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**EUROPEAN ECONOMIC & FINANCIAL INTEGRATION : WHAT IS
THE OUTLOOK ?**

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Ladies and Gentlemen,

It gives me great pleasure to participate in the Financial Forum organised by Paris Europlace in order to discuss European economic and financial integration and its outlook.

I am also delighted to address this topic with my friend Stanley Fisher.

Basically, I'd like to share views with you on two main questions:

- Firstly, what is the current stage of integration ?
- Secondly, what are the next steps ?



The current stage of integration

Allow me to begin by stressing that economic and financial integration is already well-grounded. It is indeed tangible when looking at trade, capital markets and financial structures in Europe.

As regards trade, the long track record of commercial relationships among European countries was the reason underpinning their move towards Union, which now, in turn, contributes to fuelling their reciprocal trade.

Nevertheless, one should not neglect another very important aspect of this historical process, namely the fact that 15 countries decided to merge into a single economic area – and indeed achieved it - within a very short period of time. The Single European Market was created only 10 years ago, as the result of an initiative started in 1986.

At present, labour, goods, services and capital circulate freely within the Union's territory. European integration is the most ambitious supply-side reform attempted anywhere in the world. The introduction of the euro was enabled by economic convergence and contributes to reducing transaction costs and exchange risks. No other region in the world has been so successful in removing borders for labour, goods and capital over such a short period.

These results are remarkable when one considers that now the euro area brings together 304 million citizens and represents more than 15% of world GDP. Given its sheer size, the Single Market enables significant economies of scale and offers huge business and investment opportunities. It boosts competition to the benefit of consumers and results in better capital allocation. In a number of areas, barriers to free competition have been removed, and monopolies dismantled.

Allow me also to stress that, although strongly integrated (indeed, almost half of euro area countries' external trade is carried out within Monetary Union), the euro area is also very open to the rest of the world. It is actually more open than the world's other two major economies: its average external trade makes up around 17% of GDP, against around 11% for the US.

The euro area also benefits from highly-integrated capital markets.

Integration is certainly, and naturally, most complete on the money market. Interest rate differentials across regional deposit markets have vanished and the "law of one price" applies to all transactions within a deep and highly liquid pan-European market. Cross-border transactions (for unsecured inter-bank deposits and repos) are developing rapidly and already represent more than 50% of all money market cash transactions.

Depth and liquidity of the euro area money market are now comparable to those of the US market. Market makers, funds, institutional investors and all types of issuers can now access a single European money market. They can trade or issue with counterparts located in any country of the euro area. They are perfectly used to uniform euro area-wide benchmarks such as the EONIA for overnight inter-bank deposits or the EURIBOR for longer-term money market operations. The euro market for short term interest rate derivatives has also become an international benchmark thanks to the remarkable expansion of EURIBOR futures contracts and EONIA-indexed swaps.

As regards the short-term securities market, its development may look uneven and somewhat less dynamic. However an increasing number of large corporate firms, including US firms, are issuing euro-denominated commercial paper in the euro area, especially in the French commercial paper market. Overall, the outstanding amount of CP/CDs issued in the euro area is around EUR 320 billion, EUR 250 billion of which are in the French segment. Furthermore, European market participants are currently taking up initiatives, under the aegis of the Financial Markets Association (i.e the ACI), aiming at promoting common market standards in order to foster further integration of this segment.

We, within the Eurosystem, are of course particularly interested in seeing an efficient and a pretty well-integrated money market, the existence of which is key for monetary policy impulses to be transmitted efficiently.

Though impressive, the development of an integrated money market is however far from being the only achievement in recent years. The market for euro-denominated bonds has a similar record. It is now the second largest bond market in the world. As regards size and issuance, it is increasingly comparable to the US bond market. In 2001 for instance, issues in euro and in dollars accounted respectively for 44% and 48% of total bond issues. Whereas the corporate bond market was rather poorly developed before the euro changeover, the advent of the single currency has allowed it to change gears. This segment now accounts for about half of total bond issuance in the euro area (more than four times higher than that of 1998).

Thanks to increased competition among issuers, a rise in issuance and its rapid internationalisation, the euro bond market as a whole benefits from greater liquidity and efficiency. Transaction costs are thus declining as shown by narrowing bid-ask spreads. The increasing number and diversity of issuers in turn boost investment opportunities.

