



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Economic and Monetary Union in Europe

ECB Central Banking Seminar

Frankfurt, 9 July 2018

Overview

- 1 Key facts and figures of Economic and Monetary Union (EMU)
- 2 Institutional architecture of EMU and legislative process at EU level
- 3 Deepening EMU
- 4 Financial Union/Banking Union
- 5 Fiscal Union
- 6 ESM reform
- 7 Economic Union
- 8 Conclusions

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Progress of European integration

- 1952 ECSC**
European Coal and Steel Community
- 1958 EEC and EURATOM**
European Economic Community
European Atomic Energy Community
- 1967 EC**
European Communities
- 1993 EU**
European Union (Maastricht Treaty)
- 1998 ECB**
Founding of the European Central Bank
- 2009 EU**
Treaty of Lisbon



Preparation of Economic and Monetary Union (EMU)



1970 **Werner Report**

on economic and monetary union

1979 **EMS**

European Monetary System

1986 **Single European Act**

1988 **Delors Report**

1998 Founding of the **ECB**

1999/2002

Introduction of the **euro**



Three stages to Economic and Monetary Union (EMU)

1 January 2002
Introduction of euro
banknotes and coins

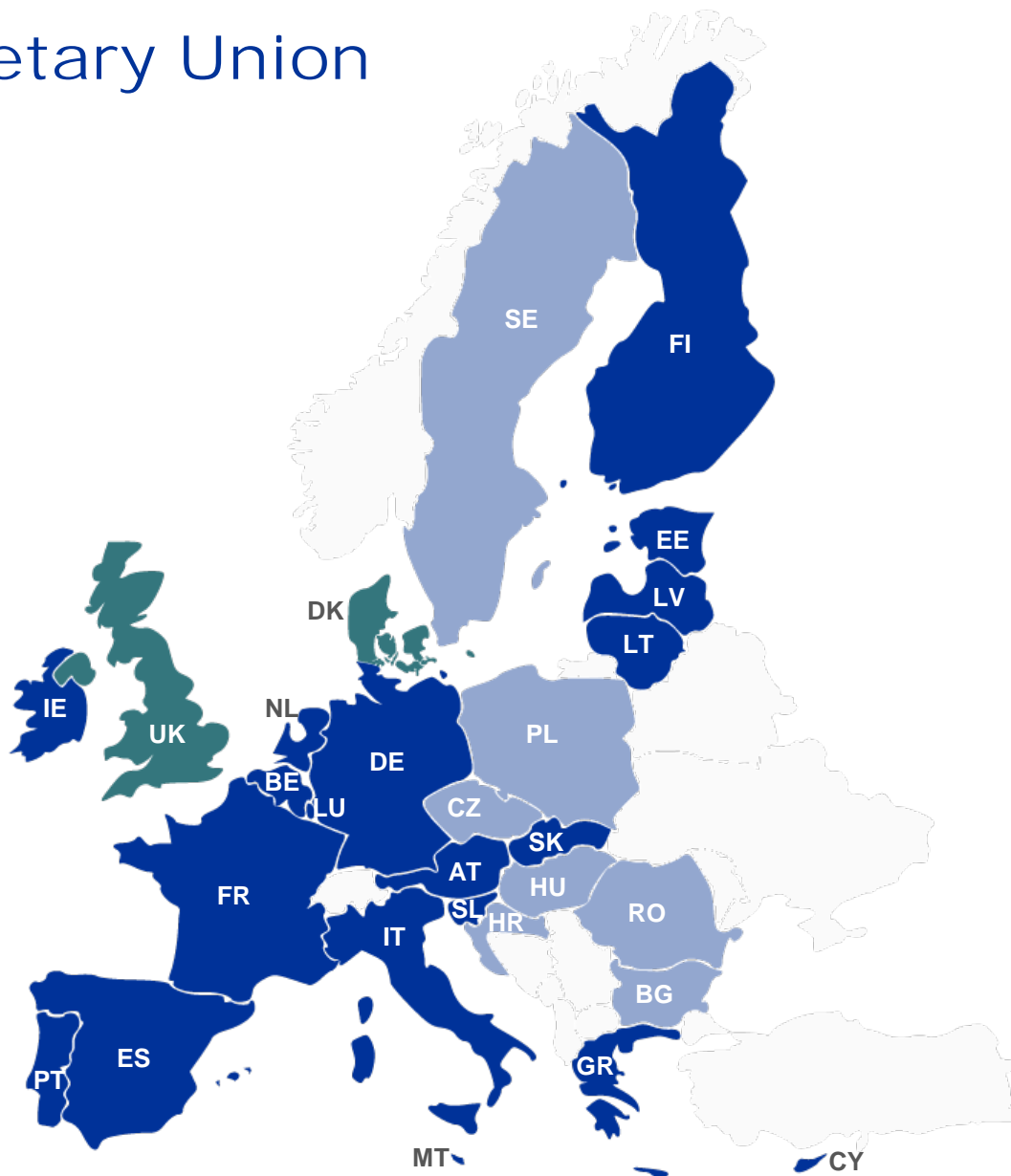
3 **1 January 1999**
Irrevocable **fixing of conversion rates**,
ECB responsible for monetary policy

