Europe’s contribution to financial development - speech by Klaus Regling

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Klaus Regling, ESM Managing Director,
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(*Please check against delivery*)

Dear distinguished guests,

It gives me great pleasure to accept the invitation to speak again at this important Forum. I last spoke here at the 9th Forum in October 2012. The European Stability Mechanism had just been born and my task was to explain how Europe was responding to the euro crisis.

Since then, we have succeeded to counter the European financial crisis and now post-crisis, we turn to matters of how to prevent future shocks and also to how technology can help us to reinforce financial stability.

We live in creative times and enjoy great opportunities.

A smartphone today holds more processing power than all the computers needed for the first moon landing 50 years ago.

There are more than 3 billion smartphone users in the world today. Many are already using technology for all their banking needs or, at least, to pay for purchases. A whole new digital economy is available in the palm of their hand. Europe, as other parts of the world, is keen to harness this technology for common good.

China is a leader in digital transformation. Chinese citizens are paying for cabs and restaurant meals using their smartphones. I see it more here than in Europe.

We witness a lot of dynamic innovations in China, in parallel with its amazing economic development.

Over several decades, China has internationalised its economy. In the process, China has seen its economy excel and now ranks as the world's second biggest. This is a colossal achievement.

China has seized the opportunities offered by digital technology and made environmental and climate change top priorities.

China is the largest exporter in the world. It holds substantial foreign exchange reserves. China is a huge owner of US and European government securities, and engages in investment projects around the world under its Belt and Road Initiative. Its currency, the renminbi, is globally recognised. All of these are examples of China further internationalising its economic activities and developing close relationships with the world.

I believe that China's enthusiastic embrace of Fintech is another example of this internationalisation. By adopting innovations and reforms in its financial system, China demonstrates why it remains at the forefront of digital payment technology. Payment technology is the lifeblood of any economy.

How Europe approaches transformation

In Europe, in the past nine years, much has changed for the better. Five euro area Member states that required the ESM's help successfully concluded their programmes. The euro crisis is far behind us.

Next on Europe's agenda are digital change in financial markets, ecological transition, and a multi-polar currency system. I see the same agenda in China. As we are addressing similar topics, there is significant room for cooperation and synergies among partners.

1. **Digitalisation to strongly impact financial markets**

I believe that digitalisation will have a strong impact on financial markets. Digitalisation has enabled the real economy of goods and services to shift towards a platform economy. On a platform, customers, producers, and providers have direct access to offer and to demand from each other. This makes production and marketing processes more efficient. Prominent examples of these platforms are Alibaba and Amazon.

Financial markets are lagging behind in terms of digitalisation, but no doubt, they will catch up. The tools for this include: social networks, machine learning, mobile applications, distributed ledger technology, cloud computing, big data analytics and artificial intelligence. These tools have given rise to new services and business models from established financial institutions and new market entrants.

In Europe, we have a large and steadily increasing number of Fintech companies. They are about to transform the traditional way of providing banking and financial services.

Just look at the potential. Developing and deploying Artificial Intelligence could add up to an estimated €2.7 trillion to European economic output by 2030, according to a McKinsey Global Institute report earlier this year.

Yet Europe has a challenge not shared by China nor the United States. Fintech companies in Europe suffer from market fragmentation that prevents them from reaching a critical size.

We have an agenda to develop a Capital Market Union (CMU) in Europe. In that context, we are adopting initiatives to address fragmentation.

The European Union adopted a Digital Finance Action Plan to promote cross-border Fintech. It will set up Innovation Hubs that provide anchor points for Fintech across Europe. The EU will create facilities for Fintech ventures to test innovative financial products and services.

The EU will rely on the European Investment Bank (EIB) and the European Investment Fund to enhance access to funding for SMEs and midcaps. It will also promote the unification of venture capital in Europe.

Earlier I referred to payment systems. CMU aims at establishing an efficient and competitive pan-European payment market. Instant payments are quickly emerging as the new norm. The EU has taken significant steps to support this development. In November 2018, the European Central Bank (ECB) launched a new market service called TIPS (TARGET Instant Payment Settlement). Like in China, TIPS allows the transferring of money – within a few seconds – across the 19 countries that belong to the euro area.

One more facet is a pan-European platform for the issuance of new bonds. It is called the European Distribution of Debt Initiative (EDDI) and is being studied by the ECB with strong support from the ESM.

While these are the opportunities, there are also challenges.

European Big Data and software are largely stored in the cloud. But this cloud storage is owned by a few big non-European providers. This makes Europe vulnerable, dependent on commercial and political decisions taken beyond its control.

To mitigate this dependency, a European initiative proposes a local cloud solution aimed at strengthening Europe's position in data storage and analytics.

Then, there are the challenges from emerging technologies. The introduction of formal crypto Central Bank money requires legal recognition of code to be developed, and an assessment of the real benefits to society. Once these hurdles are overcome, this will change market processes and redefine business models for all stakeholders.

Central banks, including the ECB and the People's Bank of China, are evaluating whether they should provide part of their money supply in crypto format. Policymakers have realised that a major, US driven private plan to launch global so-called stable coins could end up succeeding, simply because it meets consumers' needs. This has prompted central banks, and in particular, the ECB, to think harder about how to satisfy that need themselves.

