EUROPEAN CENTRAL BANK

EUROSYSTEM

Philipp Hartmann

Financial Integration in Europe

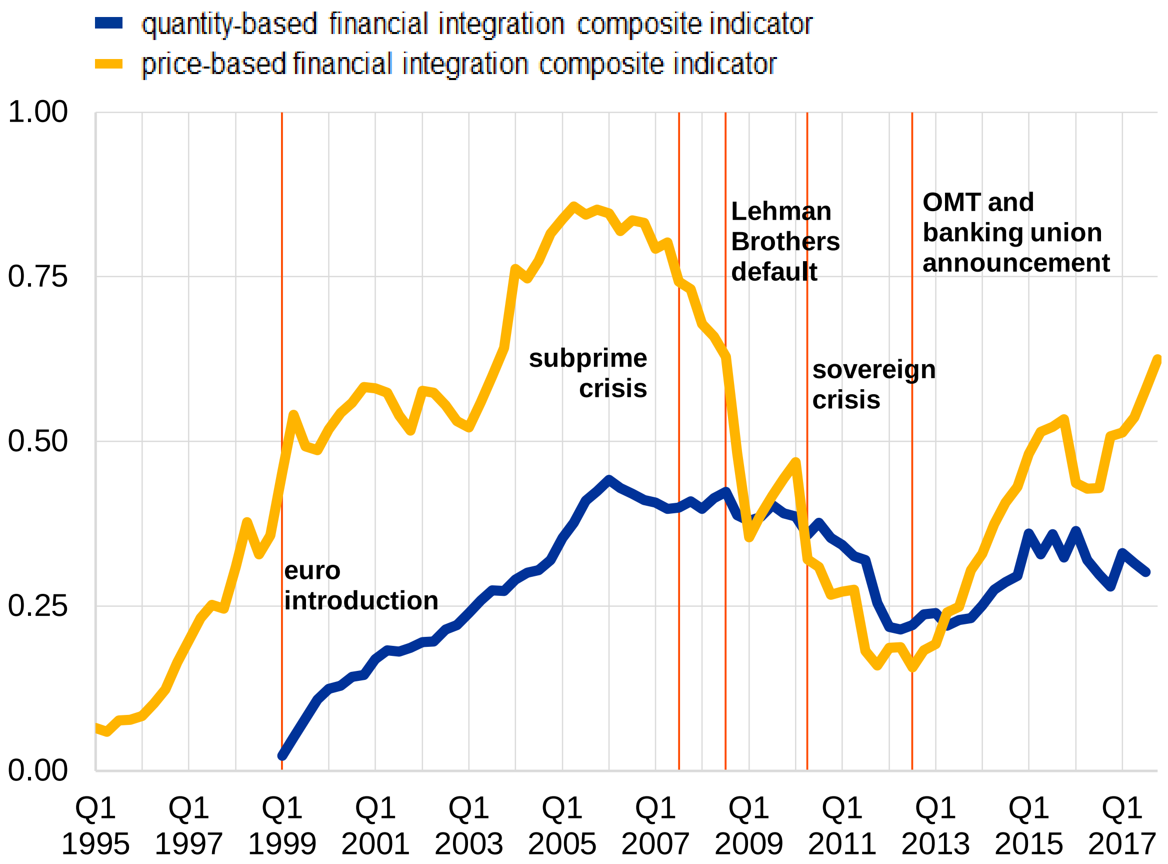
2018 Report

Frankfurt am Main
3 May 2018

Joint Conference of the European Central Bank and the European Commission on “Fostering banking union and capital markets union – a top-down or bottom-up approach?”

Aggregate post-crisis re-integration trend resumed strongly in prices but not (yet?) in quantities in EA

Aggregate financial integration indicators

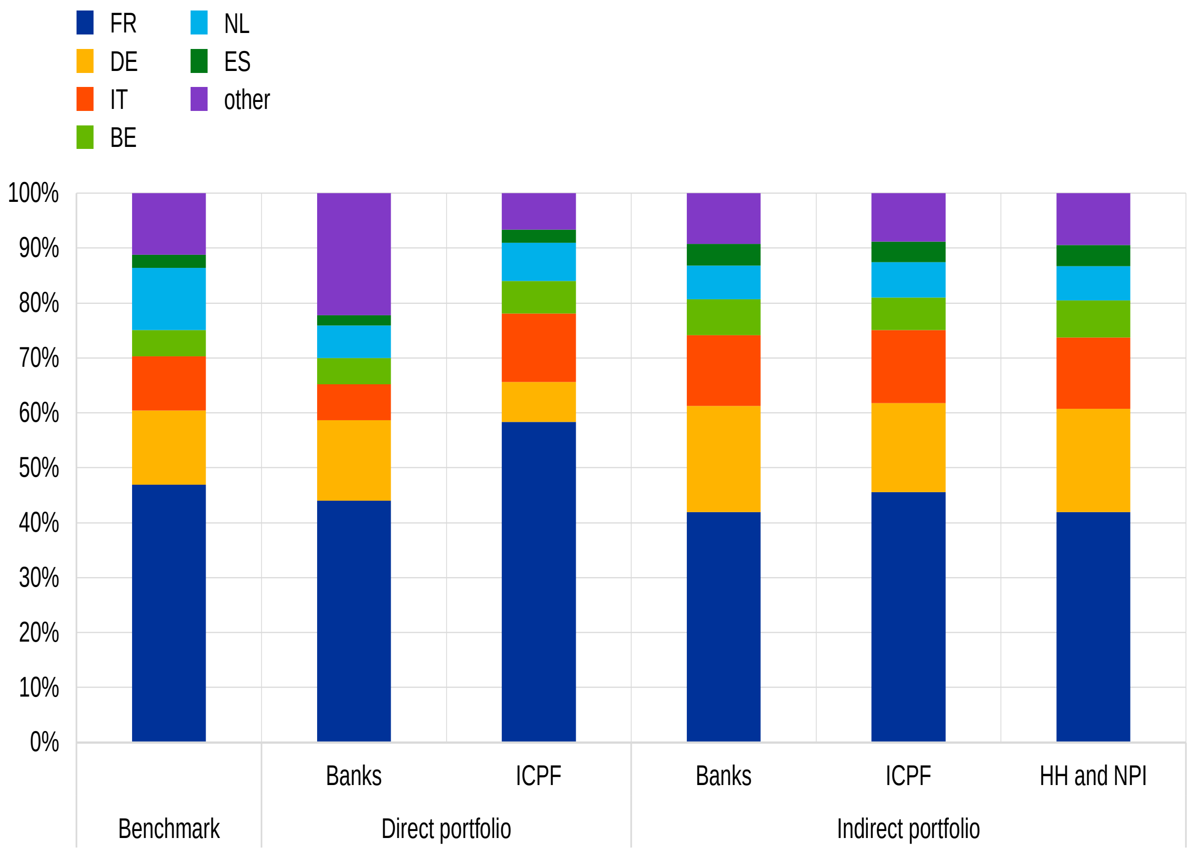


- Price convergence driven by
  - mainly equity returns
  - also bond yields
  - strengthening, broadening and rather uniform economic recovery
- Fundamental economic factors play a significant role
- Quantities mildly reduced by cross-border interbank lending (compared to 2015)

Sources: ECB and ECB calculations (based on Hoffmann, Kremer and Zaharia (2015), Financial integration in Europe through the lens of composite indicators), see Chart A in Key Messages and Charts S5 and S6 in Annex of report

Investment funds (IFs) foster financial integration by helping other investors to diversify across countries

Foreign euro area country shares in corporate bond portfolios

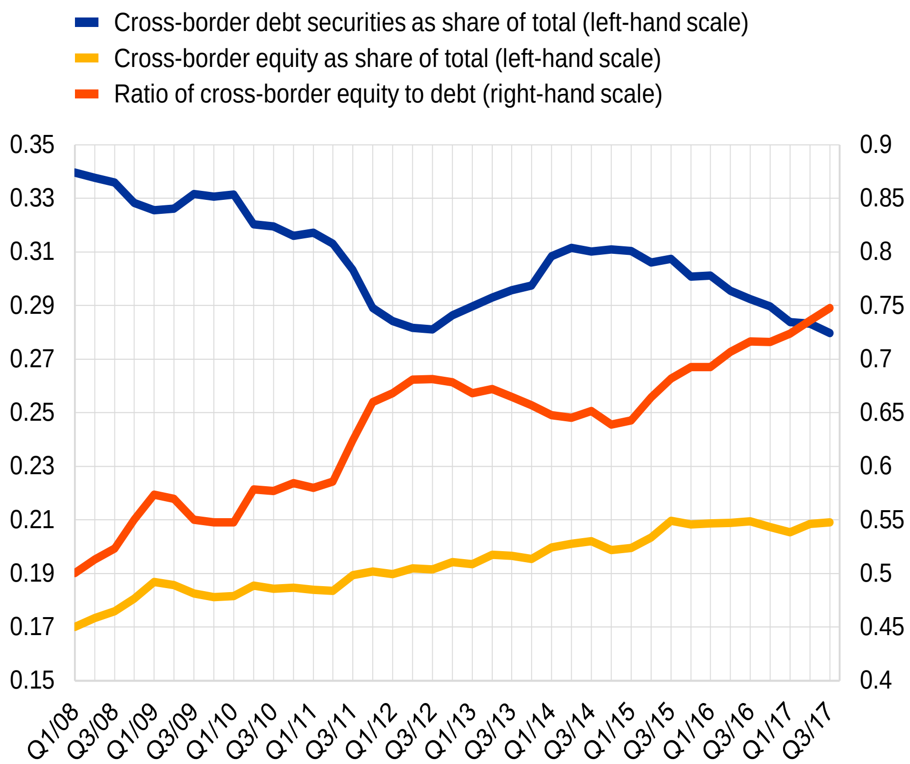


- Direct holdings of banks and insurance corporations and pension funds (ICPFs) are more concentrated than their portfolios taking indirect holdings via UCITS into account
- But new sources of risk and different channels transmitting financial instability associated with the growing popularity of IFs need to be monitored

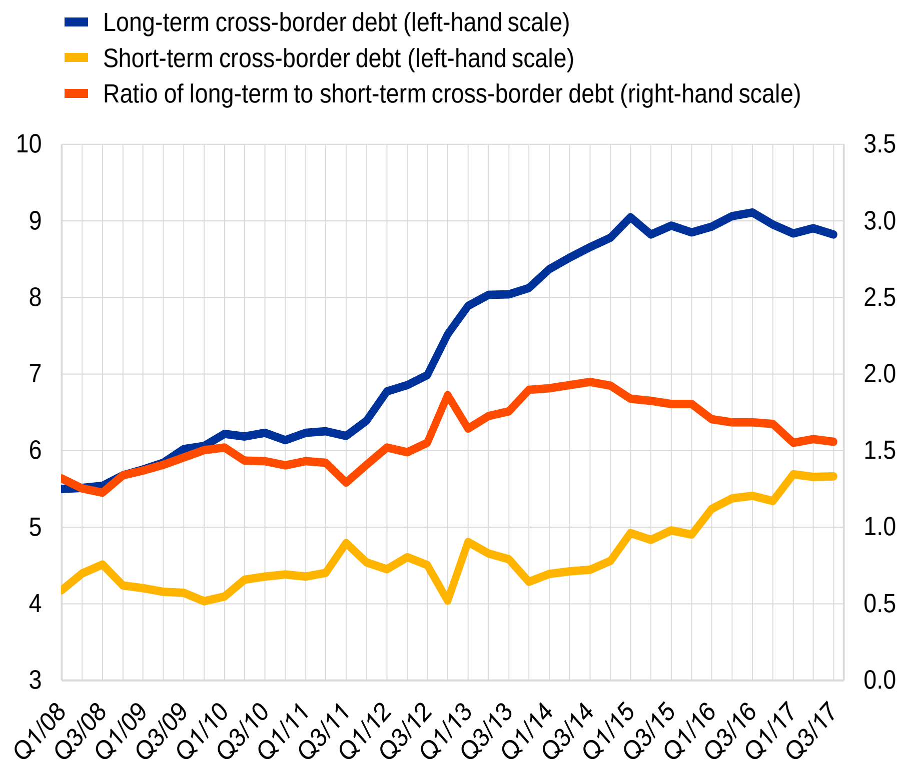
Sources: Giuzio and Nicoletti (2018) using ECB SHS and Lipper Investment Management data, see Chart 11 in Special Feature B of report

Euro area financial integration becomes more resilient in several dimensions, but short-term debt

Intra-euro area foreign equity versus foreign debt holdings (fractions)



Intra-euro area foreign long-term versus short-term debt holdings (LHS mio. EUR)

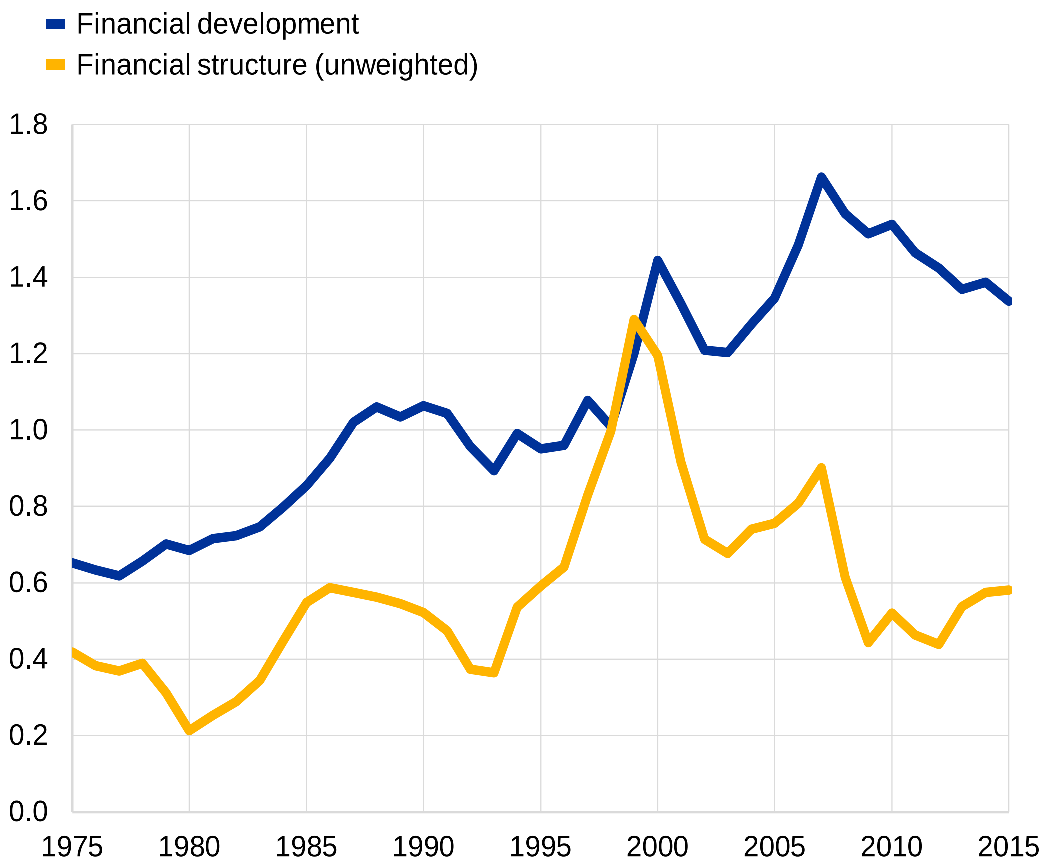


Sources: ECB, Eurostat and ECB calculations, see Chart B in Key Messages of report

- Cross-border private financial risks sharing remains low in the euro area

Initiatives to further develop equity markets promise to foster innovation, growth and risk sharing

Sum of equity financing and bank credit versus ratio of the two in the EU-21 (% of GDP)

