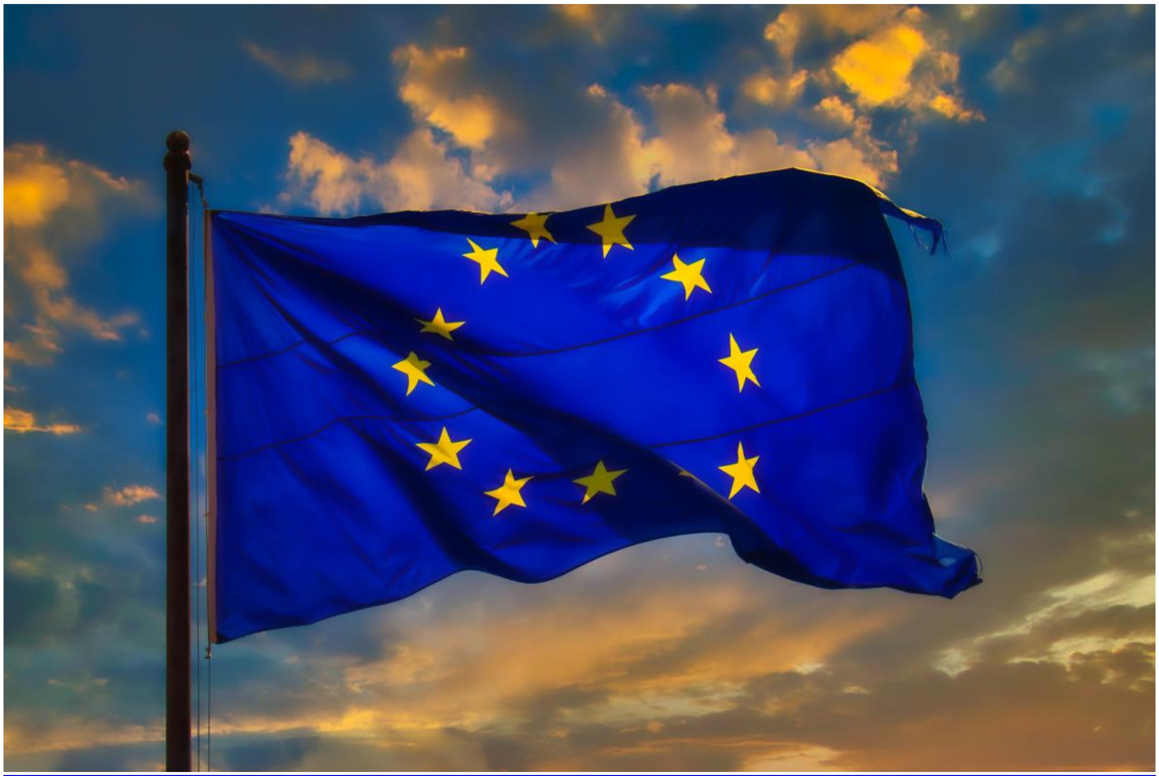
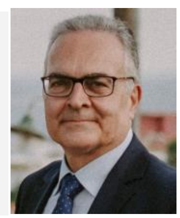


Solvency 2 News, March 2024



The European Insurance and Occupational Pensions Authority (EIOPA) published its revised Staff Paper on demand-side factors contributing to the low uptake of natural catastrophe insurance across Europe.

The Paper explores the barriers that keep consumers from buying insurance against natural catastrophes. It also proposes a number of consumer-tested solutions to overcome these challenges and in so doing, bolster European households' and businesses' resilience to extreme weather events.

With only about a quarter of natural catastrophe (NatCat) losses insured on the continent, Europe faces a significant protection gap.

While some causes of this gap stem from limitations in the supply of NatCat insurance products (see earlier work on Impact Underwriting and on Exclusions), consumers are not sufficiently engaging with the products available on the market.

Barriers

To better understand why consumers may be hesitant to invest in NatCat insurance, EIOPA carried out behavioural research on the topic. The findings reveal several barriers and drivers that can negatively impact the willingness of households to buy coverage against natural disasters.

