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PRESS RELEASE

ECB SIGNALS A GRADUAL RECOVERY OF THE EUROPEAN FINANCIAL INTEGRATION PROCESS

Today, the European Central Bank (ECB) is publishing its fourth Report on Financial Integration in Europe, which notes the return towards integration in the European financial markets. Following the financial crisis, signs of retrenchment had become evident in several market segments. But as market conditions gradually returned to normal during 2009 and especially 2010, the markets that suffered most from the crisis also began to move back to pre-crisis integration levels. However, since the functionality of European financial markets has not yet been fully restored, vigilance and the ECB's active presence in the market are still essential.

The first chapter of the report assesses the state of financial integration in the euro area, based on a set of indicators developed by the ECB. The crisis affected financial markets to very different degrees. The most integrated ones, such as the money markets, showed clear signs of retrenchment within national borders. The bond and retail banking markets, by contrast, were less affected, and the equity markets did not show any appreciable retreat from cross-border integration. As financial markets gradually returned to more normal conditions in 2009 and 2010, the markets that had suffered most also returned more rapidly towards their pre-crisis integration levels.

The second chapter contains four special features, i.e. in-depth assessments of selected topics:

- The first, on banking integration and supervision in the European Union (EU), shows that integration in retail banking markets is lagging behind, while the wholesale banking activities have traditionally been highly integrated. The financial crisis has slowed down the integration process in the banking sector, but this effect is likely to be only temporary. The crisis has accelerated the debate on financial regulation and supervision, resulting in the proposals for a new EU supervisory architecture, which is expected to be beneficial to both financial integration and stability.

- The second special feature looks at covered bonds, a key funding instrument for credit institutions in Europe. Although nearly all countries now have a legal framework in place that supports the issuance of covered bonds, markets remain fragmented. There is therefore scope for further integration, in particular through the further harmonisation of the underlying national legal frameworks and through the development of a common standard or definition of a covered bond. The crisis significantly affected the markets, but the Eurosystem's covered bond purchase programme helped revitalise them.
- The third special feature deals with harmonisation in the post-trading sector. The financial crisis underscored the crucial role that securities clearing and settlement systems play in financial integration and stability. Integration in this area continues to be hampered by legal, fiscal and technical obstacles. A major initiative to tackle them is TARGET2-Securities, which will establish single technical platform for the settlement of European securities trades in central bank money.
- The fourth special feature investigates the stability implications of financial market integration and development. Well-integrated and developed financial systems enhance financial stability. However, the recent crisis has also illustrated that under certain conditions, financial integration and development may increase the risk for financial instability, for example, on the account of higher scope for contagion across countries and less transparent financial products. Increased market transparency and effective macro-prudential supervision and crisis management can help counter these trends.

The last chapter of the report provides an overview of the Eurosystem's main activities in the field of financial integration in 2009.

Financial integration is of key importance for the European Single Market and the ECB. It facilitates the smooth implementation of monetary policy in the euro area. It also contributes to financial stability by creating larger, more liquid and competitive markets, which offer increased possibilities for risk diversification. Finally, financial integration fosters growth by encouraging the further development and efficiency of the financial system. At the same time, however, it increases the risks of contagion across borders.

The ECB's Report on Financial Integration in Europe was presented at the conference on "Financial Integration and Stability: the Legacy of the Crisis". To receive a hard copy

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