit and loss item 8 "Staff costs".

Provisions Table 16

	31.12.2009	31.12.2008	Year-on-year change	
Provisions for	€ million	€ million	€ million	%
General risk	1,937	1,888	49	2.6
Monetary policy operations	1,181	1,689	– 508	– 30.1
Direct pension commitments	2,240	2,205	35	1.6
Indirect pension commitments (supplementary pension funds)	380	367	13	3.5
Healthcare subsidy commitments to civil servants	441	404	37	9.1
Partial retirement scheme	97	89	8	9.1
Staff restructuring schemes	247	252	– 6	– 2.3
Other	40	117	– 76	– 65.6
Total	6,562	7,011	– 449	– 6.4

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Other provisions have been created for holiday entitlement not taken, overtime and positive balances of flexible working hours as well as for uncertain liabilities.

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 2009 (revaluation items "new").

Revaluation accounts Table 17

Item	Revaluation items "old"	Revaluation items "new"	Total 31.12.2009	Total 31.12.2008	Year-on-year change	
	€ million	€ million	€ million	€ million	€ million	%
Gold	18,931	56,954	75,885	60,127	15,758	26.2
US dollars	–	469	469	1,398	– 929	– 66.4
SDRs	–	–	–	6	– 6	– 100.0
Yen	–	108	108	151	– 42	– 28.2
Securities	–	315	315	1,427	– 1,112	– 77.9
Total	18,931	57,846	76,778	63,108	13,670	– 21.7

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Revaluation items "old"

A revaluation item "old" now remains only for the gold position. It represents the difference between the market value of gold on 1 January 1999 and the lower value of gold prior 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 0.2 million ozf in the gold holdings resulted in a dissolution amount of €32 million in the year under review. The dissolution amount is included in the profit and loss item 1, sub-item "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 portfolio, the positive difference between their market value on 31 December 2009 and their value in terms of the average acquisition costs carried forward from 1 January 1999 is shown in the revaluation items "new".

In the case of gold, the acquisition cost is 1 ozf = €246.370. At the end of 2009, the market value of the gold position exceeded its acquisition value, with the result that a revaluation item amounting to €56,954 million arose (2008: €41,163 million). The market values of the US dollar and Japanese yen positions at the end of 2009 were above their acquisition value (€1 = US$1.4685 and €1 = ¥160.8609), with the result that, as in 2008, there were revaluation items. In the case of the SDR position, the market value at year-end was below the respective acquisition value (1 SDR = €1.1091), with the result that, contrary to the previous year, there was a valuation loss (see profit and loss item 1, sub-item "Write-downs on financial assets and positions"). There were only slight valuation gains in the case of the other foreign currencies.

The valuation gains from securities result almost exclusively from US dollar investments.

Capital and reserves

In accordance with section 2 of the Bundesbank Act, the liable capital amounts to €2.5 billion. 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.

Profit for the year

The profit and loss account for the year 2009 closed with an annual surplus of €4,147 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 2009.

VI Notes on the profit and loss account

Net interest income

This item shows interest income less interest expense. Net interest income was lower than in the previous year, falling by €4,274 million to €4,156 million. Of this total amount, €636 million was in foreign currency (primarily foreign reserves) while the euro holdings amounted to €3,520 million (primarily from the use of monetary policy instruments).

Interest income

Interest income in foreign currency fell year on year by €474 million to €1,046 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 €8,782 million to €6,578 million. Income from the refinancing of credit institutions shrank by €5,559 million (see asset item 5 "Lending to euro-area credit institutions related to monetary policy operations denominated in euro"). This resulted primarily from the lower average rate of interest over the year. Interest income from TARGET2 settlement balances decreased by €2,239 million (see asset sub-item 9.4 "Other claims within the Eurosystem (net)") because the average interest rate fell.

Interest income

Table 18

Item	2009	2008	Year-on-year change	
	€ million	€ million	€ million	%
Interest income in foreign currency				
IMF	9	21	– 12	– 58.5
Current account holdings and overnight deposits	0	4	– 4	– 96.7
Reverse repo transactions	2	81	– 79	– 97.7
Claims arising from the provision of foreign exchange liquidity	436	540	– 104	– 19.2
Fixed-term deposits and deposits at notice	7	52	– 46	– 86.9
Securities	560	805	– 245	– 30.4
Other	33	17	16	90.7
Total	1,046	1,520	– 474	– 31.2
Interest income in euro				
Main refinancing operations	829	3,212	– 2,383	– 74.2
Longer-term refinancing operations	2,531	5,661	– 3,131	– 55.3
Other refinancing operations	15	60	– 45	– 74.7
TARGET2 balances in the ESCB	2,270	4,509	– 2,239	– 49.7
Claims arising from central bank services	38	837	– 799	– 95.5
Claims arising from the transfer of foreign reserves to the ECB	120	412	– 292	– 70.8
Securities	166	–	166	.
Financial assets	419	430	– 11	– 2.5
Other	190	239	– 48	– 20.2
Total	6,578	15,360	– 8,782	– 57.2
Grand total	7,624	16,880	– 9,256	– 54.8

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Interest expense

Interest expenditure decreased by €4,982 million to €3,468 million year on year. In the case of foreign currency, interest expenditure on liabilities fell by €114 million to €410 million in connection with the lower average US dollar interest rate. In the case of the euro, there was a year-on-year decline of €4,868 million to €3,058 million. The expenditure on remunerating intra-Eurosystem balances arising from the allocation of euro banknotes fell by €2,565 million owing to the lower rate of interest over the year (see General information on annual accounts and liability sub-item 9.2 "Liabilities related to the allocation of euro banknotes within the Eurosystem (net)"). Furthermore, interest expenditure on liabilities related to monetary policy operations (minimum reserve and fixed-term deposits/deposit facility) decreased by €1,706 million because of the lower average interest rate.

Interest expense

Table 19

Item	2009 € million	2008 € million	Year-on-year change € million	%
Interest expense in foreign currency				
Liabilities arising from the provision of foreign exchange liquidity	410	478	– 68	– 14.1
Repo transactions	0	47	– 47	– 99.9
Total	410	525	– 114	– 21.8
Interest expense in euro				
Minimum reserves	674	2,021	– 1,347	– 66.7
Time deposits/deposit facility	301	660	– 359	– 54.4
Liabilities arising from central bank services	41	820	– 780	– 95.0
Liabilities related to the allocation of banknotes	1,826	4,391	– 2,565	– 58.4
Other	217	33	183	547.9
Total	3,058	7,926	– 4,868	– 61.4
Grand total	3,468	8,451	– 4,982	– 59.0

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

The net income shown in sub-item "Realised gains/losses arising from financial operations" amounted to €673 million compared with €623 million in 2008.

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

Table 20

Item	2009 € million	2008 € million	Year-on-year change € million	%
Realised gains/losses				
Gold	112	76	36	47.3
Foreign currency	37	30	7	25.0
Securities	524	517	7	1.3
Total	673	623	50	8.0
Write-downs				
Foreign currency	– 54	– 0	– 54	.
Securities	– 88	–	– 88	.
Total	– 142	– 0	– 142	.
Transfers to/from provisions for general risks, foreign exchange risks and price risks	– 49	– 40	– 9	– 22.5
Grand total	482	583	– 101	– 17.3

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The valuation losses recorded in the sub-item "Write-downs on financial assets and positions" arise from holdings of US dollar securities (€88 million) and the SDR position (€54 million).

The sub-item "Transfers to/from provisions for general risks, foreign exchange risks and price risks" contains the rise of €49 million in the provision for general risks (see liability item 12 "Provisions").

Net income from fees and commissions

As in 2008, net income from fees and commissions amounted to €49 million.

Net income from fees and commissions Table 21

Item	2009 € million	2008 € million	Year-on-year change € million	Year-on-year change %
Income				
Cashless payments	25	29	– 4	– 12.5
Cash payments	11	9	2	23.3
Securities business and security deposit business	12	11	2	16.8
Other	15	13	2	18.1
Total	64	62	3	4.3
Expense				
Securities business and security deposit business	10	9	2	22.2
Other	4	5	– 0	– 2.8
Total	15	13	2	13.5
Grand total	49	49	1	1.8

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Income from participating interests

This item contains the Bundesbank's profit from its participating interests in the ECB, the BIS and Liquiditäts-Konsortialbank GmbH. The increase of €193 million in total income to €564 million is attributable, in particular, to the financial compensation relating to the reduction in the Bundesbank's share of the ECB's accumulated net assets (see General information on annual accounts).

Net result arising from allocation of monetary income

This item comprises income of €278 million compared with expenditures of €1,802 million in 2008. The adjustment of the provision for monetary policy operations resulted in income of €508 million (2008: expenditures of €1,689 million; see liability item 12 "Provisions"). The expense from the allocation of monetary income amounts to €230 million compared with €113 million in 2008.

The monetary income of the Eurosystem national central banks is allocated in accordance with a decision taken by the Governing Council of the ECB.[1] Since 2003, the amount of monetary income allocated to each national central bank is 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 net liabilities arising from TARGET2 accounts 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 items of the liability base mentioned 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 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 assets 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 held for monetary policy purposes generate income according to the latest available interest rate for the main refinancing operations.

If the value of a 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 paid-up shares in the fully paid-up capital of the ECB.

1 Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the national central banks of participating member states from the financial year 2002 (ECB/2001/16) and amended by its decisions of 19 May 2006 (ECB/2006/7), 22 November 2007 (ECB/2007/15), and 14 December 2009 (ECB/2009/27).

The allocation of monetary income resulted in a net expense of €230 million for the Bundesbank. This net expense represents the difference between the €3,326 million in monetary income paid by the Bundesbank into the common pool and the Bundesbank's claim of €3,097 million – corresponding to the Bundesbank's share of the ECB's paid-up capital – on the common pool.

Other income

The remaining income amounted to €90 million compared with €143 million in 2008.

Staff costs

Staff costs fell from €954 million to €857 million on the year, mainly due to lower transfers to staff provisions. Staff provisions include, in particular, pension and healthcare subsidy commitments and provisions for staff restructuring schemes as well as commitments under the partial retirement scheme (see liability item 12 "Provisions").

Staff costs Table 22

	2009	2008	Year-on-year change	
Item	€ million	€ million	€ million	%
Salaries and wages	538	555	– 17	– 3.1
Social security contributions	82	83	– 1	– 1.4
Expenditure on retirement pensions	236	315	– 79	– 25.0
Grand total	857	954	– 97	– 10.2

Deutsche Bundesbank

Pursuant to the *Code of Conduct for the members of the Executive Board of the Deutsche Bundesbank*, the remuneration received by each member of the Bundesbank's Executive Board is published. For the year 2009, the President of the Bundesbank received a pensionable salary of €302,535.84, a special non-pensionable remuneration of €76,693.78, a special payment of €3,732.23 in accordance with the law on one-off extra pension payments and a standard expenses allowance of €5,112.96, amounting to a total of €388,074.81. In 2009, the Vice-President received a pensionable salary of €242,073.66, a special non-pensionable remuneration of €61,355.03, a special payment of €2,985.79 in accordance with the law on one-off extra pension payments and a standard expenses allowance of €3,067.80, amounting to a total of €309,482.28. Owing to the downsizing of the Executive Board to six members, only one new member was appointed to the Executive Board after two members left on 30 April 2009. From the period from 1 January 2009 to the time they left, the two departing Executive Board members received a pensionable salary of €59,940.76, a special non-pensionable remuneration of €15,338.76, a special payment of €1,492.89 in accordance with the law on one-off extra pension payments and a standard expenses allowance of €852.16, amounting to a total of €77,624.57. From the time he took office on 1 May 2009 to the end of 2009, their successor received a pensionable salary of €121,670.84, a special non-pensionable remuneration of €30,677.51, a special payment of €746.45 in accordance with the law on one-off extra pension payments and a standard expenses allowance of €1,704.32, amounting to a total of €154,799.12. In 2009, each of the three other members of the Executive Board received €232,423.69; €181,611.60 of this was in the form of a pensionable salary, €46,016.27 as a special non-pensionable remuneration, €2,239.34 as a special payment in accordance with the law on one-off extra pension payments and €2,556.48 as a standard expenses allowance.

Total payments to serving and former members of the Executive Board, former members of the Bundesbank's Directorate and of the Executive Boards of Land Central Banks, including their surviving dependants, amounted to €11,614,145.35 in 2009.

Other administrative expenses

The other (non-staff) operating expenditure increased year on year by €13 million (5.5%) to €250 million.

Depreciation on tangible and intangible fixed assets

The depreciation of land and buildings, of furniture and equipment and of computer software amounted to €193 million compared with €141 million in 2008 (see asset sub-item 11.2 "Tangible and intangible fixed assets"). The year-on-year increase results, in particular, from write-downs on real estate in connection with the decision taken in 2009 to streamline the Bundesbank's branch network.