2 **1 January 1994**
Establishment of the **European Monetary Institute**,
the ECB's predecessor

1 **1 July 1990**
Abolition of all restrictions
on the movement of capital

Economic and Monetary Union (EMU)

- EU Member States which have adopted the euro
- EU Member States with a special status
- EU Member States with a derogation



In practical terms, EMU means:

- Coordination of economic policy-making between Member States
- Coordination of fiscal policies, notably through limits on government debt and deficit
- The single currency and the euro area with an independent monetary policy under the responsibility of the ECB
- Single rules and supervision of financial Institutions within the euro area under the responsibility of ECB Banking Supervision

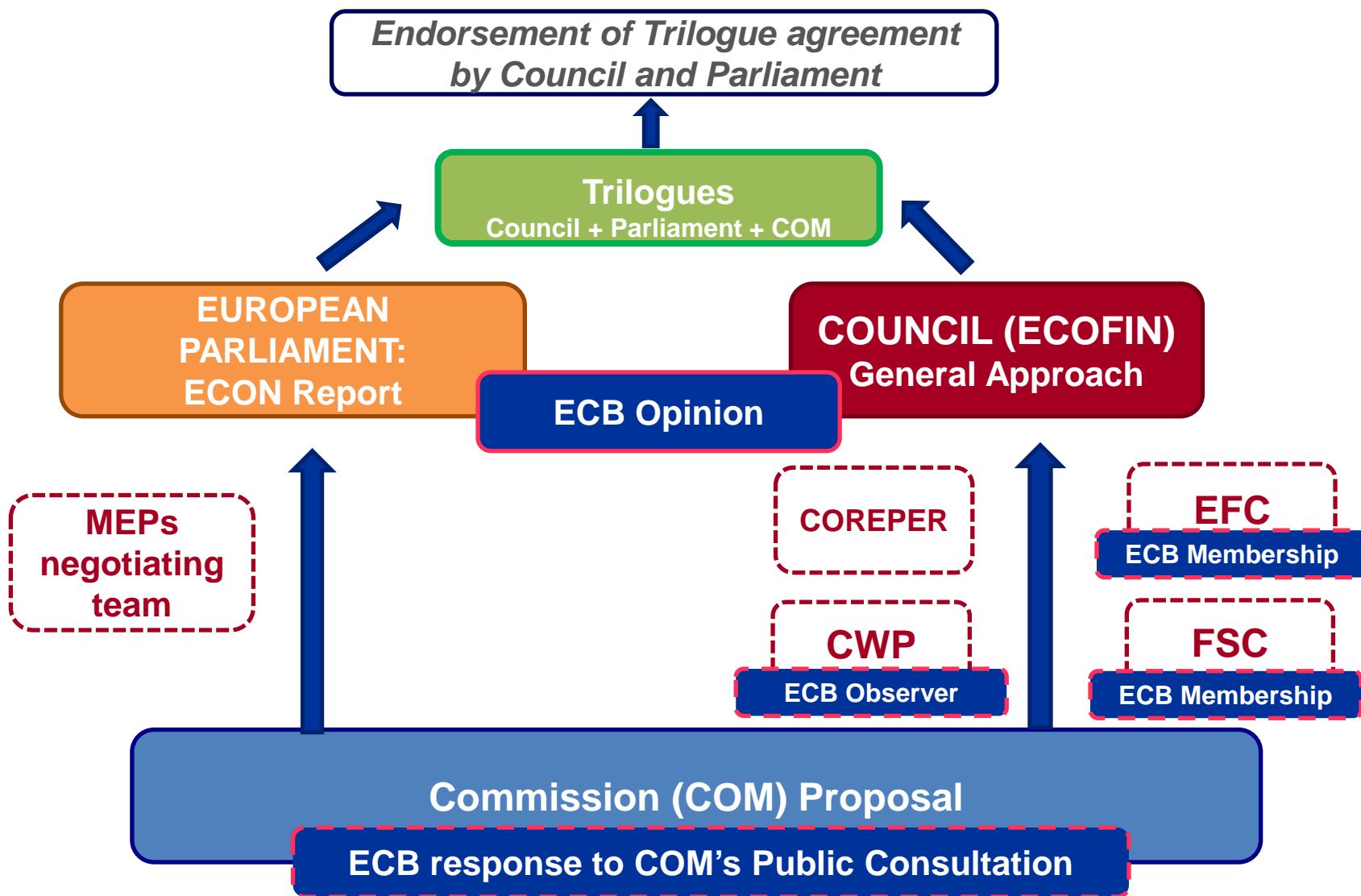
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Divided responsibilities between Member States and the EU institutions:

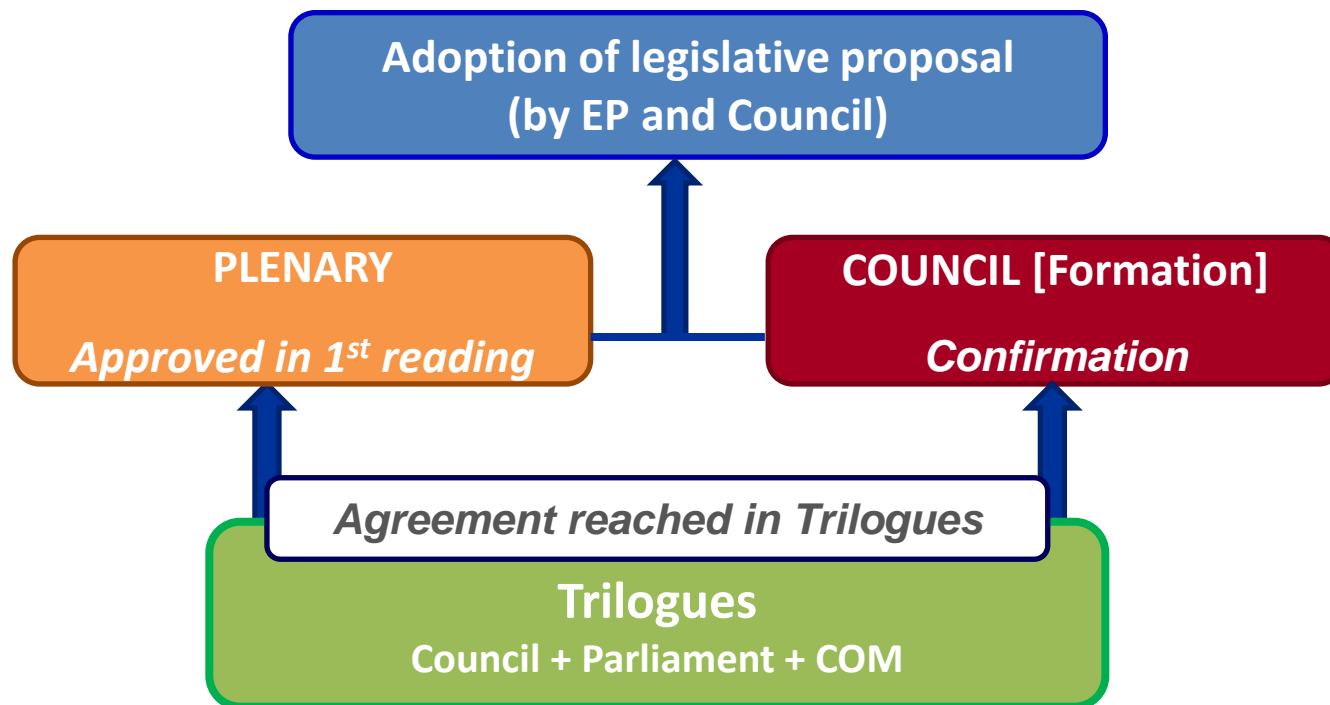
- The **European Council** – sets the main policy orientations
- The **Council of the EU** (the '**Council**') – coordinates EU economic policy-making and decides whether a Member State may adopt the euro
- The '**Eurogroup**' – coordinates policies of common interest for the euro-area Member States
- The **Member States** – set their national budgets within agreed limits for deficit and debt, and determine their own structural policies involving labour, pensions and capital markets
- The **European Commission** – monitors performance and compliance
- The **European Central Bank** (ECB) – sets monetary policy, with price stability as the primary objective, and acts as central supervisor of financial Institutions in the euro area
- The **European Parliament** - shares the job of formulating legislation with the Council, and subjects economic governance to democratic scrutiny

