# Press release



## Balance sheet press conference of the Deutsche Bundesbank on 21 March 2006

**Based on a tape recording**

Professor Axel A Weber, President of the Bundesbank

Our profit and loss account showed a profit for the year 2005 of €2.9 billion, which was €2.2 billion more than in 2004. The increase in profit is due primarily to the larger net interest income and to the much-reduced need to make write-downs on financial assets and positions, which was mainly a result of the depreciation of the euro. We transferred the full amount of the distributable profit of €2.86 billion to the Federal Government today.

The most important contributory factor to the annual surplus was net interest income, which rose, year on year, by €0.7 billion to €3.8 billion. The increases in interest income occurred in both monetary policy operations and US dollar assets.

Write-downs amounted to no more than €0.2 billion compared with €2.4 billion in 2004 owing to large depreciations in connection with the US dollar exchange rate.

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Dr Hans Georg Fabritius, a member of the Executive Board of the Deutsche Bundesbank

The Bundesbank balance sheet is essentially a mirror image of its monetary and foreign exchange operations. The balance sheet total rose by €51 billion from the previous year to €344 billion. One particular point worth mentioning is the substantial increase in the value of banknotes issued by the Bundesbank; this rose by €29 billion (or 15%) to €229 billion.

The rise in the volume of banknotes in circulation was offset by the increase of €13 billion to €204 billion in the refinancing operations of the credit institutions (asset item 5) and the increase of €22 billion to €30 billion in the TARGET claims arising from German banks' money imports (asset sub-item 9.4).

The entire volume of the banknotes in circulation in the euro area increased by €64 billion (or 12.8%) to €565 billion. This means that in terms of value 40% of all euro banknotes in circulation have been issued by the Bundesbank.

In the period under review the provisions declined by €0.5 billion to €5.4 billion. The general risk provision is maintained to cover currency risks, especially those arising in the Bundesbank's US dollar and SDR positions. The €0.2 billion decline to €2.1 billion is due primarily to the lower year-on-year fall in the level of special drawing rights held.

The provision for pensions declined by €0.1 billion from the previous year to €2.5 billion.
The provision for staff restructuring schemes was increased by €0.2 billion to €0.4 billion largely as a result of early retirement schemes for employees in connection with the structural reform. The main reason for this substantial transfer of funds is the rise in the number of early retirement agreements owing to the change in the tax treatment of severance payments at the end of 2005.

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Unrealised gains are not recognised as income but, instead, are shown in the balance sheet in liability item 13 “Revaluation accounts”. These arise if, at the end of the year, the market value of gold, foreign currency and securities is above the average acquisition costs carried forward.

The revaluation accounts rose by a total of €16 billion to €44 billion as a result of movements in gold (+€12.4 billion), the US dollar position (+€4.0 billion) and securities (-€0.1 billion).

The gold holdings themselves declined by five tonnes, falling from 3,433 tonnes to 3,428 tonnes as a result of the sale of gold to the Federal Ministry of Finance for the gold coin programme in the first year of the current gold agreement; this led to a profit of €47 million.

Professor Axel A Weber, President of the Deutsche Bundesbank

I would also like to say that, when the balance sheet was being drawn up at the turn of the year, the Executive Board decided not to sell any gold during the second year of the gold agreement. I informed the Federal Finance Minister of this decision in January of this year.

This does not affect the option to sell eight tonnes a year during the term of the agreement to be used in connection with the Federal Ministry of Finance’s gold coin programme. Five tonnes of the eight tonnes reserved for the first year were withdrawn, leading to the profit of €42 million shown in the balance sheet.

The Executive Board decides every autumn whether and, if so, to what extent the gold sales option will be exercised. The decisions about the nature and extent of the reserve assets are taken by us autonomously. This also applies to all decisions concerning the sale or reinvestment of reserve assets or the restructuring of our balance sheet as a whole.

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Dr Hans Georg Fabritius, a member of the Executive Board of the Deutsche Bundesbank

The increase of €2.2 billion in the profit for the year from €0.7 billion to €2.9 billion resulted from the following factors.

