Finance Group

German Savings Banks Association

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Key messages

from **Helmut Schleweis**

President of the

German Savings Banks Association

and **Karolin Schriever**

Executive Member of the Management Board

at the DSGV press conference held to mark

the Annual Meetings of the

World Bank and International Monetary Fund

on 12 October 2023 in Marrakech

Deutscher Sparkassen-
und Giroverband
Charlottenstraße 47
10117 Berlin

Theme 1: ***Economic development***
Key question: Is Germany being left behind and what does that mean for the prosperity we have achieved?

Key messages from DSGV President Helmut Schleweis:

- The global economy is undergoing a **period of weakness** and is constantly confronted with new crises. Existing geopolitical uncertainties have been further compounded by the war between Hamas and Israel. Much will depend on whether this appalling war can be contained within the region. Any indication of Iran's complicity could have a tangible impact on the global economy through the **oil price**.

- As things stand, we expect to see **mild economic recovery** from 2024 – not least because investments delayed during the crises are gradually catching up.

- **Europe** will take a little longer to recover. But here too we expect next year to bring declining rates of inflation and slightly positive growth.

- Compared with other industrial countries, **Germany** will trail the field this year and probably next year too. This is due to our great dependence on exports but also to specific structural weaknesses. These weaknesses can be countered effectively by taking determined action.

- Recent years until the outbreak of the Covid-19 pandemic were substantially defined by globalisation, the permanent availability of goods and extremely low interest rates. That period is over. The coming years will be marked by **geopolitical tensions, shortages and a level of inflation that remains too high.**

- For Europe in particular, a key role will be played by the **three big D's – deglobalisation, demographics and decarbonisation**. These are tempering growth and sustaining the inflationary pressures. For Germany, two more D's are also relevant – the danger of **deindustrialisation** due to the excessive costs of energy and bureaucracy and a great need to catch up on **digitalisation**.

- Doping in the form of debt-funded spending programmes at low interest is a thing of the past. Now is the **time for economic and structural policies** – and hence for policymaking in Germany. The challenges can be overcome by taking resolute action. Three points are especially important here:

- <u>First:</u> The **skilled labour** force in Germany will shrink between now and 2040 by 3.1 million people (8.8 %). This above all concerns non-academic qualifications. In the next five years, only half of the demand for skilled labour with MINT[1] qualifications can be met. So the biggest shortage is of skilled labour.

[1] MINT = Mathematics, Information Science, Natural Sciences, Technology

- If an ageing society maintains a high level of consumption but produces less and less, inflation is constantly driven upwards and that erodes our social system. To meet the demand for labour, Germany needs an inflow of up to 400,000 **migrants willing and able to work** every year.

- Constructive immigration will only be possible, from the organisational and mental perspective, if irregular migration is resolutely and effectively curbed while <u>at the same time</u> establishing an immigration system fit for today's purposes.

- Persuading people to adopt a longer working life is crucial to upholding the prosperity balance.

- <u>Second:</u> The availability and price of **energy**. Achieving the goal of climate neutrality will require about 6 per cent of annual GDP to be invested in the German economy alone up until 2045. This additional capital requirement will push up interest rates. Meanwhile, the carbon price will be rising and will translate into persistently high energy prices.

- To preserve economic prosperity, therefore, it is essential that the transition to **renewables** offering better value for money is achieved as soon as possible. The keys to this lie in expanding the networks faster and adopting storage technologies. That cannot be accomplished with the complicated, long-drawn-out planning and approval procedures in place today. These must truly and rapidly become shorter and leaner. Building the LNG terminal in Brunsbüttel showed what can be done. This German tempo must not remain a one-off experience.

- <u>Third:</u> **Digitalisation** is an essential key to solving a whole number of structural problems in Germany. Artificial Intelligence, in particular, provides grounds for hope. Two thirds of today's jobs will be directly or indirectly affected by AI. Estimates suggest that generative[2] AI alone can replace up to a quarter of the work currently performed by humans.

- This harbours an opportunity for much higher **productivity**. Germany has an urgent need for that, especially in these times when labour is in short supply. Some forecasts suggest that AI will boost annual global GDP by up to 7 per cent. We take a more cautious view, although a resolute deployment of AI will boost economic momentum substantially in Germany too. This ought to be a priority for public funding so that a digital push can at last bring about the modernisation of public infrastructure – and not least the system for permit approvals. Estonia, for one, has shown us what is possible.

- One point, however, is especially important to me in this context: the **mindset** in our country. Germany may currently have problems, but we are still strong enough to resolve them.

[2] Generative AI = technology that synthetically creates "new" content, e.g. text, images, video or audio content

- Small and medium-sized enterprises form the powerful economic backbone of our country – well capitalised, with adequate liquidity and great innovative energy. But this backbone must not be unduly strained. These small and medium-sized businesses need greater entrepreneurial freedom and room for manoeuvre, especially by reducing the burden of red tape. Germany can and must break out of these chains.

Theme 2: Interest rates
Key question: What future can consumers expect and how should they respond intelligently?

