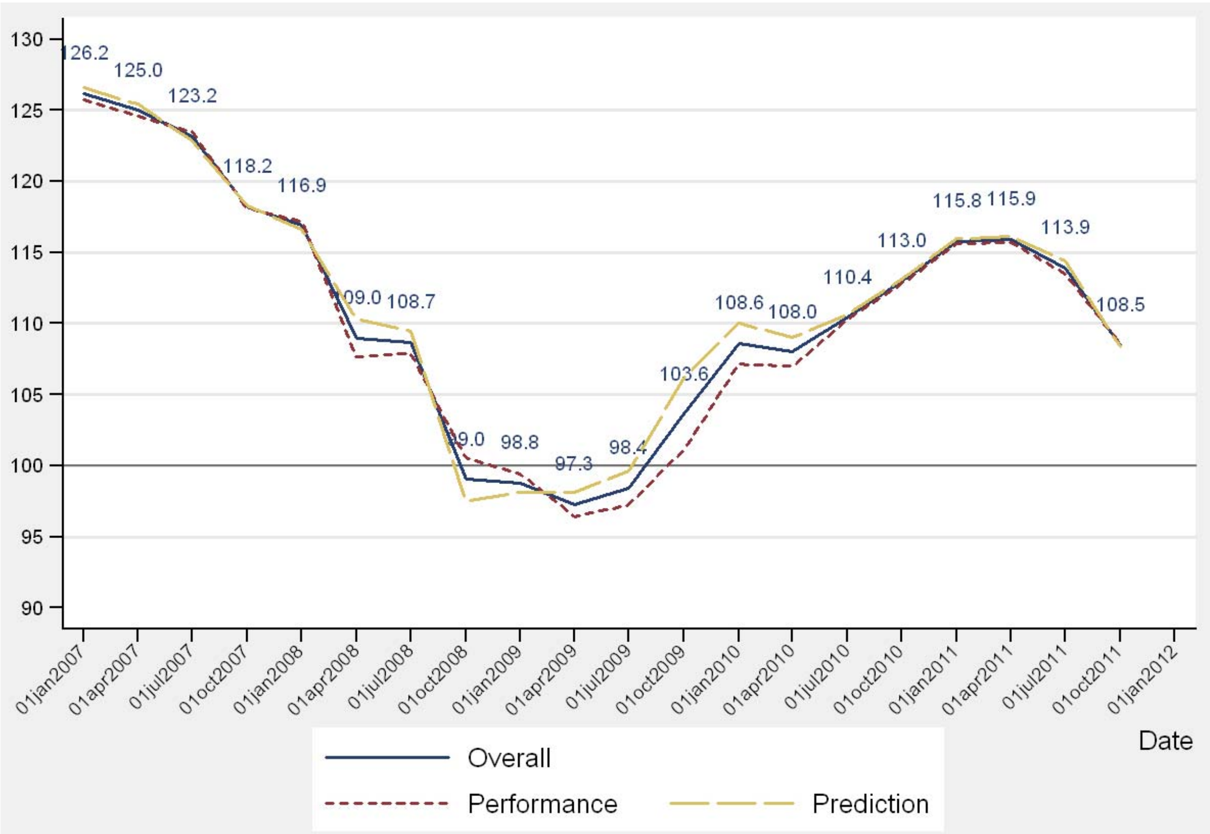
Press release

## CFS Financial Center Index drops sharply
## Earnings from financial institutions collapse / Basel III: Banks and financial service providers expect price increases in credit business

FRANKFURT, October 19. The outlook for the current business in the German financial industry has dropped significantly in October. The CFS Financial Center Index recorded a fall by 5.5 points in the third quarter compared to the previous quarter. The index, however, remains with 108.5 points, still in a positive range.

**Figure: CFS-Financial Center Index**




Among the four business indicators (sales, earnings, staff numbers and investment volumes) the drastic decrease in earnings is the main reason for the index change. This becomes apparent especially in the group *financial institutions and brokerage firms* (-15.2 points) and in the group *financial sector service providers* (-10.4 points). Only the group *supervisory and academic institutions* expect a better overall business climate (+3.9 points).

**Financial sector continues negative trend**

In the group *financial institutions and brokerage firms*, the business climate in the last quarter has cooled down markedly (-7.9 points). The shortfall in the group results in particular due to a decline in sales and earnings figures (-10.3 and -15.2 points). For the first time since the collapse of Lehman Brothers (Q4 2008), a majority of companies again recorded declining earnings (97.5 points). The earnings expectations for the coming quarter (Q4) are stable (101.0 points). The decline in staff development (-4.1 points) and investment (-6.4 points) are slightly lower than in earnings. “The changing conditions under which the banking business will take place in the future sustainably affect earnings expectations of the banks. In all likelihood, the income earned in the past can no longer be achieved in this form,” explains CFS director Professor Dr. Jan Pieter Krahnen.

In the group *financial sector service providers*, the financial situation has also deteriorated significantly in the last quarter (-6.0 points). The service providers reported a worse financial position (-10.4 points). For the current quarter, the group has revised its expectations, given the recent downward trend. Thus, in contrast to the data of this group in the past, the trend of rising business expectations is no longer present.

The group *supervisory and academic institutions* reported declining earnings figures (-8.2 points). Nevertheless, more employees are hired (+8.2 points). Above all, a comparatively robust business volume ensures that in this group the entire development is positive (+3.9 points).

Overall, the groups estimate the future international importance of Frankfurt as a financial center to be less positive than it was three months ago (-4.6 points). This can be seen in the long run as a continuation of a downward trend that began in 2009. “The financial center of Germany has not learned how to translate the relative strength of the German economy in the euro area in an appropriate competitive position of the financial market,” says Krahnen.

