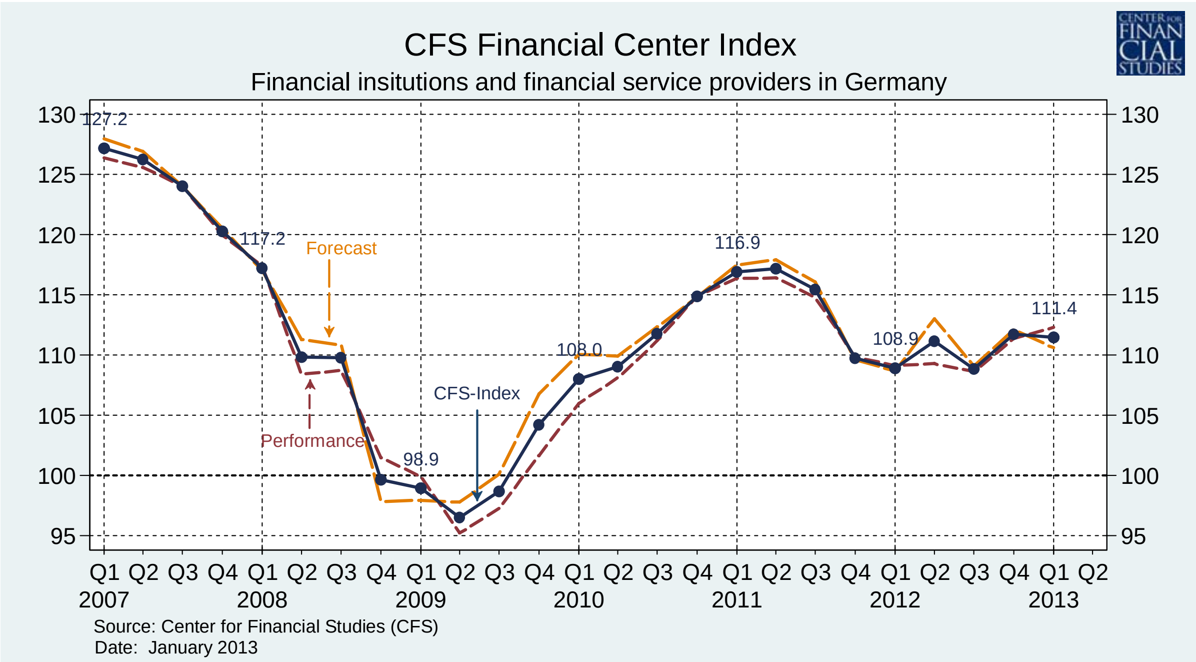
Press release

CFS Financial Center Index remains stable at a solid level

Earnings of financial institutions in Q4 increased significantly / Special survey on sovereign debt crisis: Confidence in the cohesion of the EMU has risen strongly

FRANKFURT, 21 January. The CFS Financial Center Index performed well at the beginning of the first quarter 2013 and amounted to 111.4 points. Financial institutions and service providers in the German financial center increased their revenues significantly in the fourth quarter of 2012. The expectations for the first quarter of 2013, however, have become rather subdued. There was a surprisingly strong negative movement in employment level, especially for financial institutions. Professor Jan Pieter Krahnen, Director of the Center for Financial Studies, explains: "The stabilization of the financial center index is associated with increases in productivity. These are achieved by financial institutions with cutbacks in staff."
The special survey on the European sovereign debt crisis showed that 85 percent of the respondents believe that the crisis has not been overcome yet. However, the confidence in the cohesion of the European Monetary Union has risen significantly in the recent months. Six months ago, the majority of the respondents assessed the probability of an exit from the monetary union within the next 2 to 3 years as high. However, the majority now believes this scenario to be rather unlikely.



Financial institutions and service providers increased their earnings

After a good third quarter 2012, both the financial institutions and the service providers in the German financial center continued to increase their **earnings** in the fourth quarter of 2012. Within the group of financial institutions, the earnings increased by 7.6 points, within service providers by 8.7 points. At the beginning of the fourth quarter 2012, both groups expected only a slight increase. For the first quarter of 2013, both financial institutions and service providers have cautious forecasts and anticipate a decline in income to the level recorded in the third quarter of 2012.

In terms of business volume / **revenues,** financial institutions and service providers reported also a moderate increase in the fourth quarter relative to the previous one (+3.2 points and +3.4 points). In the group of financial institutions, the upturn was below expectations from the beginning of the quarter. On the other hand, the group of service providers exceeded their rather subdued expectations. For the first quarter of 2013, financial institutions expect a slight increase in business volume, while service providers expect a decline.

