

# **Financial integration in Europe**

## **March 2007**

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# Eurosystem interest in financial integration

Financial integration is of **key importance** for the performance of the Eurosystem's **core tasks**, notably:

- **Conducting the single monetary policy**
- **Safeguarding financial stability**
- **Promoting the smooth operation of payment systems**

# Structure of the report

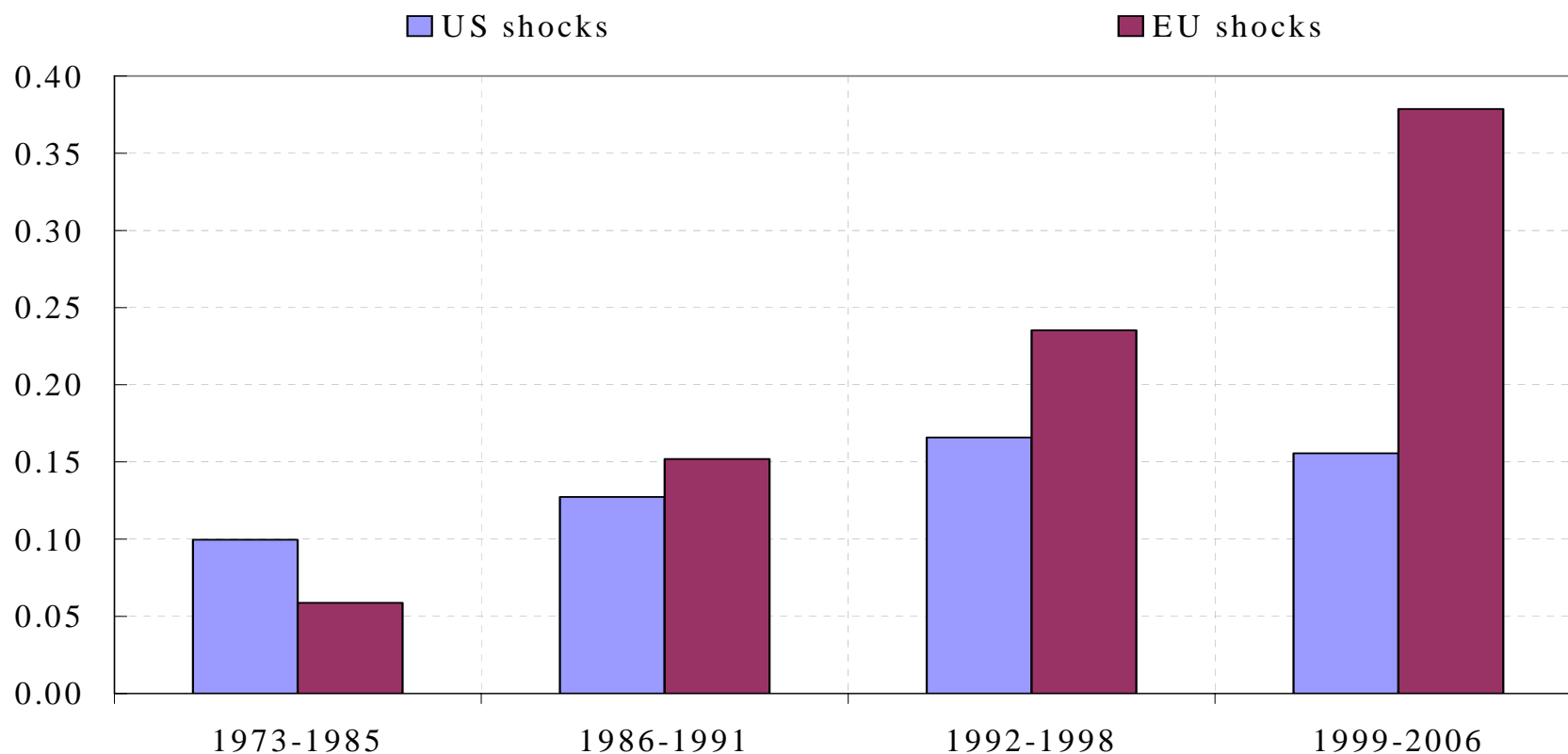
- **Chapter 1: State of financial integration in the euro area**
  - ✓ **Assessment based on a set of quantitative indicators, developed by the ECB**
- **Chapter 2: Special Features**
  - ✓ **In-depth analyses of selected issues relating to financial integration**
- **Chapter 3: Eurosystem activities**
  - ✓ **Overview of the main activities during the previous calendar year**

# Chapter I: The state of financial integration

- **Analysis covers money, bond, equity and banking markets as well as market infrastructures**
- **Degree of integration varies by market segment, generally more advanced in segments closer to the single monetary policy:**
  - ✓ **Money market and repo market fully integrated, also thanks to the operation of large-value payment systems**
  - ✓ **Considerable degree of integration in government bond markets**
  - ✓ **Increasing integration also in corporate bond markets**
  - ✓ **Some progress in integration of equity markets**

# Chapter I: Indicators – e.g. equity markets

## Proportion of variance in local equity returns explained by euro area and US shocks (percentages)



Sources: Thomson Financial Datastream and ECB calculations.