1. Increase of €1.1 billion in interest income to €6.0 billion
   - Interest income arising from monetary policy operations rose by €0.7 billion to €4.2 billion.
   - Interest income in foreign currency rose by €0.3 billion to €1.2 billion. This was due primarily to the higher average annual level of interest on US dollar assets.

2. Increase of €0.4 billion in interest expenditure to €2.2 billion

3. The write-downs on financial assets and positions declined by €2.2 billion to €0.2 billion. In contrast to 2004, no write-downs had to be made in 2005 as a result of valuation losses in the US dollar and SDR positions. In 2005 write-downs were made only on securities.

4. The exceptional effect arising from the charging-off off of D-Mark banknotes in 2004 did not recur: €1.2 billion.

5. The liability arising from the allocation of monetary income declined by €0.4 billion to €0.1 billion. The greater liability in respect of monetary income in 2004 was the result of the Bundesbank's share of the ECB's financial loss in that year. In 2005 the ECB did not incur a loss.

   The liability arising from the allocation of monetary income represents the difference between the €2,949 million in monetary income paid by the Bundesbank into the common pool and the Bundesbank's claim of €2,898 million – corresponding to the Bundesbank's share of the ECB's paid-up capital (29.6%) – on the common pool.

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6. Other changes: €0.1 billion net.
   A whole series of fairly small items is naturally involved here, but there are also some fairly large ones such as staff costs.

Staff costs increased by a total of €35 billion, or 3.7%, to €970 billion. The main reason for the increase is the greater need to transfer funds to the provision for staff restructuring schemes.

If the additions to and withdrawals from the provisions are disregarded, expenditure declined year on year by €10 million (-1.2%) owing to the reduction in staff numbers.

Overall, developments in staff costs shown in the profit and loss account (that is to say, as defined in financial accounting) between 2002 and 2005 were largely determined by expenditure on staff restructuring, notably provisions for early retirement, partial retirement and severance payments. This expenditure on restructuring will be much smaller in the coming years as the potential for staff restructuring measures will decline.

The sharp downward trend in the staffing costs of providing operational services (as defined in cost accounting), that is to say, excluding these temporary restructuring costs but including staff surpluses, shows that the Bundesbank is on course to achieve the reduction in staff costs planned for 2008 (ie €190 million less than in 2002). In 2005 the staffing costs of providing operational services were already just over €120 million below the level of 2002.

In 2006 the ‘dividend’ from the structural reform (reduction in the cost of providing operational services) will exceed the cost of the structural reform charged to the balance sheet for the first time. By the end of 2007 a cumulated net saving of anything up to half a billion euro is expected according to present forecasts.

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The targeted saving of €90 million a year in material costs envisaged in the structural reform was achieved already in 2004. Despite the rise in energy costs and the cost of building work in preparation for multi-denominational processing in the branches, the material costs of providing operational services were held last year at the 2004 level.

Professor Axel A Weber, President of the Deutsche Bundesbank

The main aims of the structural reform are to improve cost-effectiveness and strengthen the bank’s focus on Europe. The implementation of the new organisational blueprint that was adopted in 2002 was completed on schedule at Central Office and in the regional offices in 2005. This consisted primarily in streamlining the organisational structure and shortening the decision-making and reporting channels. I must mention here that we have already cut about 50% of the management positions in the regional offices and branches. We now make a very clear distinction between the functions performed at Central Office and in the regional offices and branches, and for the Bank as a whole we have concentrated the operational activities of various work areas such as procurement in 21 services centres. This restructuring measure was also completed in 2005.

There will be further consolidation in our range of services. In cash management, for example, we shall largely be withdrawing from processing coins. With respect to our branch strategy, we had reduced the number of branches and operating units by 49 to 78 by the end of 2005. That is a 39% reduction since 2001. The aim is to reduce the network to 47 locations by the end of 2007. This reduction is currently on track.

