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EUROSYSTEM

PRESS RELEASE

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Financial integration in Europe rebounds, ECB report finds

- Financial integration in the euro area has improved steadily and has reached a level close to that before the sovereign debt crisis
- Establishment of Banking Union and unconventional monetary policy actions taken by the ECB are major drivers of the improvement
- Financial integration is crucial for restoring efficient credit flows to the real economy

Overall, financial integration in Europe has returned to a level close to that recorded before the sovereign debt crisis, the European Central Bank (ECB) said today in a new report published at a Conference on Financial Integration and Stability held together with the EU Commission in Brussels.

The report, which is produced annually, finds that financial integration in the euro area has made good progress in most market segments and increased in 2014, in comparison with the level recorded in 2013, as measured by the composite indicator on financial integration, FINTEC[1]. This progress can be seen across the money, bond, and banking market segments, while the picture for the equity market segment is more mixed.

Financial integration has improved as a result of, inter alia, the establishment of the Banking Union, in particular the Single Supervisory Mechanism and the comprehensive assessment of banks that preceded its taking up operations, as well as the Single Resolution Mechanism. Moreover, the series of unconventional monetary policy actions taken by the ECB have helped counter financial fragmentation.

The report says it remains crucial to fully implement Banking Union in order to sustain the progress made in financial integration, promote its further development and limit the potential negative side effects of financial fragmentation in a crisis situation.

"European financial integration has improved over the past two years, and that has also been to the benefit of the access to finance by firms. Our measures have reduced financial fragmentation and, since last year, both the level and the dispersion of credit interest rates have been reduced, especially for small and medium-sized enterprises. Much remains to be done to deepen financial integration further. The Capital Markets Union

[1] The acronym FINTEC stands for FINancial INTEgration Composite. The FINTEC consists of standard indicators of all four (money, bond, equity and banking) market segments, and thus reflects the overall development of financial integration. Further explanations are provided in the Financial Integration Report.

project, launched by the Commission, can make a positive contribution to that goal," said Vítor Constâncio, Vice-President of the ECB.

The four market segments in detail:

In the **money markets**, the share of unsecured overnight cross-border transactions has returned to the levels observed before the Lehman default. Moreover, the dispersion of money market rates at various maturities across euro-area countries declined throughout most of 2014. The rise in confidence that this access to greater cross-border short-term funding signals is also reflected in the lower levels of excess liquidity held in the banking sector.

Indicators also show that the fragmentation in **euro area bond markets** (for sovereigns, banks and non-financial corporates) receded further in 2014, as result of at least three main factors: a) the implementation of structural reforms in distressed countries; b) progress on euro area financial architecture reforms; and c) the ECB's monetary policy measures. Search for high-yielding debt securities abroad may also play a role in the convergence of corporate rates and would need to be monitored carefully from a financial stability perspective.

Financial integration also improved in the **euro area banking markets** in 2014. The cross-border dispersion of retail rates on loans to, and deposits held by, non-financial corporates continued to decline, and the gap between such rates in distressed and non-distressed countries became smaller in 2014. The fact that the narrowing of the gap is particularly visible for small retail loans indicates the success of some policy initiatives aimed at restoring SME financing, which plays a crucial role in restoring sound economic growth in distressed countries.

Progress in **equity market** integration is less clear than in the case of the money, bond and banking markets. Price-based indicators show, for example, a persistently higher fragmentation of equity markets among distressed countries relative to non-distressed countries. Quantity-based indicators exhibit a stable level of intra-euro area cross-border equity holdings. The diversification observed to equity outside the euro area, at the expense of domestic holdings, may have some benefits for financial stability.

The full report can be downloaded from the ECB's website.

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