Figure 1. Summary of the identified demand-side barriers and drivers limiting uptake of NatCat coverage

Demand-side barriers	Demand-side drivers
• Income, financial literacy, experience with insurance products, and education all have an impact on the willingness to purchase insurance against natural catastrophes.	• In product related factors, for consumers, the most important factor is the premium, which largely determines the decision of whether to insure.
• Risk perceptions are significant in determining natcat insurance uptake, although they may not reflect the actual risk of individuals.	• Risk communication can be an effective tool to increase willingness to insure against natural catastrophes.
	• Insurance culture and social norms.
	• Expectations of public support.
	• Individuals' behavioural biases often negatively affect their uptake of natcat insurance.
	• Perceived difficulty of the purchasing process, including the need of selecting the most optimal policy and identifying the right level of coverage.

These barriers and drivers include:

- a strong focus on the premium rather than the overall usefulness of the product, leading to the perception that coverage is not affordable;
- lack of clarity in terms and conditions;
- previous negative experiences with insurance claims;
- misperceptions regarding the likelihood of being impacted by natural catastrophes;
- high expectations of state intervention in the event of a catastrophe; and
- the perception that the process of taking out insurance is complex and time-consuming.

Solutions

Based on the drivers identified and drawing insights from behavioural science, EIOPA developed and tested a series of solutions to encourage greater uptake of NatCat insurance in Europe. Uptake-increasing solutions include:

- raising awareness of the level of risk consumers face, such as via public or independent tools and with targeted messages at 'teachable moments' (e.g. prior to renting or buying a home);

- ➢ promoting more standardized and easily comparable products in terms of coverage, exclusions and pricing structures;
- ➢ streamlining the consumer journey during the purchasing process, including via digital channels; and
- ➢ offering incentives (e.g. premium discounts) for implementing risk-mitigation measures.

Petra Hielkema, Chair of EIOPA said:

“The devastating floods and forest fires of the past years have shown with unmistakable clarity that we are not immune to the effects of a warming planet. Even when natural disasters do not result in loss of life, they bring disruption and destruction that demand significant efforts to rebuild from. Insurance makes the recovery process faster and financially less painful, but insurance can only help if it’s being used. Today’s publication sheds light on critically important demand-side factors that will be key to raising Europe’s protection levels. Regulators, policymakers, and insurance professionals must work together towards dismantling the barriers identified and foster a better-protected, more resilient society.”

To read more: https://www.eiopa.europa.eu/new-eiopa-research-probes-reasons-behind-consumers-reluctance-taking-out-natural-catastrophe-2024-02-29_en

Insurance industry	Drivers	Public authorities
• Raise awareness about opportunities for adaptation. • Raise awareness on mitigation and prevention measures.	**Misevaluation of risks**	• Increase awareness about existing risks. • Provide clear guidance on risky zones – develop accessible tools that provide consumers with first-hand information on the risk they are facing. • Design communication campaigns targeting consumers to match their Natcat risk perception with actual risks.
• Targeted marketing. • Provide clearer and more frequent information on Natcat risk offer (i.e. information to be more frequent and salient	**Price perception (as high) and low awareness of available insurance coverage options due to insufficient advertising**	• Provide Natcat insurance coverage as default option and give the consumer the possibility to opt out. • Automatic information provided on consumers’ frequent touch points (e.g. when new property ownership is registered).
• Simplify the purchasing process. • Enhance product simplicity and ensure POG is implemented. • Implementation of simple product guidelines. • Provide adequate advise.	**Perception of a difficult and time-consuming purchasing process**	• Promote consumer journey simplicity. • Ensure comparability of all available insurance products with coverage for Natcat (PCW with enhanced comparison criteria additional to price). • Standardized disclosure.
• Design insurance policies which are easy to understand and comparable on attributes other than price, i.e. coverage etc.	**Contract complexity**	

Project Aurum 2.0: Improving privacy for retail CBDC payment

The BIS Innovation Hub Hong Kong centre has launched the second phase of Project Aurum, in collaboration with the Hong Kong Monetary Authority.

After testing the feasibility of a technological stack that integrates a wholesale interbank system and a retail e-wallet in its first phase, Project Aurum 2.0 will now focus on how to enhance privacy for retail central bank digital currencies (CBDC).

Privacy is one of the key considerations of consumers when contemplating the adoption of CBDC, as highlighted by several public consultations on the topic in different countries. Central Banks recognise the importance of privacy and exploring measures to balance privacy and transparency.

Building on the existing Aurum prototype, the next phase aims to leverage expertise from multiple disciplines, by collaborating with universities and privacy experts. The project seeks to advance the practical understanding of central banks around privacy when designing their CBDC systems and demonstrate to public sector how technology can protect personal data in the CBDC space.