So, how far have we got with the structural reform? The first point to mention is that we reduced the costs of providing operational services in 2005 (excluding the cost of banknote printing) by €256 million, which means that they are now about 20% less than in 2002. We have also achieved a cut in the number of staff since the start of the structural reform in 2001 by reducing the number of core staff by 3,343, or about 21%, to 12,308 (that is of the end of 2005).

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It now looks as though we shall be able to achieve, as a result of the structural reform, savings of about €280 million from 2008. That is equivalent to about 22% since the start of the structural reform. €190 million will be savings on staff and €90 million on material costs including write-downs.

Regarding the employment level at the Bundesbank, I would like to add two further points which are important for the Bank and which impinge on the aforementioned outlook. The first concerns the future course of our structural reform within the current planning period up to the end of 2007. We expect that the number of staff will fall to 11,300. That represents a further reduction of about 1,000 employees.

The second concerns the further reduction in staff levels with which we wish to press ahead between the end of the structural reform and the year 2010. The reduction in staff will continue until the number eventually reaches about 10,300. That means that between now and 2010 there will be a further cut of 2,000 employees. In my opinion, however, the number of full-time equivalent jobs is more important than the head count. Up to the end of 2010 we shall be working towards an employment position that is equivalent to 9,800 full-time employees.

This change in the staffing level is important because it shows, in particular, that we shall make further cost savings from staff reductions beyond 2007 in addition to the reduction in material costs.

The other important point worth mentioning is that the structural reform has focused on the reorganisation and consolidation of the Bank’s service profile and on the streamlining of management levels between Central Office, the regional offices and the branches. The most important new elements of structural reform II, for which we are currently planning the strategic targets, may be summarised by saying that we want to focus the Bundesbank on its core business areas very much more than in the past. This planning process is now under way, and the strategic horizon covers the period between 2008 and 2012. Our primary concern here is to enhance the Bundesbank’s profile as the largest central bank in the Eurosystem. On the Executive Board we see the Bundesbank’s future core business areas in five of our main activities.

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- Monetary policy. The Bundesbank wants to improve its standing by further extending its influence in this area. We want to extend and safeguard our role and the part we play in formulating the monetary policy of the European System of Central Banks by augmenting our capacities in the field of monetary and macroeconomic analysis.
- Banking supervision. We want to play our part in ensuring that, while implementing Basel II and adequately representing German interests in the European and global supervisory bodies, we also help to improve banking supervision in Germany.
- Cashless payments. Together with the Banca d'Italia and the Banque de France, we want to promote the single shared platform of TARGET 2 and, as the German central bank, we, in cooperation with the credit institutions, are involved in the creation of a single European payments area (SEPA).
- Financial and monetary system. In this area we have already begun to extend our expertise by publishing a *Financial Stability Review*. We also want to continue focusing our resources on the early identification of crises and on evaluating risks to financial stability. The Bundesbank is represented by me in the International Monetary Fund as I am a governor of the IMF. We cooperate in very many international bodies and want to continue promoting this work here in the Bank and to enhance our profile in this field.
- Cash management. By applying advances in technology to multi-denominational processing, we want to achieve additional synergies at the Bank. And we want to assist in implementing the Framework in the European System of Central Banks.

In addition to these five core areas, which we have outlined again, the underlying basis is to be seen in two aspects: we see the Deutsche Bundesbank as an institution in which research and our joint work in international bodies will be important in future for our external profile, in other words, our expertise and our international profile are the basis of our actions. This is something that we want to strengthen. And in the months ahead we shall develop in these various areas a somewhat clearer and more precisely defined role by identifying and assessing, for example, tangible products or features of the Bundesbank

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that are important for its external presence and by redirecting relevant staff development measures to that end.

A key objective for me during my period of office up to 2012 is that we make progress not only in consolidating but also in refining our profile and in focusing on specific areas of responsibility as well as continuing to slim down the Bundesbank through this structural reform to fulfil only those functions which we think are important.