Key messages from DSGV President Helmut Schleweis:

- The phase of double-digit inflation rates is behind us. Monetary tightening is taking effect and very high **inflation is receding**. We therefore do not expect further rate hikes in the Euro zone in the foreseeable future and advise that this is a time to wait while the impact of these dramatic rate increases kicks in. Rate cuts are unlikely before late 2024 **at the earliest**.

- While **inflation** remains high, investors can expect negative or at best very low **real rates of interest**. Under these conditions, overnight deposits will not beat inflation. The public fixation with overnight deposits is not, therefore, a recommendable basis for investment.

- The best way to preserve purchasing power in the longer run is to hold a diverse **portfolio of securities**. Investors must be willing and able to withstand fluctuating values. In our assessment, the equity markets will continue moving sideways in the short term as prices range substantially up and down. In the medium term, they will benefit once again from global growth and the restructuring of the economy towards digitalisation and sustainability.

- Faced with this new inflation and interest environment, fluctuations in the capital markets and the phenomenon of negative or at best very low real interest rates, the broader population are crucially in need of **good advice**. That is why we have been campaigning against any new hurdles for small investors seeking that advice. Such hurdles are created if people have to pay for their advice even if they do not purchase a product. Or if the costs of providing advice to small investors cannot be shared, in a spirit of solidarity, by charging commissions on volume. There must be no ban in the EU on commission-funded advice and no obligation to charge a fee to the customer.

Theme 3: Bank regulation and sustainability
Key question: What does it mean for businesses and consumers if regulation of the financial markets and banking sector is designed to channel more and more capital towards sustainable (environment-related) purposes and how can people prepare for or benefit from this?

Key messages from Karolin Schriever:

- Helmut Schleweis has already mentioned that effective **climate action demands substantial investments**. This calls for framework conditions that promote investment and the commercial profitability of pro-climate business models rather than obstructing them.

- **Regulatory and supervisory requirements** around sustainability have increased considerably in recent years. The EU is successively imposing duties on banks, investors, insurers and companies based on the EU Taxonomy Regulation and related disclosure rules with regard to measuring sustainability and reporting results.

- We support the objective behind these political measures but we believe that the chosen approach, a proliferation of bureaucratic requirements, is wrong. Political micromanagement of market players acts as a constraint on the **market** and hence on the entrepreneurial creativity that can generate faster, better solutions. In our view, the aim should be to provide economic incentives for climate-related improvements instead of generating an additional bureaucratic workload.

- Climate impacts are the adverse external effects of economic activities. But the economic consequences are usually borne not by those who actually caused the problem but by society as a whole. That means that these impacts are not sufficiently reflected in the **pricing** of goods. In a market economy, however, price is the most effective way to influence behaviour.

- Instead of trying to channel capital towards politically desirable goals by means of governmental regulation, we believe it is better to put a price on the use of resources so that this is firmly factored into any economic calculations. One option is a **symmetrical carbon tax**. This would not only attach a price to new carbon emissions but also reward the absorption of atmospheric carbon. In market economies, a price mechanism like this is far superior to a policy of prohibition.

- **Carbon pricing creates incentives** for business enterprises and individuals to cut their emissions. It lets the market identify the most efficient way to reduce the footprint. That generates public **revenues** which can then be used to invest in renewables, pro-climate infrastructure and not least social compensations for excessive burdens on individuals.

- It is vital, however, that carbon pricing does not **shift emissions** into countries with poorer environmental standards. That is why we believe it is important to put the case at international conferences like this for a concerted approach – at least among the industrialised nations.

- Let me point out that **evasion** is likewise a problem for **European regulation**. There too, there is a risk that companies with environmentally harmful activities will dodge the issue by shifting to less well regulated markets. That is why sustainability is a global challenge which always calls for international cooperation, with commercial solutions to be favoured over management by governments.

- The need for global cooperation also applies to **taxonomy standards and sustainability reporting.** Today's capital markets are oriented towards the international arena. Given that investment strategies are internationally framed, European standards (EU CSRD reporting vs. ISSB reporting) are difficult to uphold. Asset managers cannot easily rate international portfolios based on European standards. Different interpretations of sustainability mean, however, that customers cannot understand what actually goes into a sustainable financial product. This results in considerable investor uncertainty. There is a risk that this could erode the honest desire to invest in sustainable causes.

- One important thought on the significance of **globalisation** in this context. We are seeing that it has passed its peak and that renationalisation and protectionism are gaining ground once more.

- From a German perspective, deglobalisation makes painful inroads into value creation, triggering a **loss of prosperity** because our economy is export-driven and has been built on an international division of labour. A renationalisation, or even a re-Europeanisation, of our economy would entail substantial economic costs. The Ifo Institute concludes that relocating production back to Germany would cut our GDP by 9.7 per cent and relocating it back to the EU by 4.2 per cent. Germany therefore has a fundamental economic interest in advocating good international relations and minimal disruption to global trade. This means that foreign policy must respond with sensitivity and understanding to other value systems. Germany should maintain a clear moral compass without seeking to lecture the world.