**Basel III: Banks expect low credit supply**

As for the recommendations of the Basel Committee on Banking Supervision for the introduction of Basel III guidelines and the associated higher equity capital requirements for banks, the majority of respondents rated the recommendations positively. The majority also expect the new rules to impact lending and thus the real economy.

The majority of surveyed banks have the opinion that with the introduction of Basel III, the stability of the German banking system will increase (70%). Also, the majority of the surveyed non-credit institutions agree with this assessment (78%). Concerning the effect on competition of banks in Germany, there is no uniform picture. Less than a third of the surveyed banks and 38% of other respondents believe that the introduction of Basel III will lead to an increase in competition, while 23% of the respondents expect that it will have no impact.

A significant need for action with the introduction of Basel III and the increase of equity capital requirements is seen by the majority of respondents only in private commercial banks (60%) and public-sector banks (56%) but not in co-operative banks (25%). The proposed core capital ratio of 7% is seen by the majority of credit and non-credit institutions as appropriate (58% and 47%). Less than a fifth of the credit institutions and more than a third of non-credit institutions which made a statement call for a higher core capital ratio. The relative majority of respondents (47%) believe that the majority of banks in Germany are in a position to fulfill Basel III "without greater difficulty." It is noteworthy that a relatively high proportion of respondents (38% of banks and 37% of non-credit institutions) do not believe that the implementation will run smoothly. The planned phased introduction of the Basel III guidelines (from 2013 to 2019) were assessed by the majority of credit institutions (57%) and half of non-credit institutions as "appropriate." Among institutions which submitted a statement, nearly a quarter of the banks and more than a third of non-credit institutions consider the launch speed to be too slow. As for possible effects of Basel III on the real economy, 63% of respondents expect a shortage and/or a rise in credit prices.

**Banks insist on level playing field**

About 75% of the surveyed banks reject the introduction of Basel III, if the rules are not internationally implemented at the same time. The relative majority of the surveyed non-credit institutions (47%) share this opinion. When asked about introducing the rules even when they cannot be implemented at the same time, 15% of credit institutions and 44% of non-credit institutions agreed. “The differing responses point to different areas of concern by international competition,” notes Krahnen.

Two-thirds of all respondents that made a statement are also of the opinion that there will be a shift of risk from the regulated to the unregulated financial sector. “For the next few years, the expected shift in risk is likely one of the major construction sites of financial market regulation – not least because they can threaten the stabilizing effect of Basel III," said Krahnen.

**Index calculation of the CFS Financial Center Index**

The CFS Financial Center Index is based on a quarterly management survey of currently 400 enterprises of the financial center of Germany. The survey contains four questions about the participant's view on different business parameters (transaction volume, profits, employment and investment in product- and process innovations). The answers to the questions may be given as "positive", "neutral", or "negative" and a response is requested for the previous and the current quarter. The index is compiled from different sub-indices, as all participants are allocated to branch-specific groups. Within each group, a balance of the share of positive and negative responses is evaluated and transformed into performance data. These performance data are then aggregated in order to constitute the CFS Financial Center Index. Due to construction, the maximum index value is 150, the minimum index value is 50; a value of 100 signalizes a neutral business sentiment. The survey-panel consists of enterprises and institutions of the financial industry and selected companies, which profit from the financial sector.

**History and Future prospects**

The CFS Financial Center Index is part of the Hessian project "Financial Center Monitoring", which is to measure the competitiveness of the financial center of Germany in a European context. The project is supported by Helaba, the Landesbank Hessen-Thüringen. More information about the CFS Financial Center Index, e.g. an overview of the survey and a broad definition of the German financial center can be found at: www.financialcenterindex.com.

**Profile CFS**

The Center for Financial Studies (CFS) is a financially independent research institute, affiliated to Goethe University Frankfurt. CFS conducts independent and internationally-oriented research on financial markets, financial intermediaries and monetary economics and interacts as the German partner with other international research centers specifically on the subject of financial market architecture and the role played by banks and stock exchanges. President of CFS is Prof. Dr. Dr. h.c. mult. Otmar Issing. Chairman of the supporting association: Dr. Rolf-E. Breuer. Overall management of the institute is conducted by the directors Prof. Michael Haliassos, Ph.D., Prof. Dr. Jan Pieter Krahnen, Prof. Dr. Uwe Walz.

**Profile Frankfurt Main Finance**

In Frankfurt Main Finance, the financial industry, the State of Hesse, the City of Frankfurt, as well as scientific institutions and the services sector have joined forces in order to strengthen Frankfurt's position in competition among the world's financial centres. Frankfurt Main Finance has 27 members: Bankhaus Metzler, Commerzbank, Corealcredit Bank, Crédit Agricole Cheuvreux, Close Brothers Seydler Bank, Deutsche Bank, Deutsche Börse, Deka Investments, Deutsche Vereinigung für Finanzanalyse und Asset Management (DVFA), DWS Investments, DZ Bank, Fides Falk Financial Services, Frankfurter Sparkasse, Frankfurt School of Finance and Management, Frankfurter Volksbank, GFT Technologies, Helaba Landesbank Hessen-Thüringen, House of Finance, ICF Kursmakler, Interxion, the State of Hesse, Lupus Alpha, Morgan Stanley, dr P. Keppler Verlag, Roland Berger Strategy Consultants, Royal Bank of Scotland, the City of Frankfurt, Steigenberger Frankfurter Hof, Tata Consultancy Services Deutschland, UBS Deutschland, vwd Vereinigte Wirtschaftsdienste, White & Case, WHU – Otto Beisheim School of Management and Wolfgang Steubing AG.

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