Integration is also impressive as regards euro area stock markets. It is fuelled by euro area-wide benchmarks (such as Eurostoxx indices) which are now commonly used. European-oriented investment funds have replaced more locally oriented ones. Derivatives markets also allow participants to shift from a country perspective to a euro area-wide one. Empirical evidence confirms that sectoral factors are playing an increasing role in price dynamics. As integration enlarges the population of investors, a number of which specialise in providing funds to young and innovative firms, the number of new listings has been rising.

The integration of trading has undoubtedly been facilitated by increasingly integrated market structures.

As regards stock exchanges, the European landscape is also being rapidly reshaped. The Amsterdam, Brussels and Paris exchanges merged in mid-2000 to form Euronext. They have been joined by the Portuguese exchanges and the LIFFE (London derivatives exchange).

Let me mention also that electronic trading systems have contributed decisively to standardising markets, enhancing transparency and reducing transaction costs in Europe. This has proved particularly true in government bond trading : after a phase of fierce competition, it is now experiencing a dramatic increase in turn-over, both in the cash bond market and in the repo market. Platforms like those of MTS or Broker Tech now play a key role in this segment.

As regards other types of infrastructures,

- TARGET is, of course, the most remarkable achievement. Inter-linking EU Member-States real-time gross settlement systems was indeed crucial to the integration of national inter-bank markets and thus local money markets. In 2001, almost 40% of daily transactions through our RTGS and TARGET (for an average daily value of more than EUR 500 billion) were cross-border transactions.
- The euro also spectacularly sped up the pan-European integration of securities settlement systems. The first step in the current market-driven integration process was the consolidation of the French, Dutch and Belgian central depositories within the Euroclear Group. The latter's very recent merger with Crest Co (the British CSD) is a further and significant step in this process, which will provide users with more efficient and less costly settlement services for a broad range of capital markets.
- Clearing houses are experiencing a very similar move with Clearnet, which already provides clearing services with a central counterparty for stocks, bonds and derivatives products to the French, Belgian and Dutch markets.

Thanks to the euro, which itself acts as a catalyst, one can see to what extent significant progress has already been made in the financial sector : many concrete results have been achieved on the markets themselves, but a lot of positive changes also stem from public initiatives, which play a key role in this respect.

On that account, there is now clearly strong governmental support to help perfect economic and financial harmonisation in Europe. To that end, in March 2000, Heads of Member States meeting in Lisbon launched an ambitious Financial Services Action Plan which encompasses a wide range of far-reaching measures. This plan is aimed at harmonising and improving the conditions under which issuers, investors, and intermediaries conduct their activities in the European markets. The whole plan is to be implemented by 2005. Measures relating to the securities markets should come into force even sooner, by 2003.

At present, 30 out of the 42 FSAP objectives have already been brought to a successful conclusion allowing significant breakthroughs in various crucial areas. All these objectives involve far-reaching reforms, such as, for example, ensuring a level playing field for mutual funds (UCITS), setting up an adequate framework for the oversight of the activities of financial conglomerates, or harmonising rules concerning the use of collateral in financial transactions, especially in a cross-border context.

Let me also remind you that, a year ago, the Committee of European Securities Regulators (CESR) was set up so as to enhance co-operation among Member States securities market supervisors as well as to play an advisory role in order to speed up the implementation of the various measures encompassed in the FSAP. Recently, it embarked with the European System of Central Banks on considering standards to be applied to the European securities settlement and clearing systems. Against this background, as suggested in the Lamfalussy Report, Member States aim at improving their own regulatory and supervisory bodies.

All in all, the euro and the combined effects of these reforms contribute to reinforcing the foundations of our financial system and to making the euro area economy much more attractive and resilient to shocks.

In facilitating prices, taxes and earnings' comparisons, and thus cost reductions, the single currency not only enhances competition and the effective functioning of the Single European Market, but also reduces uncertainty and facilitates investment and production decisions within the euro area. Moreover, for the euro area to be set up, we had to achieve low inflation and low inflation expectations, while keeping low nominal rates. This created a very favourable environment, which is now helping the euro area to cope with the global slowdown.

That said, integration remains an on-going process. So, let me turn now to the next steps in this process.

What are the next steps ?

Clearly, there are two major points at issue for the future of EU : enlargement and a further deepening of integration. These two topics are to be dealt with over the coming years.

Let me first turn to the issue of European Union enlargement.

Thanks to enlargement, ten new countries comprising a total population of 108 million people are likely to join the EU in less than two years, thus completing European reunification. Although new countries' combined GDP is rather small (equivalent to that of the Netherlands for instance), in terms of population size, they will propel the EU to about twice the size of the US and three times that of Russia. Enlargement will boost present Member States' economic activity. I do not want to minimise the fact that noteworthy adjustment efforts will be required. This however represents a unique opportunity to extend present benefits of the Single Market to a market place of some 500 million consumers.

Let me focus on another essential goal which can now be met in a pretty short period of time : financial integration. In this field, looking at the current situation, we can be reasonably optimistic. However, progress is still necessary and possible to allow financial integration to deliver its full benefits.

Firstly, several initiatives are underway to further increase transparency.

Recent difficulties faced by corporate firms have indeed highlighted how crucial the issue of information and financial disclosure is. Fair assessment of equity valuation by all kinds of market participants ultimately depends on complete and reliable information. To that extent, the current EU move towards a uniform body of accounting standards will prove very useful. Such a move should not of course result in increased volatility in financial firms balance sheets.

Further improvement in market functioning might also be brought about by enhancing transparency as a whole. As regards issuing costs, the planned Prospectus Directive will make it easier for European issuers to raise capital, whilst ensuring an adequate level of investor protection, by replacing the cost of 15 different prospectuses with a true "single passport for issuers" : once agreed in one Member State, it will be used for raising capital within the whole Union.

In retail financial markets, there is also scope for rules aimed at ensuring larger access to information for consumers and preventing service providers from exploiting their superior information. In this respect, much is expected, for example, from the Directives on distant marketing of financial products and on market abuse.

In addition, harmonisation may still be strengthened in some fields.

Within the Union, market practices, regulation, tax and legal treatments still unavoidably encompass a number of national features.

For example, it is worth pursuing efforts to allow the full integration of securities trading. As regards trading, further achievements in the integration of the European repo market, for instance, imply that some remaining differences in national tax and legal treatments be removed. As for market infrastructures, evidence suggests that cross-border securities trades remain more expensive than domestic trades. Such impediments may prevent market participants' from systematically adopting euro area-wide investment and trading approaches.

However, several initiatives have already been taken to tackle those issues and strengthen harmonisation and standardisation of market practices and procedures. Among them, the implementation of the Directive on the use of collateral will enhance legal certainty as regards cross-border transactions. Moreover, the forthcoming revision of the Investment Services Directive will lead to the setting up of a harmonised framework for the provision of all kinds of investment activities, encompassing both regulated markets and new electronic trading facilities, and thus contributing to raising market efficiency overall.



As a conclusion, I would now like to very briefly address the conditions under which we could efficiently meet the ambitions that I have just mentioned.

Political commitment is needed in order to ensure financial integration. On that topic, it is worth repeating that financial integration is at the very heart of the EU's strategy to enhance the Union's dynamism and competitiveness. This strategy, endorsed in Lisbon in March 2000, was confirmed and strengthened in Stockholm in 2001 and in Barcelona in March 2002. It aims at meeting two fundamental and complementary objectives : harmonisation of general rules and principles at the level of the whole community, and close co-operation among market regulators, supervisors and central banks on technical and operational issues.

Financial sector commitment is key as well. Indeed, a great deal of the harmonisation process in Europe relies on private sector involvement given its practical and operational implications. Harmonised rules or operational standards, which are adopted after repeated consultations with the private sector, are only devoted to ensuring a level and integrated playing field. Once such a requirement is fulfilled, it's up to private agents to play their role.

A very large part of EU financial integration has thus been driven by market forces, through, for instance, internal restructuring or consolidation in the financial industry, internationalisation of investment funds and the development of electronic trading platforms. Some initiatives are even all the more beneficial because they come from the private sector. Examples are the market-driven creation of the EONIA index, or the recent initiative of the Financial Markets Association (ACI) with a view to promoting standards for the euro area short-term paper market. There is no doubt that the ongoing emergence of pan-European financial institutions will also create powerful engines for further financial integration.

Private sector initiatives thus trigger a sort of virtuous circle : the more market participants behave as they would in a fully integrated area (or with the aim of reinforcing it), the more they justify the need to strengthen legal harmonisation and the more they speed up the integration process itself. And this is indeed what is being done by financial authorities. By mutually interacting, public and private forces are presently reinforcing European financial integration in a way which has never been seen before.

I therefore strongly believe that this huge change taking place will further and rapidly strengthen our European financial markets and thus bring all our economies' increased growth and well-being.

Thank you.