Note: The first column shows the unweighted average of the relative importance of US equity market fluctuations for the variance of euro area equity market returns. The second column shows the unweighted average of the relative importance of euro area-wide factors, other than US equity market fluctuations, in the variance of euro area countries' equity market returns ("variance ratio").

## Chapter 2: Special Features

- **In-depth assessments of major policy issues and/or analytical articles on financial integration**
- **Topics mainly selected on the basis of their importance to the EU's financial integration agenda and their relevance to the ECB's tasks**
- **Special Features of the March 2007 report:**
  - ✓ **Monetary Policy and financial integration**
  - ✓ **Strengthening the EU framework for cross-border banks**
  - ✓ **The SEPA initiative and its implications for financial integration**

# Chapter 2: Monetary policy and financial integration

- **Impact of financial integration on the monetary policy transmission mechanism**
  - ✓ Thanks to increased financial integration, transmission mechanism **operates in a broadly similar way** across euro area countries
  - ✓ Some **discrepancies in interest rate pass-through** across countries seem to persist; may reflect a lack of sufficient financial integration
  - ✓ Greater financial market integration could **eliminate some remaining differences** and facilitate further the transmission of monetary policy within the euro area

## Chapter 2: Cross-border banking

- **Recent developments in cross-border banking**
  - ✓ Increased **prominence of cross-border banking activities in the euro area**
  - ✓ **EU policy framework needs to ensure equal market access and support the efficient operation of cross-border banks**
- **Strengthening the EU policy framework**
  - ✓ **Measures to address potential prudential, legal and fiscal obstacles to cross-border M&A have been adopted or are under preparation**
  - ✓ **Supervisory framework has been substantially enhanced to achieve supervisory convergence and cooperation, but benefits of the present institutional setting should be fully reaped**
  - ✓ **Review of EU supervisory framework by end-2007 will permit evaluation of the current framework and possible need for further action**



# Chapter 2: SEPA

- **Single Euro Payments Area (SEPA) project**
  - ✓ **Enable customers to make more efficient cashless payments throughout the euro area from a single account, irrespective of location**
  - ✓ **Will define technical standards and access conditions to the market and this creates level-playing field**
  - ✓ **Banking industry has made substantial progress**
  - ✓ **Commitment to introducing SEPA instruments and procedures from January 2008, and for migrating a critical mass of customer payments by end-2010**
  - ✓ **Work on transparency and interoperability to be finalised**

# Chapter 3: Eurosystem activities

- **Four types of Eurosystem activities:**
  - ✓ **Giving advice on the legislative and regulatory framework** for the financial system and direct rule-making;
  - ✓ **Acting as a catalyst** for private sector activities;
  - ✓ **Enhancing knowledge**, raising awareness and **monitoring** the state of European financial integration;
  - ✓ **Providing central bank services** that also foster European financial integration.

## Chapter 3: Giving advice

- **Example: Integration of EU securities clearing and settlement infrastructure**
  - ✓ **Crucial for lowering post-trading costs of cross-border securities transactions, exploiting the potential economies of scale and establishing a European level playing-field**
  - ✓ **Affects performance of ECB's tasks, e.g. the implementation of monetary policy (via the collateralisation of monetary policy operations), the safeguarding of financial stability, and the promotion of smooth payment systems**
  - ✓ **ECB involved in the work of the Clearing and Settlement Advisory and Monitoring Expert Group**
  - ✓ **European Code of Conduct for Clearing and Settlement**

## Chapter 3: Catalyst for private sector activities

- **Example: Short-Term European Paper (STEP) initiative**
  - ✓ **Promote development of pan-European short-term paper market through market players' voluntary compliance with standards of STEP Market Convention**
  - ✓ **ECB and nine NCBs of the Eurosystem provide technical assistance to the STEP Secretariat concerning the STEP labelling process until June 2008**
  - ✓ **ECB regularly produces statistics on yields and volumes in the STEP market and publishes them on its website**
  - ✓ **February 2007: outstanding amount of euro-denominated STEP securities €166 billion in 32 STEP-compliant programmes**

## Chapter 3: Enhancing knowledge

- **Example: ECB-CFS Research Network on “Capital markets and financial integration in Europe”**
  - ✓ **ECB and Center for Financial Studies (CFS) in Frankfurt as well as NCBs**
  - ✓ **Organise conferences attended by academics, market participants and policymakers, e.g. “Financial System Modernisation and Economic Growth” (hosted by Deutsche Bundesbank, September 2006)**
  - ✓ **Awards every year five “Lamfalussy fellowships” to promising young researchers**

## Chapter 3: Central bank services

- **Example: TARGET2 – future wholesale payment system**
  - ✓ **Financial infrastructure supports integration of related financial markets**
  - ✓ **Single technical platform TARGET2**
  - ✓ **Harmonised service level, single price structure, and harmonised set of cash settlement services in central bank money for all ancillary systems**
  - ✓ **Start date: 19 November 2007**

## Concluding remarks

- **Financial integration is an important driver for increasing the efficiency of the financial system, and thus helps to raise the economy's potential for non-inflationary growth**
- **Efficiency of financial system also depends on other factors, e.g. the degree of its development and the quality of the fundamental determinants of the framework conditions of the financial market;**
- **Future ECB reports on Financial Integration in Europe will have a wider scope to also encompass such factors.**