The Bank for International Settlements is exploring the creation a central bank digital currency for wholesale use between banks.

Meanwhile, Bank of England governor Mark Carney suggested this summer that a new synthetic currency could be created. It would be issued as a combination of central banks' digital currencies and could gradually replace the dominance of the US dollar in international transactions.

2. Ecological transition and Sustainability Finance

With the growing importance of the ecological transition, financial markets and global politics will increase the focus on sustainability. This will bring a new dimension to capital markets, adding a new set of criteria to ratings, pricing, transparency and reporting. Sustainability is already a big business in Europe.

There has been a steep rise in public awareness on sustainability-related topics, which has also influenced investors, who are key to the work of the ESM. Sustainability-focused investments reached a value of more than $30.7 trillion globally at the start of 2018, a jump of 34% within two years. The largest region is Europe, at $14.1 trillion (€12.3 trillion). These figures are cited by the Global

Sustainable Investment Alliance in their Global Sustainable Investment Review 2018. Green and Social Bonds are an important component of the umbrella term ‘sustainability investments’, given that these have the most defined criteria. They reached an issuance level of €149 billion in 2018, and are expected to reach €180 billion this year.
Supranational and Sovereign Agency issuers are considered the pioneers of the green and social bond market. They represent the single biggest issuer group of sustainability-focused bonds with a market share of 45% in 2018.
In March 2018, the European Commission (EC) published the ‘Commission action plan on financing sustainable growth’ to help deliver on the Paris Climate Agreement and the Sustainable Development Goals.

Via the action plan, the EC is trying to encourage capital flows towards sustainability-focused investments. Around €180 billion of additional investments a year are needed in Europe to achieve the 2030 Paris Climate targets.

The ESM is actively responding to these developments. Sustainable economic growth and financial stability are closely interlinked.

With more than €80 billion of paid-in capital that needs to be invested, the ESM is committed to the promotion of sustainability in its own investments.
The ESM Investment Guidelines require the ESM to invest in a limited range of highly-rated entities predominantly within the Supranational and Sovereign Agency sector.
Entities, such as governments, public agencies, and supranationals with a significant social and environmental contribution represented more than 69% of the ESM’s invested paid-in capital in 2018.
The bonds issued by the ESM to finance adjustment programmes can be viewed as an example of a sustainability bond of their own kind. They contribute to social stability.

3. **Emergence of a multi-polar currency system**

The emergence of China as the second-largest economy in the world will also shape the international financial system.

In recognition of its potential as a global currency, the renminbi was included in 2016 in the currency basket of the IMF.

I believe the international monetary system will evolve to become a multi-polar system over time, with a limited number of currencies of roughly equal importance. The US dollar and the renminbi will definitely be part of it.

So what is Europe's plan to become part of a multi-polar system and what are the difficulties we need to overcome?

The challenge to Europe

Most importantly, we have to continue on our course to deepen European Monetary Union. A lot has been achieved. The euro area is much stronger today than 10 years ago. But three important elements are missing.

First, for the banking union, this means that an insurance scheme is still missing that would guarantee all depositors across Europe the same minimum amount in case their bank fails, supported by all euro area countries. A common insurance scheme would enhance security for clients of European banks and make it easier for banks to develop cross-border activities. All this would support the euro currency.

As agreed in principle this month at the Eurogroup, the ESM would provide the financial backstop to the banks' resolution mechanism called the Single Resolution Fund, and to sever the link between banks' losses and sovereign debt. The trust in the euro area would increase.

Second, Europe will need fiscal capacity for macroeconomic stabilisation across euro area countries. Though controversial, it is a key element missing in the architecture of our monetary union. It would help contain macroeconomic disparities within the euro area. This could include reinsurance of national unemployment systems, a rainy-day fund or investment protection scheme.

All this could be designed without creating additional permanent transfers.

Third, the creation of a European safe asset, although controversial among Member States, would increase the size of the high quality bond market that is crucial for the fine-tuning of banking, financial and capital markets, the transmission of monetary policy and the international role of the euro.

We have safe assets in the form of German, Dutch, Finnish and other bonds, as well as bonds of the ESM and EIB. But their overall size has declined due to the consolidation of national budgets. A European safe asset would attract more overseas investors to European bonds, thereby bolstering the international status of the euro.

Establishing a multi-currency system also requires international cooperation. In Europe, we prize multilateralism.

The EU comprises 28 countries – 27 after Brexit – and practices multilateral cooperation every day. The rest of the world admires Europe for that, I believe.
As the only euro area representative speaking here today, I would like to congratulate China on issuing its first euro-denominated bonds in fifteen years. The issue of 4 billion euros of seven- 12- and 20-year bonds took place last month and we consider this an endorsement of both the euro and the stability restored in the currency since the financial crisis a decade ago.

We now look forward to working with China on improving the infrastructure for Fintech, digitalisation of the economy and advancing the prospects for a multi-currency arrangement for world trade and the international monetary system.

Thank you.

Author

Klaus Regling
Managing Director

Contacts

Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu

Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu