

ECB Report on Financial Integration in Europe April 2008

Lucas Papademos

Frankfurt am Main, 29 April 2008

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 aimed at fostering financial integration

Chapter I: The state of financial integration

Financial markets

Market	State of integration	Related infrastructures
Money markets		
a) Unsecured	Near perfect	Fully integrated
b) Secured	Advanced	Collateral leg fragmented
Bond markets		
a) Government bonds	Very advanced	Fragmented
b) Corporate bonds	Fair	Fragmented
Equity markets	Incipient	Highly fragmented

Chapter I: The state of financial integration

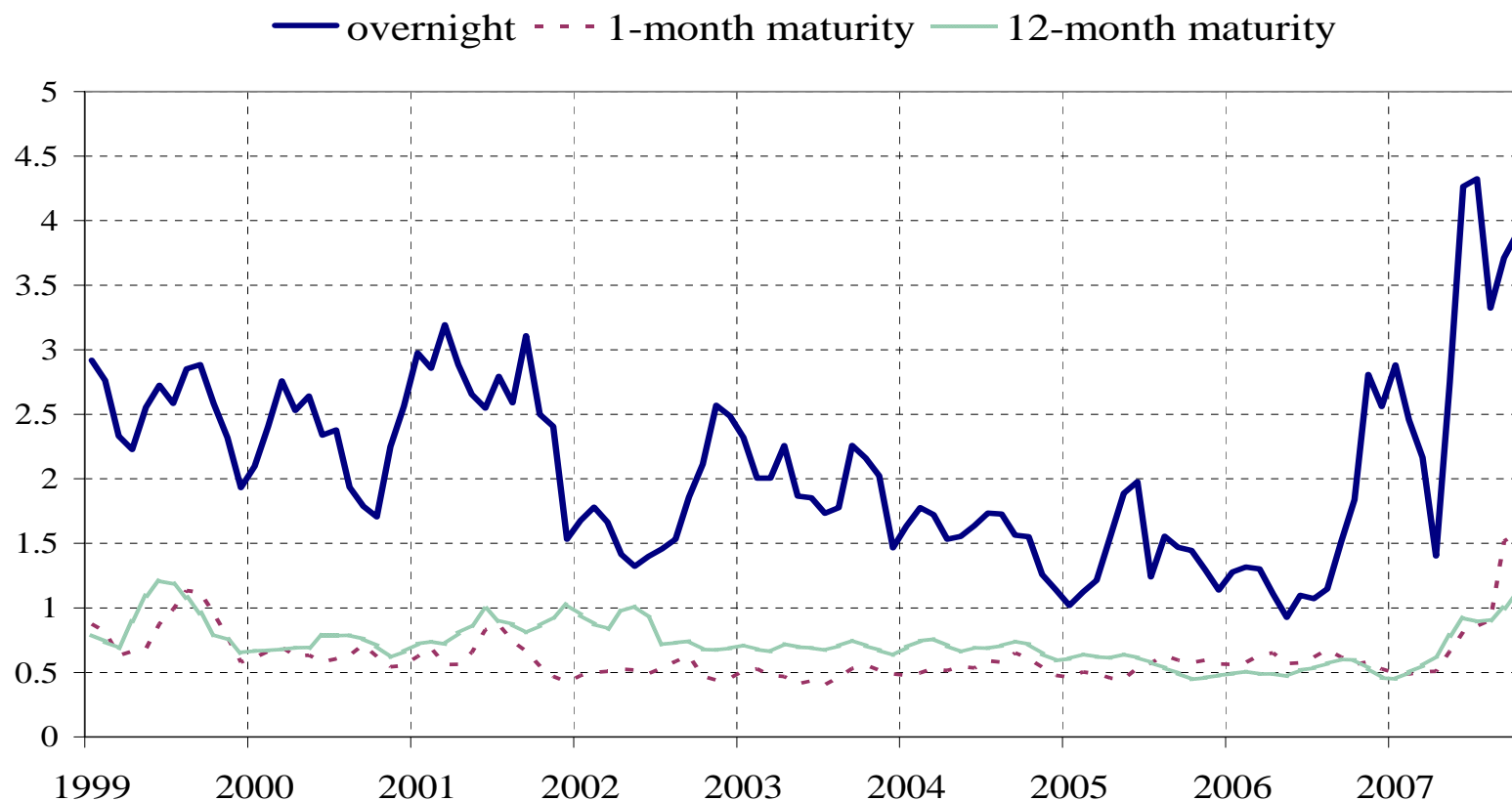
Banking markets

Market	State of integration	Related infrastructures
Wholesale banking	Well advanced	Fully integrated
Capital-market activities	Advanced	Fragmented
Retail banking	Very low	Highly fragmented

Chapter I: Signs of turmoil in money market...