Project Aurum: a prototype for two-tier central bank digital currency (CBDC)

Project Aurum is a collaboration between the BIS Innovation Hub Hong Kong Centre, the Hong Kong Monetary Authority, and the Hong Kong Applied Science and Technology Research Institute.

The project will focus on privacy by design as a principle and will explore the relevance of several privacy-enhancing technologies, including pseudonymization and zero knowledge proof. It will also test how increasing privacy affects the performance and compliance of a system.

To read more: https://www.bis.org/about/bisih/topics/cbdc/aurum2_0.htm

In the era of digitisation, central banks stand before a choice: does retail central bank money need to go digital and, if so, how? Jointly embarking on the challenge to design a full-stack central bank digital currency (CBDC) system, the Bank for International Settlements (BIS) Innovation Hub Hong Kong Centre and the Hong Kong Monetary Authority (HKMA) dubbed the project "Aurum", the Latin word for gold, reflecting our starting premise that digital currency issued under the auspices of a central bank must be as robust and trustworthy as gold.

Through the creation of a technology stack comprised of: (1) a wholesale interbank system in which the wholesale CBDC (wCBDC) is issued to banks for onward distribution to retail users, and (2) a retail e-wallet system in which the retail CBDC (rCBDC) circulates among retail users, we set a goal to bring to life two very different types of retail tokens: (a) intermediated CBDC, also referred to herein as CBDC-tokens, and (b) CBDC-backed stablecoins, or in short, stablecoins. Given the complexity of the endeavour, the project was executed in partnership with the Hong Kong Applied Science and Technology Research Institute (ASTRI).

We are glad to report that after a year of development, the prototype system was successfully completed. The present report provides an overview of the Aurum technology architecture. It is presented at a more technical level, supplemented by user interface visualisations, and should best be read in conjunction with the three e-HKD papers[1], as well as with the extensive body of foundational research issued by the BIS.[2]

The Aurum system is accompanied by technical manuals totalling over 250 pages that, together with the source code, are made accessible to all BIS central bank members on BIS Open Tech to serve as a public good that furthers the study of rCBDC architectures. The Aurum prototype also provides a solid basis for furthering the exploration and testing of e-HKD design in Hong Kong.

Against this backdrop, we have no doubt that the Aurum prototype will catalyse and inspire the global quest for the most suitable rCBDC architecture.[3]

Revisiting the deal after Christmas

Corporate sustainability due diligence: Council and Parliament strike deal to protect environment and human rights

European Council
Council of the European Union

The Council and the European Parliament reached a provisional deal on the corporate sustainability due diligence directive (CSDDD), which aims to enhance the protection of the environment and human rights in the EU and globally.

The due diligence directive will set obligations for large companies regarding actual and potential adverse impacts on human rights and the environment, with respect to their own operations, those of their subsidiaries, and those carried out by their business partners.

Obligations for companies

The due diligence directive lays down rules on obligations for large companies regarding actual and potential adverse impacts on the environment and human rights for their business chain of activities which covers the upstream business partners of the company and partially the downstream activities, such as distribution or recycling.

The directive also lays down rules on penalties and civil liability for infringing those obligations; it requires companies to adopt a plan ensuring that their business model and strategy are compatible with the Paris agreement on climate change.

Main elements of the agreement

The provisional agreement reached today between the two co-legislators frames the scope of the directive, clarifies the liabilities for non-compliant companies, better defines the different penalties, and completes the list of rights and prohibitions that companies should respect.

Scope of the directive

The agreement fixes the scope of the directive on large companies that have more than 500 employees and a net worldwide turnover over €150 million. For non-EU companies it will apply if they have over €150 million net turnover generated in the EU, three years from the entry into force of the directive. The Commission will have to publish a list of non-EU companies that fall under the scope of the directive.

Financial Sector

According to the deal reached today, financial services will be temporarily excluded from the scope of the directive, but there will be a review clause for a possible future inclusion of the financial downstream sector based on a sufficient impact assessment.

Climate change and civil liability

The compromise struck today strengthens the provisions related to the obligation of means for large companies to adopt and put into effect, through best efforts, a transition plan for climate change mitigation.

On civil liability, the agreement reinforces the access to justice of persons affected. It establishes a period of five years to bring claims by those concerned by adverse impacts (including trade unions or civil society organisations). It also limits the disclosure of evidence, injunctive measures, and cost of the proceedings for claimants.

As a last resort, companies that identify adverse impacts on environment or human rights by some of their business partners will have to end those business relationships when these impacts cannot be prevented or ended.