Banknote printing

Expenditure on banknote printing amounted to €154 million compared with €157 million in 2008.

Other expenses

Other expenses fell on the year by €4 million to €19 million.

The Deutsche Bundesbank: key figures

	2008	2009
Staff[1]		
Core staff (full-time equivalents)	10,038	9,822
– Contraction since 31 December 2001[2]	4,762 (= 32.2%)	4,978 (= 33.6%)
Projected core staff (full-time equivalents)		
– End-2012 = 9,000		
Locations/core staff (full-time equivalents)[1]		
Central Office	1 / 3,474	1 / 3,517
Regional Offices	9 / 2,752	9 / 2,720
Branches	47 / 3,812	47 / 3,585
Annual accounts[1]		
Profit for the year	€6,261 million	€4,147 million
Net interest income	€8,429 million	€4,156 million
Balance sheet total	€612,563 million	€588,043 million
Foreign reserve assets (total)	€99.2 billion	€125.5 billion
– *of which* foreign currency	€27.7 billion	€25.6 billion
– *of which* gold	(3,413 t) €68.2 billion	(3,407 t) €83.9 billion
– *of which* receivables from the IMF	€3.3 billion	€16.0 billion
ECB capital key[3]		
Share of subscribed capital		18.9373%
Share of paid-up capital		27.1341%
Amount of the participating interest in the ECB		€1.09 billion
Foreign reserve assets transferred to the ECB		€10.91 billion
Money market transactions (main refinancing operations)		
Banks participating in the Eurosystem (average)	443	404
– *of which* using the Bundesbank as an intermediary	316	288
Amount outstanding for main refinancing operations in the Eurosystem[4]	€203 billion	€152 billion
– *of which* counterparties of the Bundesbank	€78 billion	€61 billion
Cash payments		
Volume of euro banknotes in circulation (Eurosystem)[1]	€762.8 billion	€806.4 billion
Volume of euro coins in circulation (Eurosystem)[1]	€20.4 billion	€21.3 billion
Value of DM/euro exchange transactions	DM184.5 million	DM162.8 million
Unreturned DM banknotes and coins[1]	DM13.83 billion	DM13.60 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 2009.
4 Daily average.

	2008	2009
Incidence of counterfeit money in Germany		
Euro banknotes (number)	40,800	52,500
Euro coins (number)	80,000	78,500
Cashless payments		
Payments via the Bundesbank (number of transactions)	2,516.0 million	2,634.4 million
– *of which* via RPS	2,462.9 million	2,585.5 million
– *of which* via TARGET2-BBk	46.5 million	44.7 million
Payments via the Bundesbank (value)	€253 trillion	€176 trillion
– *of which* via RPS	€2,344 billion	€2,295 billion
– *of which* via TARGET2-BBk	€248 trillion	€171 trillion
Share of TARGET2-BBk transactions in EU-wide TARGET2 system	49%	Approx 50%
Banking supervision		
Number of institutions to be supervised	3,030	3,589
Audits of banking operations	215	223
Monthly returns processed	32,425	30,291
Audit reports processed	5,869	6,328
Reports on Own Funds Principle (Solvency Regulation)[5]	27,013	8,684
Reports on Liquidity Principle (Liquidity Regulation)	25,847	26,052
Meetings with senior management	2,465	3,051
Cooperation with foreign central banks		
Training and advisory events	296	309
– Number of participants (total)	3,610	3,557
– Number of participating countries (total)	91	99
Selected publications (editions/circulation)		
Annual Report	1 / 20,800	1 / 20,000
Financial Stability Review	–	1 / 17,800
Monthly Report	12 / 17,200	12 / 16,700
Statistical Supplements	52 / 3,000	52 / 2,750
Research Centre Discussion Papers	50 / 380	50 / 324
Publications in academic journals/books	61 / –	51 / –
External communication/public relations		
Visitors to the Money Museum	37,100	38,780
Written answers to queries	18,600	15,700
Press releases	217	292
Visits to the website (www.bundesbank.de)	6,406,600	7,121,000
Training sessions on counterfeit prevention	850	1,200
– Number of participants	17,600	25,000

5 Since 2009, quarterly reports only.