Cross-country standard deviation of average unsecured interbank lending rates across euro area countries

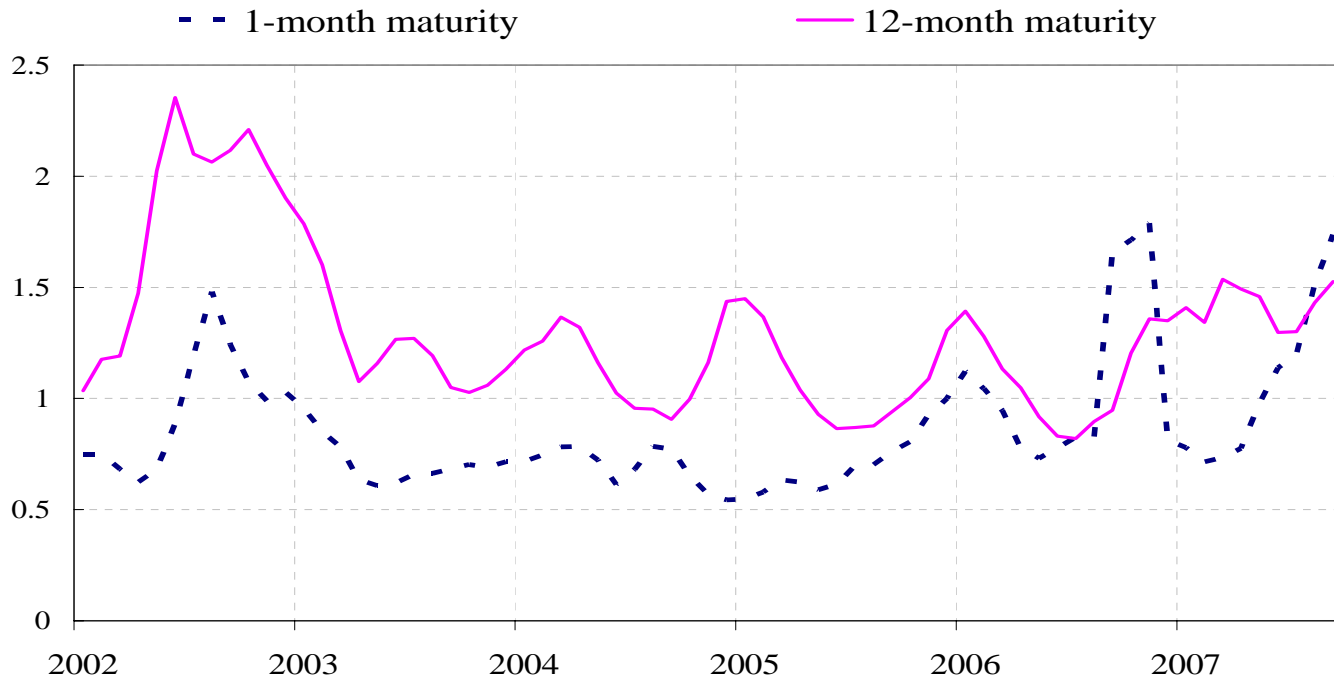
(61-day moving average, basis points)



Sources : EBF, ECB calculations.

Chapter I: ...do not necessarily imply increased segmentation

Cross-country standard deviation of average interbank repo rates across euro area countries (61-day moving average, basis points)

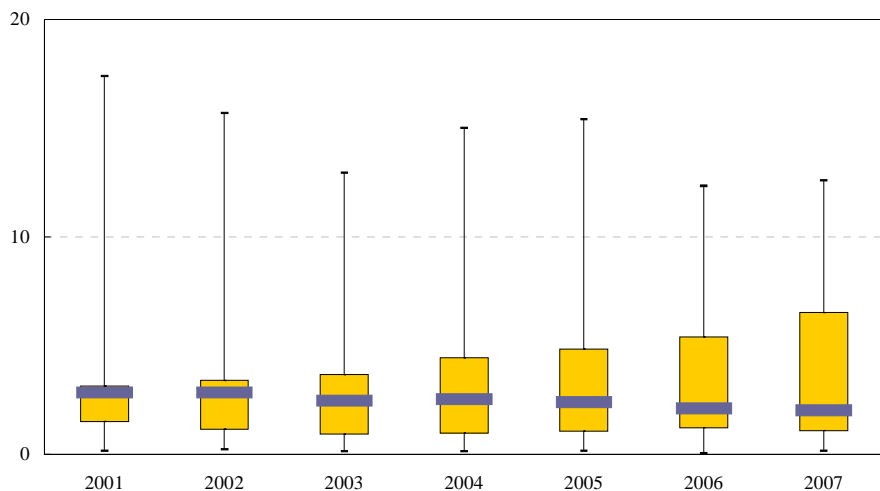


Sources: : EBF, ECB calculations.

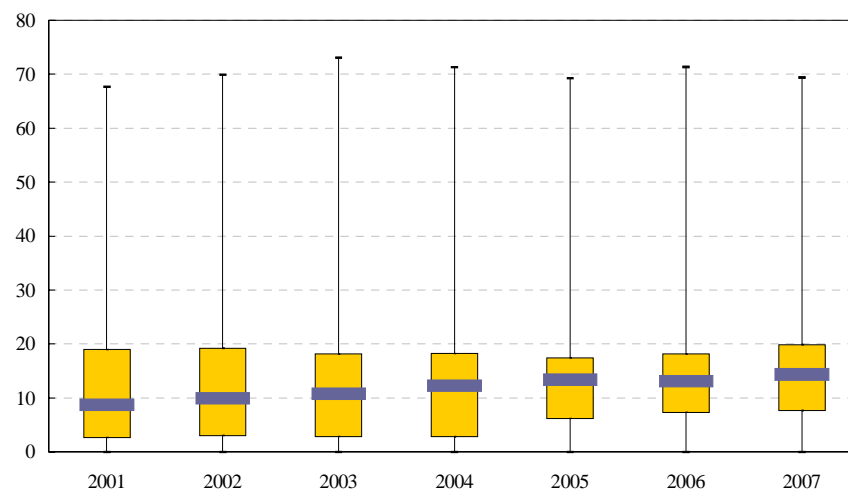
Chapter I: Retail banking market still fragmented

Dispersion of the total assets of euro area bank branches and subsidiaries across euro area countries

(as a percentage of the total assets of the euro area banking sector)



Branches



Subsidiaries

Source: ECB.