Penalties

For companies that fail to pay fines imposed on them in the event of violation of the directive, the provisional agreement includes several injunction measures, and takes into consideration the turnover of the company to impose pecuniary penalties (i.e. a minimum maximum of 5% of the company's net turnover). The deal includes the obligation for companies to carry out meaningful engagement including a dialogue and consultation with affected stakeholders, as one of the measures of the due diligence process.

Public procurement

The deal establishes that compliance with the CSDDD could be qualified as a criterion for the award of public contracts and concessions.

Definitions

The provisional agreement clarifies the obligations for companies described in Annex I, a list of specific rights and prohibitions which constitutes an adverse human rights impact when they are abused or violated. The list makes references to international instruments that have been ratified by all member states and that set sufficiently clear standards that can be observed by companies.

The compromise adds new elements to the obligations and instruments listed in the Annex as regards human rights, particularly for vulnerable groups. Core International Labour Organisation (ILO) Conventions can also be added to the list, by delegated acts, once they have been ratified by all member states.

The provisional agreement also introduces in the annex references to other UN conventions, such as the International covenant on civil and political rights or the

International covenant on economic, social and cultural rights, or the Convention on the rights of the child.

Likewise, the compromise clarifies the nature of environmental impacts covered by this directive as any measurable environmental degradation, such as harmful soil change, water or air pollution, harmful emissions or excessive water consumption or other impacts on natural resources.

Next steps

The provisional agreement reached with the European Parliament now needs to be endorsed and formally adopted by both institutions.

To read more: https://www.consilium.europa.eu/en/press/press-releases/2023/12/14/corporate-sustainability-due-diligence-council-and-parliament-strike-deal-to-protect-environment-and-human-rights/#:~:text=The%20due%20diligence%20directive%20lays,the%20downstream%20activities%2C%20such%20as

Digital Services Act starts applying to all online platforms in the EU

European Commission

On 17 February, the Digital Services Act (DSA), the EU's landmark rulebook that aims to make the online environment safer, fairer and more transparent, starts applying to all online intermediaries in the EU.

Under the DSA, EU users are better protected against illegal goods and content and have their rights upheld on online platforms where they connect with other users, share information, or buy products.

New responsibilities for platforms and empowered users

All online platforms with users in the EU, with the exception of small and micro enterprises employing fewer than 50 persons and with an annual turnover below €10 million, must implement measures to:

- Counter illegal content, goods, and services: online platforms must provide users with means to flag illegal content, including goods and services. More so, online platforms will have to cooperate with 'trusted flaggers', specialised entities whose notices will have to be given priority by platforms.
- Protect minors: including a complete ban of targeting minors with ads based on profiling or on their personal data.
- Empower users with information about advertisements they see, such as why the ads are being shown to them and on who paid for the advertisement.
- Ban advertisements that target users based on sensitive data, such as political or religious beliefs, sexual preferences, etc.
- Provide statements of reasons to a user affected by any content moderation decision, e.g., content removal, account suspension, etc. and upload the statement of reasons to the DSA Transparency database.
- Provide users with access to a complaint mechanism to challenge content moderation decisions.
- Publish a report of their content moderation procedures at least once per year.
- Provide the user with clear terms and conditions, and include the main parameters based on which their content recommender systems work.
- Designate a point of contact for authorities, as well as users.

In addition to online platforms, the Digital Services Act also applies to hosting services (e.g. cloud services or domain name systems, background services which connect users to requested website addresses), as well as to online intermediaries (e.g. internet service providers, or domain). Hosting services and online intermediaries are subject to a subset of obligations under the DSA.

Since end of August 2023, the DSA has already applied to the 19 Very Large Online Platforms (VLOPs) and Search Engines (VLOSEs) designated in April 2023 (with more than 45 million monthly users on average). Three other platforms designated as VLOPs in December 2023 have until end of April to comply with the most stringent obligations under the DSA. However, they will have to comply with the general DSA obligations from tomorrow.

Digital Services Coordinators in Member States

Platforms not designated as VLOPs or VLOSEs will be supervised at Member State level by an independent regulator acting as the national Digital Services Coordinator (DSC). It will be the responsibility of the DSCs to ensure that these platforms play by the rules. DSCs will supervise and enforce the DSA for the platforms established on their territory.

In practice, the Digital Services Coordinators will:

- Be the first port of call for complaints by users on infringements against the DSA by any platform, including VLOPs and VLOSEs. The Digital Services Co-ordinator will, when appropriate, transmit the complaint to the Digital Services Co-ordinator of the platform's Member State of establishment, where appropriate, accompanied by an opinion.

- Certify existing out-of-court appeal mechanisms for users to address complaints and challenge content moderation decisions.

- Assess and award the status of trusted flaggers to suitable applicants, or independent entities that have demonstrated expertise in detecting, identifying, and notifying illegal content online.

- Process researchers' requests for access to VLOPs and VLOSEs data for specific research. The DSCs will vet the researchers and request access to data on their behalf.

- Be equipped with strong investigation and enforcement powers, to ensure compliance with the DSA by the providers established in their territory.

  They will be able to order inspections following a suspected infringement of the DSA, impose fines on online platforms failing to comply with the DSA, and impose interim measures in case of serious harm to the public sphere.

The European Board for Digital Services

The Digital Services Coordinators and the Commission will form an independent advisory group, the European Board for Digital Services, to ensure that the DSA is applied consistently, and that users across the EU enjoy the same rights, regardless of where the online platforms are established.

The Board will be consulted on the enforcement of the DSA and advise on arising issues related to the DSA and can contribute to guidelines and analysis. It will also assist in the supervision of Very Large Online Platforms and Very Large Online Search Engines and will issue yearly reports on the prominent systemic risks and best practices in mitigating them.

Next Steps

In March 2024, the Commission intends to adopt Guidelines on risk mitigation measures for electoral processes.

A public consultation on the data access delegated act is expected in April with adoption by July and entry into force in October 2024.

In May, the Commission plans to adopt an Implementing Act on transparency report templates.

To read more:
https://ec.europa.eu/commission/presscorner/detail/en/ip_24_881

Basel Committee agrees to revisions to Basel Core Principles

- Basel Committee approves revisions to Core principles for effective banking supervision.

- Decides to consult on potential measures to address window-dressing behaviour by some banks in the context of the framework for global systemically important banks.

- Reaffirms expectation that all aspects of Basel III will be implemented in full, consistently and as soon as possible.

The Basel Committee on Banking Supervision met on 28–29 February 2024 in Madrid to take stock of recent market developments and risks to the global banking system, and to discuss a range of policy and supervisory initiatives.

Risks and vulnerabilities to the global banking system

The Committee discussed the outlook for the global banking system in the light of recent economic and financial market developments. It discussed risks to banks from sectors facing headwinds, including segments of commercial real estate.

Members also discussed banks' interconnections with non-bank financial intermediaries, including the growing role of private credit. Banks and supervisors need to remain vigilant to emerging risks in these areas.

Basel Core Principles

The Committee discussed the comments received to its consultation on revisions to the Core principles for effective banking supervision (Basel Core Principles). Drawing on the inputs received from a wide range of stakeholders, the Committee approved the final revisions to the Core Principles, which draw on supervisory insights and structural changes to the banking system since the previous update in 2012.

The final standard will be published following the International Conference of Banking Supervisors on 24–25 April 2024.

Global systemically important banks and window-dressing

Building on the discussion at its previous meeting, the Committee looked at a range of empirical analyses that highlight window-dressing behaviour by some banks in the context of the framework for global systemically important banks (G-SIBs). Such regulatory arbitrage behaviour seeks to temporarily reduce banks' perceived systemic footprint around the reference dates used for the reporting and public disclosure of the G-SIB scores.

As noted previously by the Committee, window-dressing by banks undermines the intended policy objectives of the Committee's standards and risks disrupting the operations of financial markets. To that end, the Committee agreed to consult on potential measures aimed at reducing window-dressing behaviour.

The consultation paper, and an accompanying working paper summarising the empirical analyses, will be published next month. The Committee also agreed to publish a working paper on an assessment of the G-SIB score dynamics over the past decade.

Climate-related financial risks

As part of its holistic approach to addressing climate-related financial risks, the Committee discussed the role of scenario analysis in assessing the resilience of banks' business models, strategies and overall risk profile to a range of plausible climate-related pathways. Members noted that the field of scenario analysis is dynamic, with practices expected to evolve rapidly as climate science advances.

Building on its existing supervisory principles, the Committee agreed to publish a discussion paper on the use of climate scenario analysis by banks and supervisors to help inform potential future work in this area. The discussion paper will be published in the coming months.