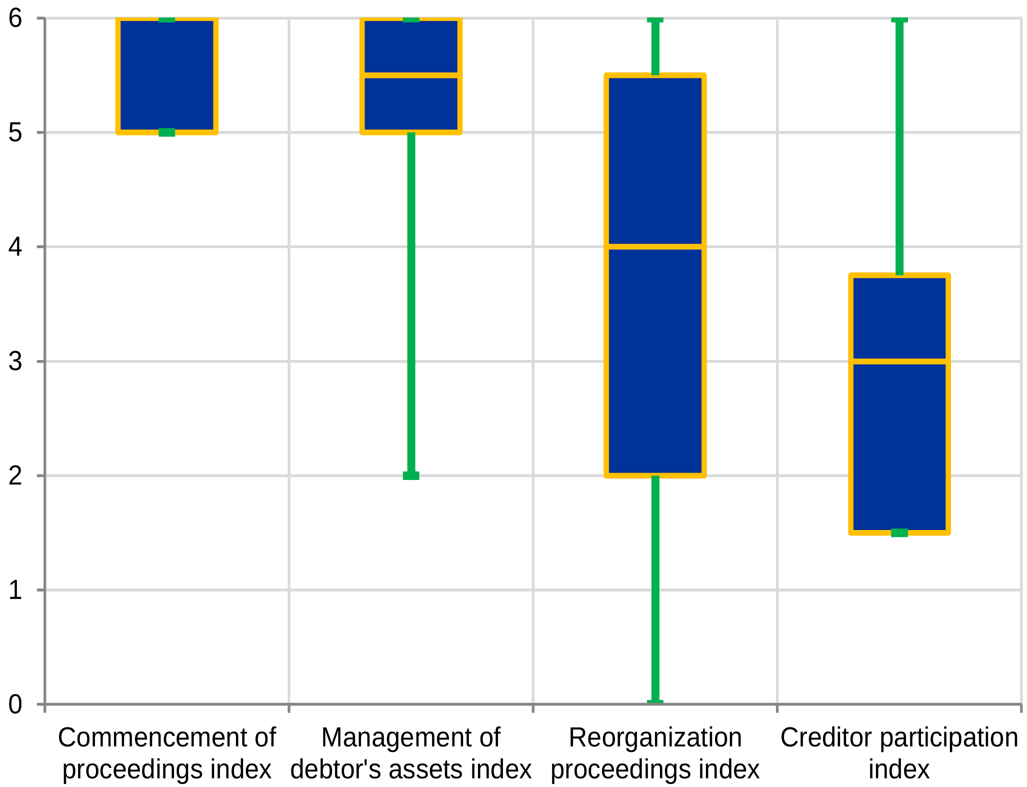


Sources: Kremer and Popov (2018) using World Bank data, see Chart C in Key Messages of report

- New empirical literature: financial structure matters
- Evidence for EU-21 in Special Feature A: before the crisis
  - countries with larger equity markets experienced higher firm value-added growth
  - also observed for high-tech and patent-intensive industries
  - driven by labour productivity rather than capital accumulation
- Mature literature: cross-country holdings of firm claims particularly foster risk sharing
- Potential directions: financial literacy, private pensions and…

Reorganisation proceedings/creditor participation areas for further improving insolvency frameworks

Euro area cross-country medians and dispersions of strength of insolvency framework sub-indexes (ranging between 0 and 6)



Sources: Giovannini, Hartmann, Imbs and Popov (forthcoming) using World Bank data, see Chart A in Box 1 in Chapter 1 of report

- Evidence that good insolvency frameworks strengthen risk sharing in the euro area via capital and credit markets
- Reorganisation proceedings or creditor participation not addressed in welcome CMU draft directive in the area
- But also court efficiency needs to improve in some countries
- Out-of-court frameworks helpful where not existing yet
  - Non-binding EU guidelines
  - Formal EU regime
- Banking regulation
  - General depositor preference
  - Harmonisation suppl. capital instr.

ECB promotes harmonising options and national discretions (O&Ds) and prudent use of waivers

- O&Ds relate to capital, liquidity, large exposures and governance
- Prudent use of waivers fosters banking integration
- Remove impediments to waivers not justified by prudential considerations

ECB decisions and proposals on cross-border liquidity and capital waivers

	Liquidity Coverage Ratio	Capital
Status and legal basis	Current framework: Art. 8 CRR, ECB Guide on O&Ds	Not in current framework: ECB Opinion on CRR
Scope	All subsidiaries	Subsidiaries not exceeding a significance threshold and 100% owned by guaranteeing parent
Prudential conditions	Significant subsidiaries' HQLA at least equal to lower of (a) % required at parent level or (b) 75% of fully phased-in LCR	Floor of 75% of own fund requirements without waiver
Review clause	By 2018	Within three years of entry into force

Sources: see Table A in Box 1 of Chapter 2 in report

Completion of TARGET2-Securities migration by the Eurosystem in 2017 constituted a major milestone for the integration of European securities markets

- 20 European markets and
- 21 central securities depositories
- Operating on the single T2S platform