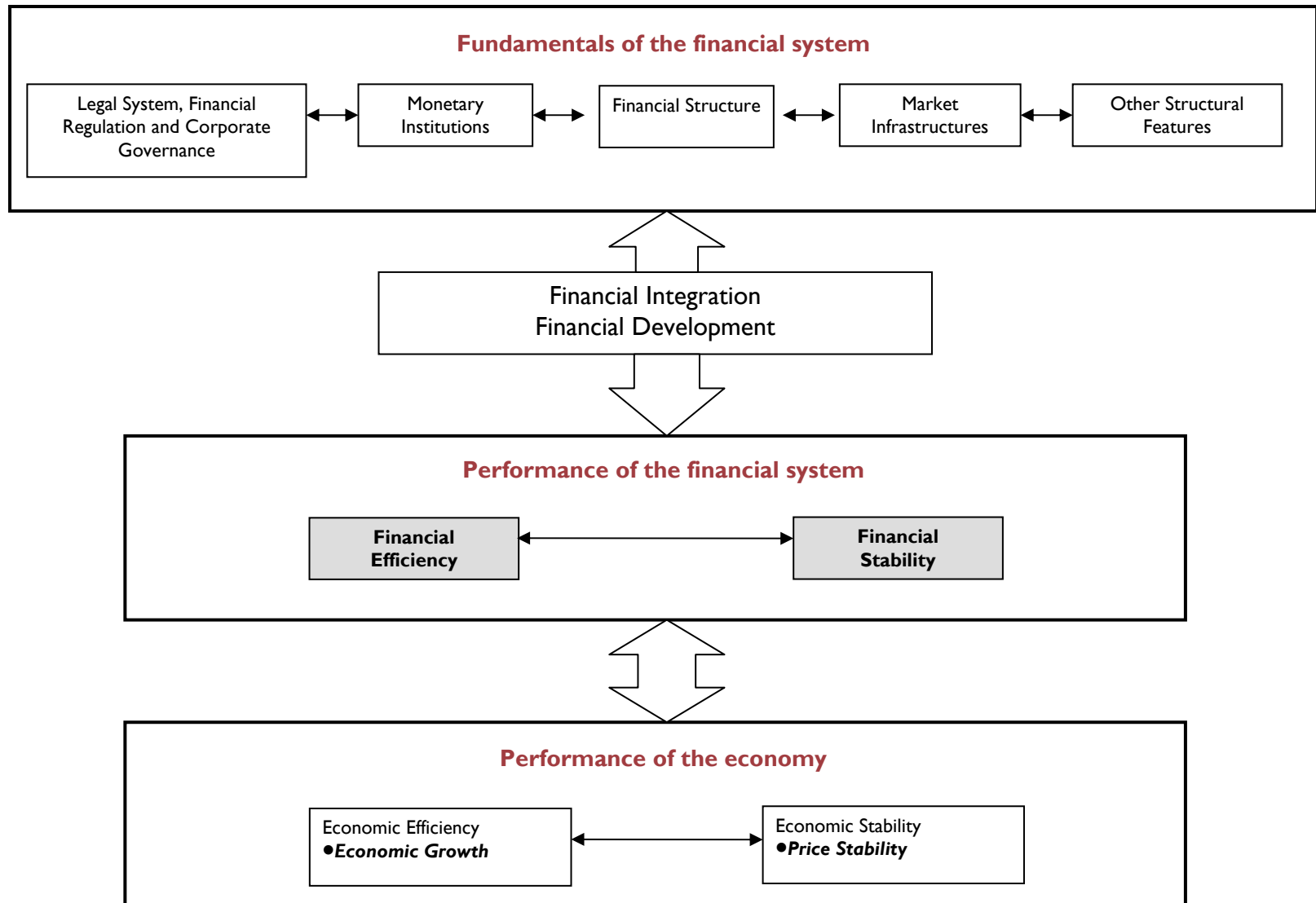
Chapter II: Special Features

- **In-depth assessments of major policy issues and/or analytical studies on financial integration**
- **Selected on the basis of their importance to the EU's financial integration agenda and relevance to the ECB's tasks**
- **Special Features of the April 2008 report:**
 - ✓ **Financial development: concepts and measures**
 - ✓ **The STEP initiative**
 - ✓ **Integration and development of mortgage markets in Europe**
 - ✓ **Integration of large-value payment and securities transactions: TARGET2, T2S and CCBM2**

Chapter II: I. Financial development

- **Process of financial innovation, institutional and organisational improvements in the financial system that**
 - ✓ reduce asymmetric information
 - ✓ increase the completeness of markets and contracting possibilities
 - ✓ lower transaction costs and
 - ✓ enhance competition
- **Financial development is complementary to financial integration in reducing market frictions and fostering financial market efficiency**