Implementation of Basel III reforms

The Committee took stock of the implementation status of the outstanding Basel III standards, which were finalised in 2017. Committee members have continued to make good progress with implementation, though it remains uneven.

Members unanimously reaffirmed their expectation of implementing all aspects of the Basel III framework in full, consistently and as soon as possible. Members also approved a workplan for the jurisdictional assessments of the implementation of these standards as part of the Committee's Regulatory Consistency Assessment Programme.

To read more: https://www.bis.org/press/p240229.htm

EU Digital Markets Act: the application by Bytedance (TikTok) seeking suspension of the Commission decision designating it as a gatekeeper is dismissed

COURT OF JUSTICE
OF THE EUROPEAN UNION

Bytedance has failed to demonstrate the urgency required for an interim order in order to avoid serious and irreparable damage.

Bytedance Ltd is a non-operating holding company established in China in 2012 which, through local subsidiaries, provides the entertainment platform TikTok.

By decision of 5 September 2023, the Commission designated Bytedance as a gatekeeper under the Digital Markets Act.

In November 2023, Bytedance brought an action for annulment of that decision.

By separate document, Bytedance lodged an application for interim measures seeking suspension of that decision.

By today's order, the President of the General Court dismisses Bytedance's application for interim measures.

According to the President of the General Court, Bytedance has not shown that it is necessary to suspend the contested decision until the proceedings on the substance of the case are closed in order to avoid serious and irreparable harm to Bytedance.

Bytedance argued, inter alia, that the immediate implementation of the contested decision risks causing the disclosure of highly strategic information concerning TikTok's user profiling practices, which is not otherwise in the public domain.

That disclosure would enable TikTok's competitors and other third parties to obtain insight into TikTok's business strategies in a way that would significantly harm its business.

According to the President of the General Court, Bytedance has not shown that there is a real risk of disclosure of confidential information or that such a risk would give rise to serious and irreparable harm.

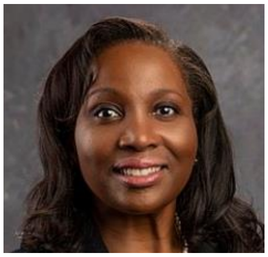
NOTE: The General Court will deliver final judgment on the substance of this case at a later date. An order as to interim measures is without prejudice to the outcome of the main proceedings. An appeal, limited to points of law only, may be brought before the Vice-President of the Court of Justice against the decision of the President of the General Court within two months and ten days of notification of the decision.

NOTE: An action for annulment seeks the annulment of acts of the institutions of the European Union that are contrary to EU law. The Member States, the European institutions and individuals may, under certain conditions, bring an action for annulment before the Court of Justice or the General Court. If the action is well founded, the act is annulled. The institution concerned must fill any legal vacuum created by the annulment of the act.

To read more: https://curia.europa.eu/jcms/upload/docs/application/pdf/2024-02/cp240028en.pdf

Sources of Uncertainty in the Short Run and the Long Run

Governor Lisa D. Cook, at "Macrofinance in the Long Run: New Insights on the Global Economy" 2024 Annual Conference of the Julis-Rabinowitz Center for Public Policy & Finance at Princeton's School of Public and International Affairs, Princeton, New Jersey



Thank you, Gianluca, and thank you for the opportunity to speak to you today.

Let me begin by recognizing the Department of Economics at Princeton for its history of nurturing and supporting scholars in reaching their full potential.

Some of the most important, transformative conversations I have had in my career have happened on this campus and with economists making significant contributions to the field. Let me start with the last time I was here.

When I was a post doc at Stanford, I emailed Alan Krueger out of the blue and attached an early version of a new paper, asking him if he would meet with me for an hour to discuss it.

Because of his experience with large data sets, and his curiosity, thoughtfulness, and generosity, one hour turned into three hours. And he brought along a new assistant professor, Dean Karlan.

Not only did I learn a tremendous amount from Alan during that encounter, almost ten years later, I learned even more from him working as a senior economist at the Council of Economic Advisers when Alan was Chair.

It is a great legacy of your department that you provided the conditions and support for Alan to make his seminal contributions to economics.

I think similar conditions were in place at Princeton to allow Sir Arthur Lewis, the only person of African descent to receive the Nobel Prize in economics, to be productive and thrive.

While I never met him, Sir Arthur has been an inspiration throughout my career, and I am grateful for his contribution that was aided by Princeton.