The **investments** declined slightly for both the financial institutions and the service providers (-1.1 point). The financial institutions forecasted an increase at the beginning of the quarter and were thus behind their expectations. The service providers, on the other hand, were expecting a big decline, so the fact that only a small negative change occurred was a positive surprise. For the first quarter of 2013, financial institutions are again expecting a substantial increase in investment, while service providers remain slightly pessimistic.

The sub-index **employment level** of financial institutions fell significantly (-7.8 points) in the fourth quarter of 2012 and is now below the neutral score of 100 points. Moreover, for the first quarter of 2013, financial institutions expect a further decline in the number of employees. Service providers marginally increased the employment level (+0.7 points) despite their negative expectations and forecast further rises for the first quarter of 2013.

In comparison to the previous quarter, the respondents estimate the future importance of the German financial center much more positively (+11.4 points). In this respect, Professor Jan Pieter Krahnen says: “For the international importance of Germany as a financial center, this is the strongest upward trend since the beginning of the survey in 2007. This upward trend shows in particular the growing importance of Frankfurt as a regulatory center in the euro zone."

Special Survey: European sovereign debt crisis not yet over; Exit of a member country from the euro no longer highly probable

In the special survey, 85 percent of respondents answered negatively on the question of whether the European sovereign debt crisis has been overcome. This group of respondents assesses that in order to fully solve the crisis, further structural reforms in the crisis countries (50%) and a unified European banking supervision (25%) are needed. Professor Jan Pieter Krahnen says: "The European sovereign debt crisis is seen overwhelmingly as enduring. In this respect, there is a particular need for action regarding structural reforms in the crisis countries, followed by a single bank supervision. Only in third place comes the question of a European liability. These responses coincide quite well with the current policies in Brussels politics. Hence, there is a general agreement for prioritizing structural reforms and single bank supervision. "

Only ten percent of the respondents expressed the opinion that the crisis has been overcome based on the bond purchase program by the ECB (70%), the reforms in the crisis countries (70%) and the unlimited supply of liquidity by the ECB (67%).

The confidence in the cohesion of the European Monetary Union expressed by the panel participants increased significantly in the last six months. In July 2012, the probability that the euro area will experience an exit of a member country within the next 2 to 3 years was, on average, assessed to be as high as 56 percent, whereas in the current survey, it amounted to less than a half by dropping to 25 percent.

Macroeconomic conditions: Low interest rates will be kept for short to medium term; Probability of an asset bubble in real estate market most likely

Half of the respondents expect that the low interest rate policy in Europe will continue for the next two years, while 40 percent anticipate that low interest rates will be carried out for the next five years. The probability that the interest rates will remain low for an extensive period of time is perceived to be higher by the financial institutions than by the service providers. Public and cooperative banks have beliefs similar to the general public. On the other hand, less than one third of private bank representatives expect the policy to be continued for only two years and the majority from this group assess that it will be prolonged for the next five years.

More than 60 percent of the respondents assume that the unlimited liquidity access program by the European Central Bank will last for the next two years, whereas 30 percent of the respondents expect the program to continue for five years or more. The majority of the representatives from private and public banks expect unlimited liquidity access to be provided for the next two years, whereas in public banks, a total of 40 percent expect unlimited liquidity access to be as long as 5 years.

The weighted average of the answers about the continuation of the low interest rate policy leads to an estimate of 3-4 years. However, the same calculation for the unlimited liquidity access by the ECB suggests a shorter duration (2-3 years). Prof. Dr. Jan Pieter Krahnen comments: "Taking into account the expectations of low interest rate and unlimited liquidity access policy by the ECB, it is clear that respondents assume that the low interest rate policy will be maintained longer than the generous supply of liquidity by the Central Bank. In other words, it is mainly expected that the end of free bank refinancing by the ECB will not lead to a rapid change in interest rates."

When asked in which asset class the emergence of an asset bubble is currently most likely, 57 percent of the respondents see the highest probability in the real estate sector, 19 percent in the bonds market, 6 percent in the equities market and 5 percent in the commodities market. The breakdown by banking groups showed significant differences on this issue. The respondents from public and cooperative banks assessed the risk of a price bubble in the real estate sector as very high, but the representatives of the private banks chose this answer in only 24 percent of the cases. Additionally, as much as 43 percent of the respondents expect an asset bubble to form in the bond market.

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. 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.

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.

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