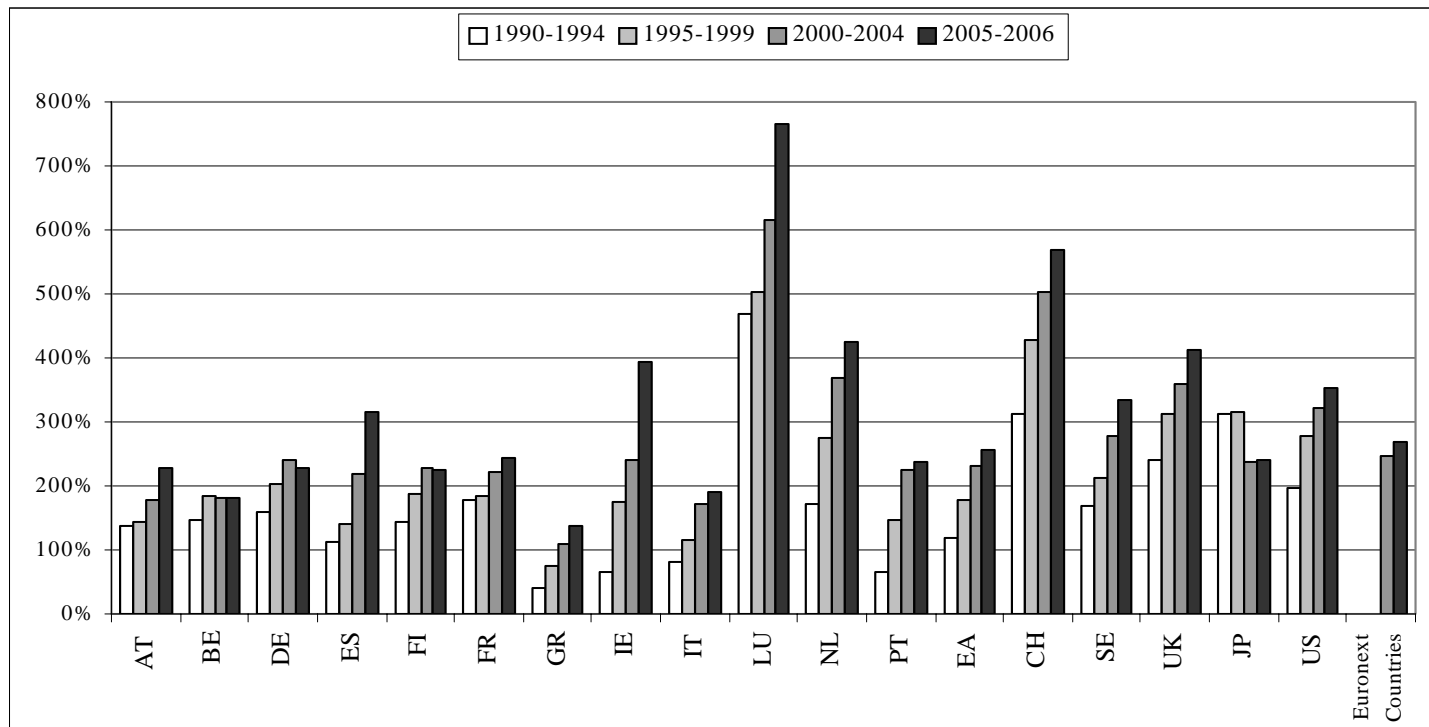
Chapter II: I. Financial development



Chapter II: I. Financial development

- **A selection of indicators to monitor and assess frictions in the financial system**

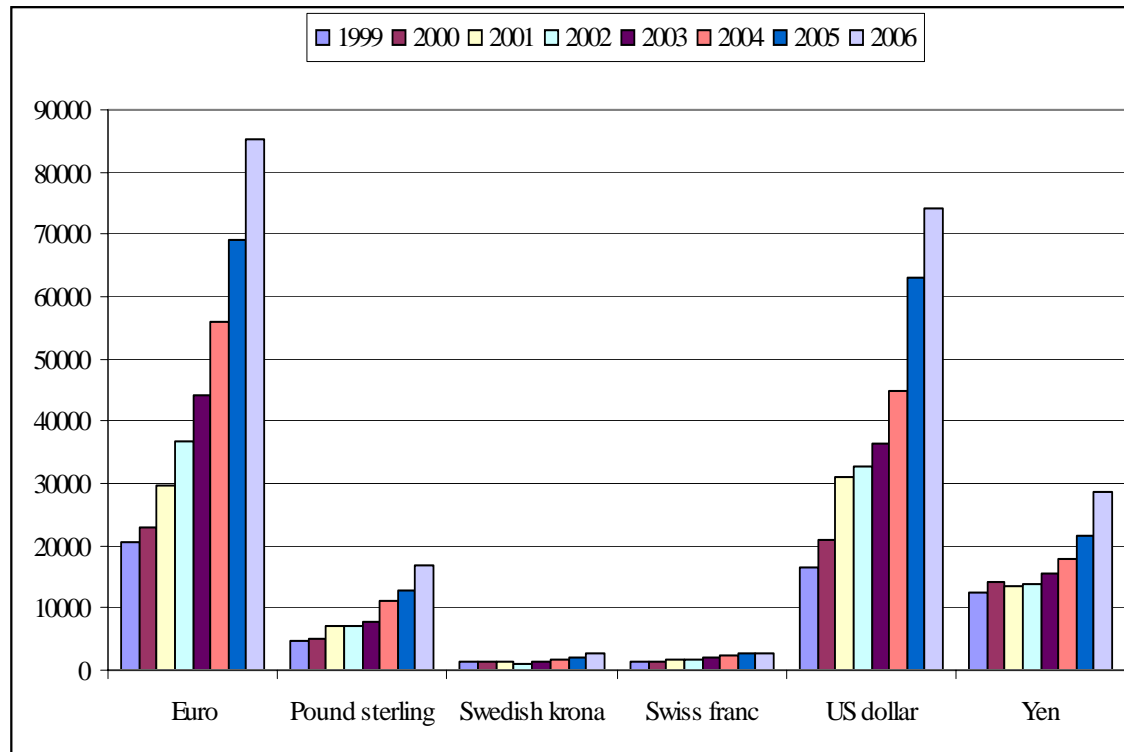
Example I: Capital Market Size (as percentage of GDP)



Sources: BIS, ECB, Eurostat, Datastream, IMF, WFE and own calculations.