The good work done here continues with the subject at hand today. The focus of this conference on macrofinance in the long run provides a good opportunity to reflect on what has changed and what has not changed since the onset of the pandemic four years ago.

A feature of the past few years has been heightened uncertainty about how the economy would emerge from the turmoil of the pandemic and the subsequent recovery.

I will talk about some types of uncertainty I see as having diminished recently and others that remain elevated. Then I will conclude with a discussion of my views on current monetary policy.

When the global pandemic hit in the spring of 2020, economies around the world shut down or sharply limited activity, especially for in-person services. Policymakers took action to support incomes and limit the scarring from those temporary shutdowns.

During the post-pandemic recovery in 2021 and 2022, as strong aggregate demand met still-constrained supply, inflation in many economies rose to levels not seen in decades.

Uncertainty about the future course of inflation and the supply side of the economy was high, both in the short run and in the longer run.

Would supply remain persistently depressed because of scarring from the pandemic? Would inflation become stuck well above the Fed's 2 percent target or even continue to rise?

To read more:
https://www.federalreserve.gov/newsevents/speech/cook20240222a.htm

Presentation of the Deutsche Bundesbank's Annual Report 2023

Introductory statement by Dr Joachim Nagel, President of the Deutsche Bundesbank, at the press conference presenting the Annual Report 2023

DEUTSCHE BUNDESBANK EUROSYSTEM

1 Welcome

Ladies and gentlemen, I would like to welcome you most warmly to this press conference.

Sabine Mauderer will explain our annual accounts to you in more detail in just a few moments. Before that, I would like to say a few words about economic and price developments as well as monetary policy in the euro area.

It won't come as a surprise that I'm about to present you with a whole host of figures – a "bird's-eye" view of the economy, so to speak. However, I believe it is important to bear in mind the specific impact of these developments on people.

That's why I would like to begin with the results of the household survey carried out as part of our Bundesbank Online Panel – Households. Looking back on 2023, respondents were asked to estimate to what extent inflation represented a financial burden for their household.

Almost half of households responded that inflation presented them with a financial burden (47% in the survey categories 5-7). This figure was only slightly lower than in 2022 (when it stood at 50%). 11% reported very high financial burdens – exactly the same figure as in the previous year.

For low-income households, this figure was as high as 17%.

This shows once again how important our mandate is. Inflation has economic and social costs. By achieving price stability, we make life easier for many people. It relieves them of one major worry, especially those forced to live on little money. Price stability therefore also promotes social cohesion.

2023 began with inflation rates of over 8% in the euro area. From the outset, the key monetary policy task of the year was therefore clear: to curb the high inflation.

Looking back, it is safe to say that we have embarked on the right path and have already made good progress. For instance, we have come much closer to our 2% target. But we have not yet reached it.

I would now like to outline which paths we took in 2023, where we are today and where we are headed.

2 Economic and price developments

2.1 Economic developments

2023 was a challenging year for the German economy. The period of weakness that followed the start of Russia's war of aggression against Ukraine has continued.

Headwinds initially came from the aftermath of the sharp rise in energy costs. Three other main factors slowed the economic recovery: weak external demand weighed on the industrial sector; high inflation held back private consumption; tight monetary policy led to rising financing costs, which dampened investment.

However, there were also developments that supported economic activity. Many supply bottlenecks eased over the course of the year.

Moreover, the labour market proved remarkably robust. Despite the persistently weak economic environment, the number of persons in employment rose to 45.9 million, an all-time high.

On balance, economic output fell slightly on the year in 2023; it was down by 0.1% in price and calendar-adjusted terms.

The outlook for 2024 promises a little more light than shadow again. Our experts expect the German economy to gradually regain its footing during the course of the year and embark onto a growth path.

First, foreign sales markets are expected to provide tailwinds. We expect an economic recovery here. This will probably push up global demand for German goods and cause German exports to grow.

Second, private consumption should benefit from an improvement in households' purchasing power. Thanks to a stable labour market, strong wage growth and falling inflation, people will effectively have more money in their pockets.

However, as things stand today, the anticipated recovery is likely to start somewhat later than we had projected in December. German economic output could once again decline slightly in the first quarter of 2024.

For instance, foreign industrial demand recently trended significantly downward, too. Besides this, consumers are likely to remain cautious about spending. Because of the delay in the economic recovery, as things stand, the German economy is more likely to tread water on average in 2024.

There are clear risks to the economic outlook, if, for example, geopolitical conflicts intensify. This could lead to rising energy and commodity prices and disrupt supply chains again. This would weigh on the German economy and, at the same time, fuel inflation.

