The Competitiveness of European Financial Markets

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“An Englishman is a person who does things because they have been done before. An American is a person who does things because they haven't been done before.” (Mark Twain)
Outline

• Financial integration and development
• State of EU integration
• US financial integration experience
• Role of ECB in integration
• Integration projects
• Conclusions
Financial integration and financial development

• Financial integration and development
  → efficiency
  → competitiveness
  → overall economic growth

• Schumpeter and Bagehot “creative destruction”

• Total productivity gap EU vs US

• Reforms:
  – Lisbon Agenda
  – Financial Services Action Plan
Financial integration and financial development

Size of capital markets (in % of GDP): US > EU

State of EU integration

• Financial integration uneven:
  – Full integration: money market
  – Near perfect: large-value payment systems
  – Well advanced: government bonds
  – Fair: corporate bonds
  – Fledging: equity markets

• Progress, but:
  – Securities infrastructure integration not sufficient
  – Fragmented retail banking market
State of EU integration

Number of payment and settlement systems remains high

![Bar chart showing the number of retail payment systems and securities settlement systems from 1998 to 2006 and 2006 (US). The chart indicates a decrease in the number of systems over time.]

- **Retail Payment Systems**: 19 in 1998, 14 in 2006, 3 in 2006 (US)
- **Securities Settlement Systems**: 21 in 1998, 19 in 2006, 2 in 2006 (US)
State of EU integration

In 2006: Cross-border exceeds domestic collateral for Eurosystem credit operations for the first time.

![Graph showing the percentage of cross-border and domestic collateral from 2002 to 2006.](chart.png)

- 2002: 27.7%
- 2003: 35.4%
- 2004: 40.8%
- 2005: 45.3%
- 2006: 50.2%
US/EU financial integration experience

Number of credit institutions

- Euro Area
- US


Number of credit institutions:
- Euro Area: 10,000, 11,000, 10,000, 9,000, 8,000, 7,000, 6,000, 5,000, 4,000
- US: 7,000, 8,000, 9,000, 10,000, 11,000, 12,000, 13,000, 14,000, 15,000
US financial integration experience

• Deregulation:
  – EU from early 1990s

• Consolidation in US and EU

• Intrastate/national consolidation

• Cross-border/interstate

M&A activity: US > EU
Role of ECB in integration

- Central banking services
- Catalyst for private sector activities
- Monitors integration
- Advice on EU framework
Integration projects

1. Central bank services: TARGET2-Securities
   - Eurosystème prepares securities settlement services
   - Fragmented securities infrastructure
   - Safety and efficiency of settlement
   - Fostering competition between CSDs
Integration projects

2. **Catalyst: SEPA**
   - National = cross-border payments
   - Opportunities:
     - better prices, cost savings, new business, simplified payments
   - Challenges:
     - investments, competition, pressure on revenues
   - **Short-term costs versus long-term benefits.**
Integration projects

3. **Monitoring integration:** Mortgage markets
   - Mortgage markets crucial for financial system and monetary policy transmission
   - More integration:
     - Funding side
     - Secondary market
   - Remove integration barriers
   - ECB supports European Commission
Integration projects

Dispersion mortgage rates: US < EU

Chart A. Dispersion of floating and short-term rates on loans to households for house purchase and corresponding market rates across US regions and euro area countries, respectively (new business rates; coefficient of variation)

- Euro area mortgage loans at floating rates and up to one year initial rate fixation
- US 1-year adjustable rate
Integration projects

4. **Strengthening the EU framework:** Cross-border banking
   - Cross-border banking integration less advanced
   - Enhance public sector framework
   - Enhance EU framework for cross-border banking
Conclusions

“A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain.” (Mark Twain)
Conclusions

• Competitive financial sector key for economic growth
• European economy in process of significant change
• Financial integration plays pivotal role
Conclusions

• Financial integration progress, but more needed
• US financial integration valuable for EU
• “Old” Europe, but able to integrate fast