Chapter II: I. Financial development

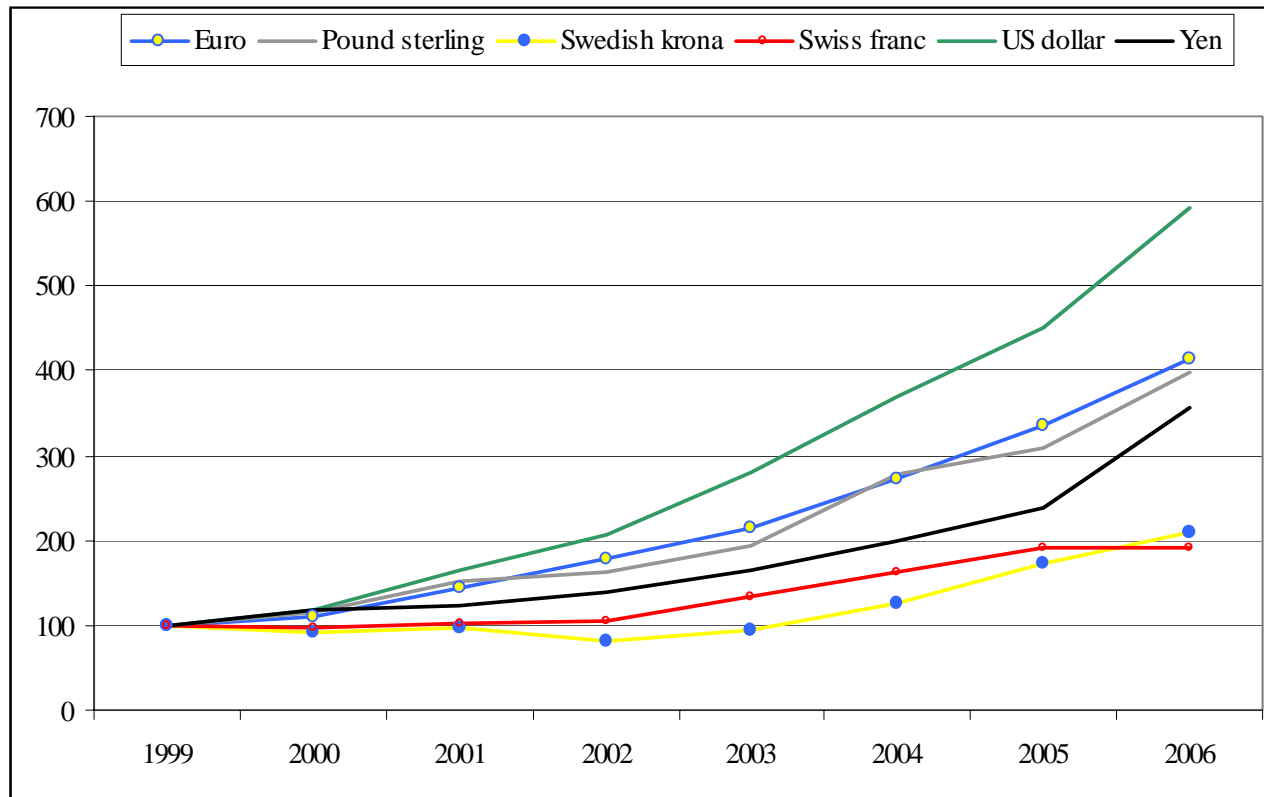
Example 2: Notional amounts outstanding of OTC single currency interest rate derivatives (EUR billions)



Sources: BIS and IMF.

Chapter II: I. Financial development

Example 3: Notional amounts outstanding of OTC single currency interest rate derivatives (EUR billions; 1999=100)