2.2 Inflation

How we see price developments last year also depends on which perspective we take.

Looking at the annual average, inflation was still exceptionally high in 2023. Germany recorded its second-highest inflation rate since reunification. The Harmonised Index of Consumer Prices (HICP) rose by 6%, compared with 8.7% the previous year. In the euro area, it went up by 5.4%. After 8.4% the previous year, this is the highest figure recorded since the launch of monetary union 25 years ago.

However, these annual averages mask the marked decline in inflation over the course of the year. In Germany, it fell from more than 9% at the start of the year to less than 4% at the end of the year, and in the euro area, from over 8% to under 3%. This was mainly due to lower energy prices.

Government relief measures and lower market prices for fuels were dampening factors here. Food prices grew by double digits on average during the year. But here, too, we can see that price pressures eased significantly over the course of the year.

Core inflation excluding energy and food continued to rise in 2023, at 5.1% in Germany and 4.9% in the euro area. Services prices, in particular, rose more sharply than in the previous year. At first, pent-up demand for services that were unavailable during the pandemic still played a role here.

Think, for example, of travelling or eating out. This allowed some sectors to expand their profit margins. In addition, wages rose sharply in response to inflation, which also put pressure on prices.

Comparing today's situation with the situation a year ago, the nature of inflation has changed significantly. Back then, inflation was mainly being fuelled by high energy and food prices. On an annual average for 2022, headline inflation was more than twice as high as core inflation. In the meantime, the picture has changed. Of late, the core rate was significantly higher than the headline rate.

What does this mean? Energy and food prices play a key role in headline inflation. These prices typically fluctuate more strongly. By contrast, core inflation is much more stubborn and persistent. It is shaped largely by developments in wages, productivity and firms' profit margins.

In January, euro area headline inflation was only around 1 percentage point higher than its pre-pandemic average. Meanwhile, at 3.3%, core inflation was still 2 percentage points higher than its average rate between 1999 and 2019.

When analysing the headline rate, we take a detailed look at core inflation. This is because, as a measure of underlying price pressures, core inflation helps us to assess future inflation developments.

It does not look as though a series of large decreases in the inflation rate, as seen in the last quarter of 2023, is to be expected any more. We will have to get used to small steps. Setbacks like those we experienced in December cannot be ruled out in this area. This was mainly due to a statistical base effect in Germany for energy. Further base effects are foreseeable.

For example, Easter falls in March instead of April this year. Travel in March, for example, will therefore be particularly expensive. However, the one-off effects do not alter the trend: inflation is falling.

The latest Eurosystem staff macroeconomic projections will be published in just under two weeks. I won't jump the gun on this topic.

In Germany, our experts still expect the annual average increase in the HICP to more than halve in 2024. The high level of inflation is likely to come down in the euro area, too. Nonetheless, inflation rates – especially the "hard core" – will still remain markedly higher than 2% in the coming months.

To read more: https://www.bundesbank.de/en/press/speeches/introductory-statement-925324

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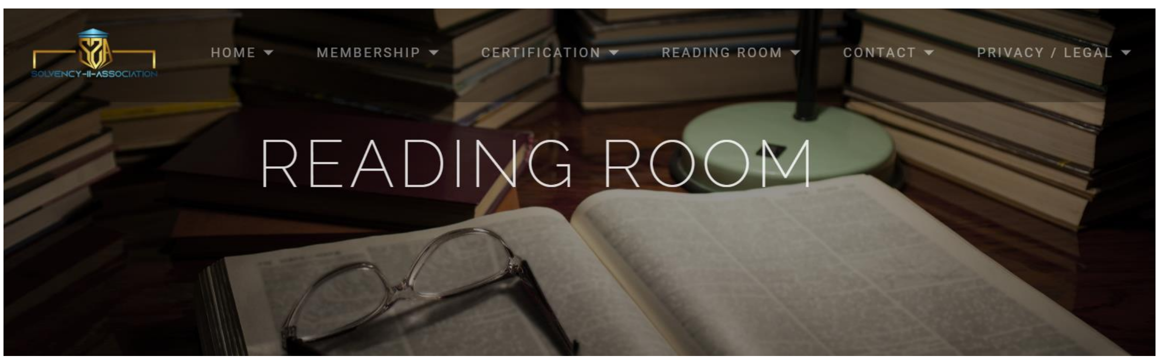

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