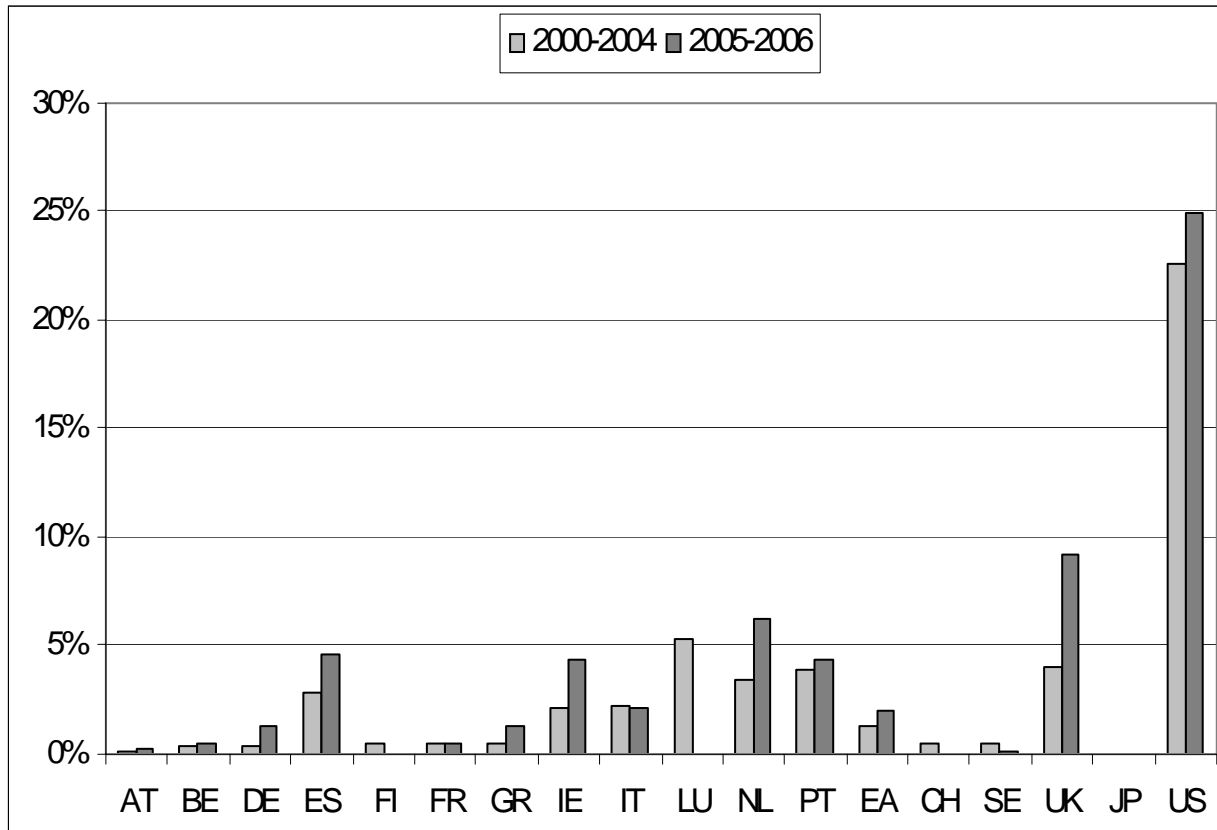


Sources: BIS, IMF and own calculations.

Chapter II: I. Financial development

Example 4: Securitisation

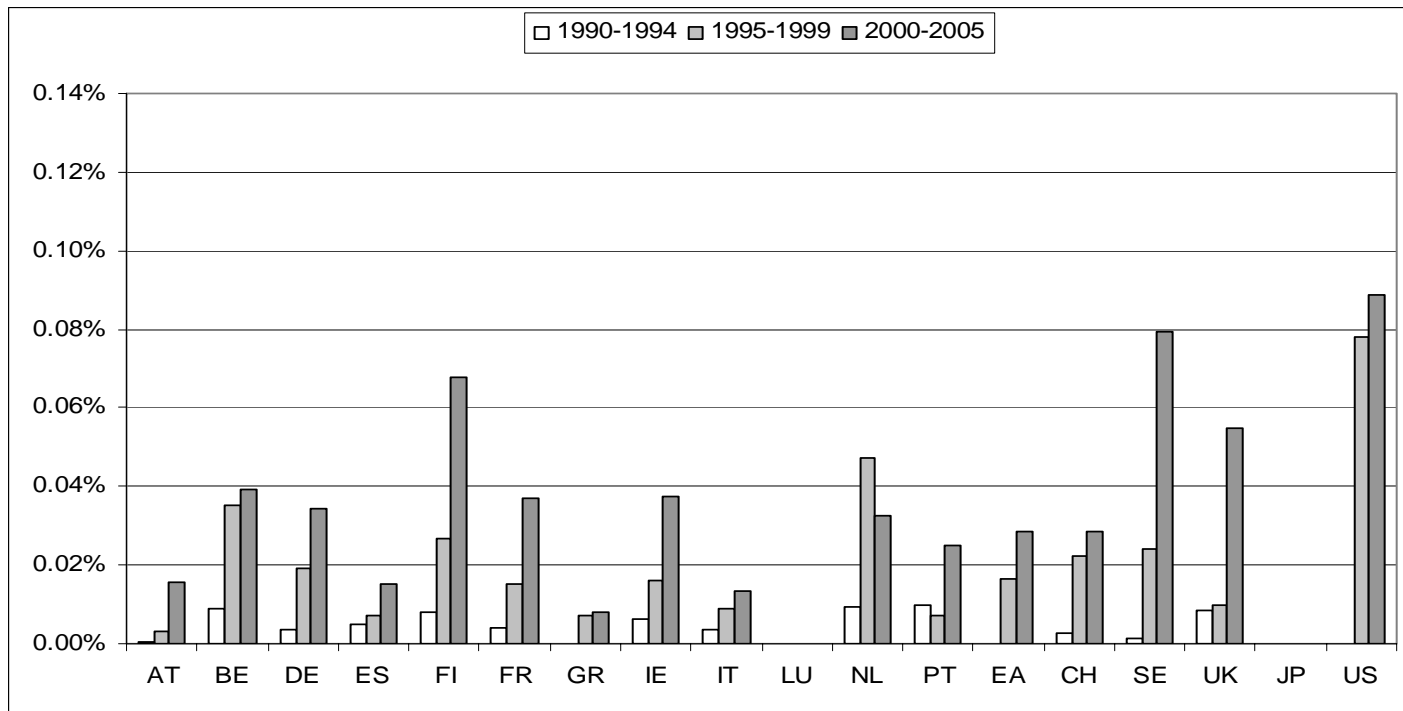
(as percentage of GDP, by country of collateral)



Sources: European Securitisation Forum, Bond Market Association and Eurostat.

Chapter II: I. Financial development

Example 5: Venture capital financing (early stage investments, as percentage of GDP)



Sources: World Bank; European Private Equity and Venture Capital Association, PricewaterhouseCoopers and Eurostat

Chapter II: I. Financial development

- **Two main conclusions:**
 - ✓ A fair degree of **heterogeneity** in financial development exists across markets and countries in the euro area
 - ✓ Scope for **further analysis** of indicators of financial development and for the implementation of **reforms to increase financial efficiency**

Chapter II: 2. The STEP initiative

- Targeted to improve integration in **the short-term securities market**, the **least integrated** segment of the money market
- Improves integration via
 - ✓ Development of **core market standards and practices**
 - ✓ **Voluntary compliance** of market participants
- Significant progress in market integration and transparency
- There are still important challenges being faced in expanding the usage of the **STEP** label

Chapter II: 3. Mortgage markets

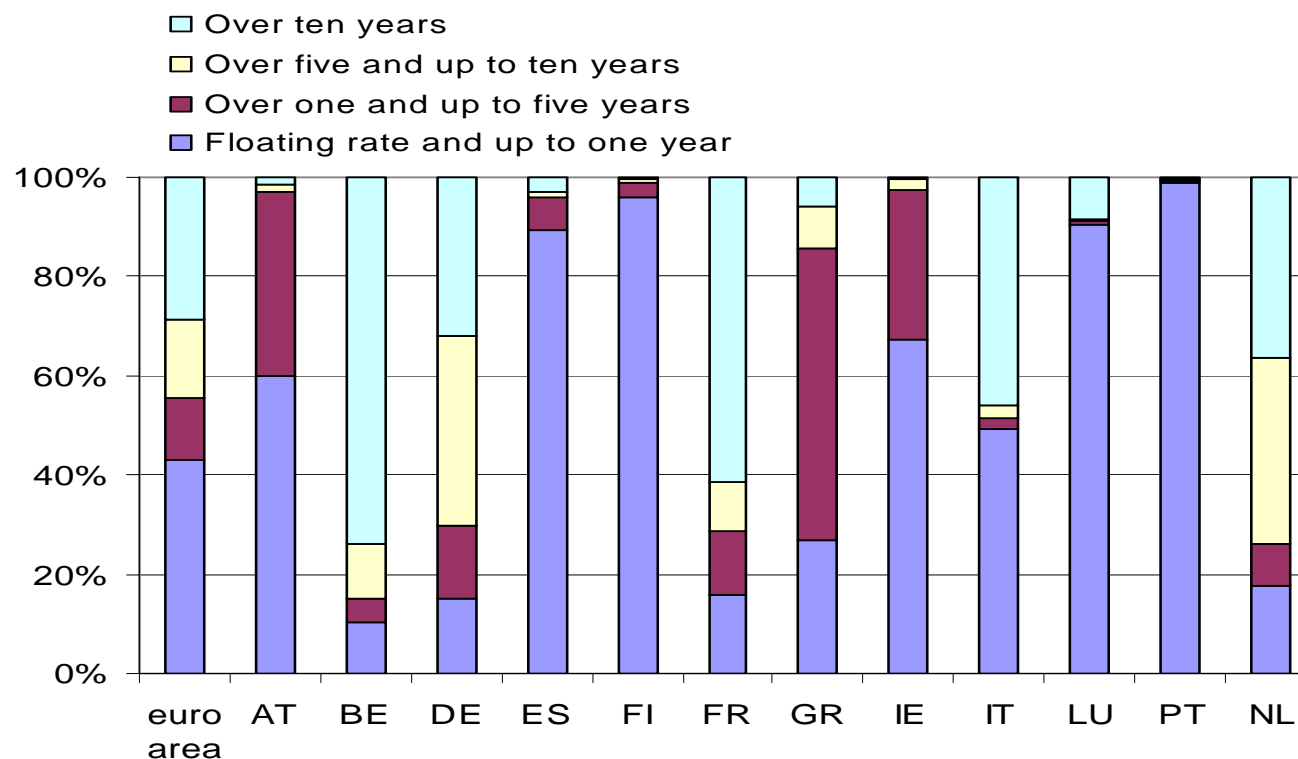
- **Mortgage markets are an important part of the euro area financial system**
- **State of European mortgage markets:**
 - ✓ **Low degree of integration;** lending and funding markets continue to be fragmented and diverse across countries
 - ✓ **Slow progress** towards further integration
- **Causes**
 - ✓ **Natural obstacles:** language, culture, preferences
 - ✓ **Other obstacles:** domestic infrastructures, legal and consumer protection frameworks

Chapter II: 3. Mortgage markets

Diversity on the lending side

New business volume of loans to households for house purchase by period of initial rate fixation

(percentages of total; average between January and November 2007)

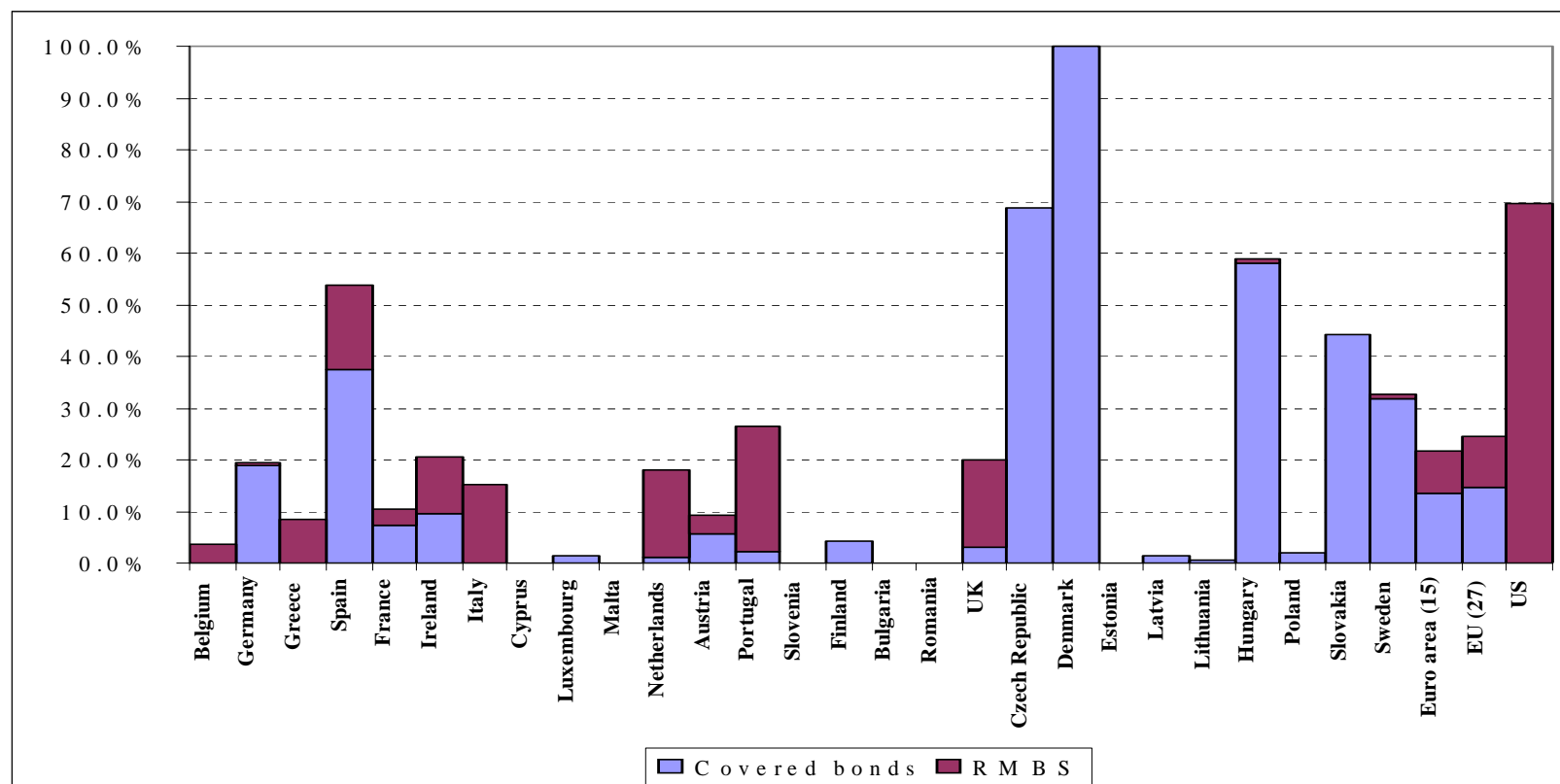


Chapter II: 3. Mortgage markets

Diversity on the funding side

Share of covered bonds and Residential Mortgage-Backed Securities (RMBSs) as the source of residential mortgage funding

(end 2006; percentages)



Chapter II: 3. Mortgage markets

- **Further integration desirable:**
 - ✓ **More homogeneous transmission of monetary policy**
 - ✓ **More stable financial system**
- **But:**
 - ✓ **May also entail certain risks**
 - ✓ **Careful monitoring of process is therefore needed**

Chapter II: 3. Mortgage markets

- **Significant progress can be achieved by the actions of market participants**
- **The Eurosystem stands ready to support and assist market initiatives in the areas of**
 - ✓ **Improved transparency and statistics**
 - ✓ **Promotion of standardised mortgage products**
 - ✓ **Development of market benchmarks**

Chapter II: 4. TARGET2, T2S and CCBM2

- **TARGET** and **CCBM**: **first-generation systems** providing euro area-wide payment services, but did not yet allow to manage **cash, collateral and securities positions** in an integrated way
- **TARGET2** has provided **both the trigger and the enabler** of new integration initiatives, **T2S** and **CCBM2**
- **Significant combined benefits** from the three systems, which include allowing market participants, issuers and investors to operate throughout the euro area on a **single interface** basis

Chapter III: Eurosystem activities

Four types of Eurosystem activities that foster European financial integration:

- **Giving advice:** e.g. review of the Lamfalussy framework
- **Acting as a catalyst for private sector activities:** e.g. STEP initiative
- **Enhancing knowledge and monitoring:** e.g. indicators of financial integration
- **Providing central bank services:** e.g. TARGET2

Concluding remarks

- **The efficiency of the financial system depends on:**
 - **Financial integration**
 - **Financial development**
- **Future reports are envisaged to encompass analysis and assessment of the various factors determining the efficient functioning of the financial system**
- **Special feature on financial development is a first step in this direction**