Legislative Process (ordinary legislative procedure)



Trilogues

- Informal tripartite meetings between COM reps, EP (ECON) and Council (ECOFIN)
- Formed when there is disagreement on the legislative proposal between the EP and the Council
- **Final output:** package of amendments accepted by both the EP and the EU Council



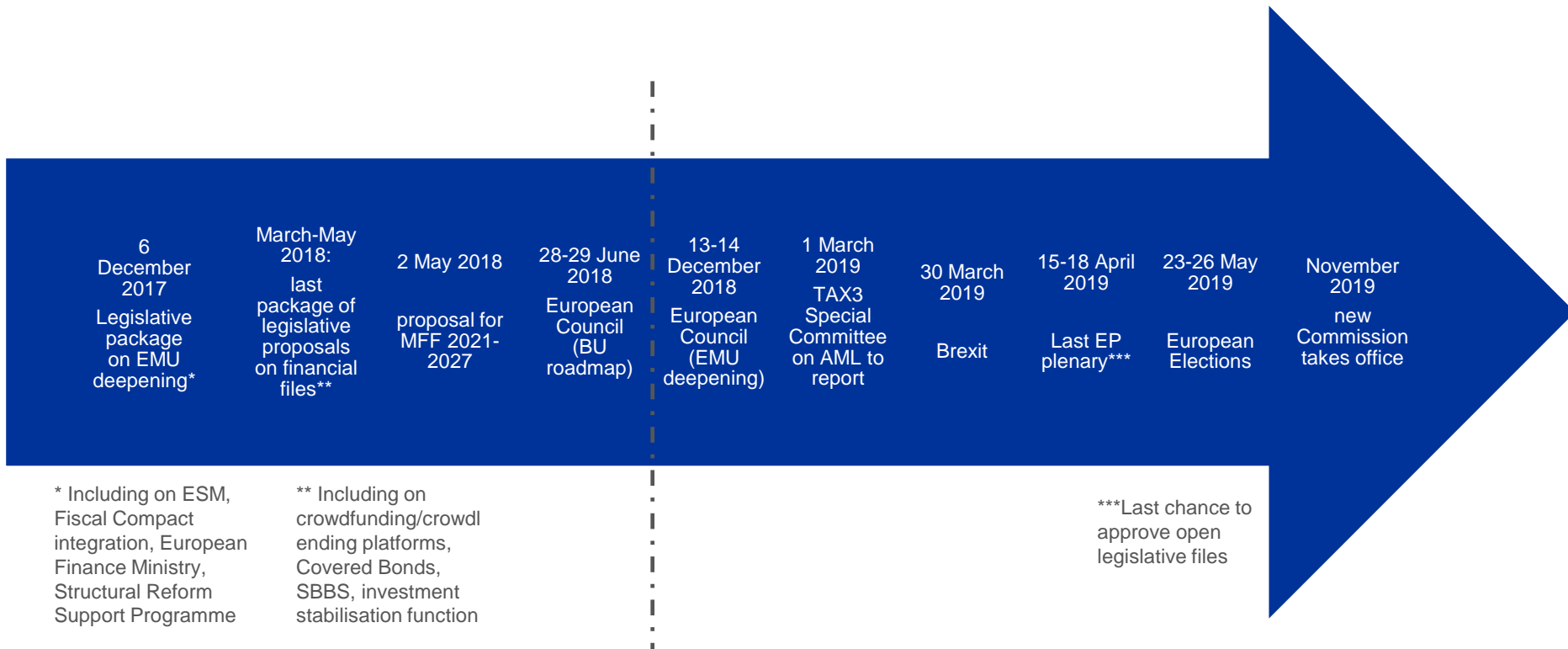
The ECB in the European legislative process

- Art 127 TFEU foresees that **the ECB shall be consulted on any proposed Union act in its fields of competence**. It publishes **opinions** to this effect, which are addressed to the EP and Council.
- Art 134 TFEU grants the ECB's participation in the Economic and Financial Committee (**EFC**)
- Art 138 TFEU foresees the **Council's prior consultation of the ECB** when adopting common positions on matters of interest for the EMU and measures to ensure unified representation in international fora
- Art 48 TEU establishes that the ECB shall also be consulted in the case of institutional changes in the monetary area

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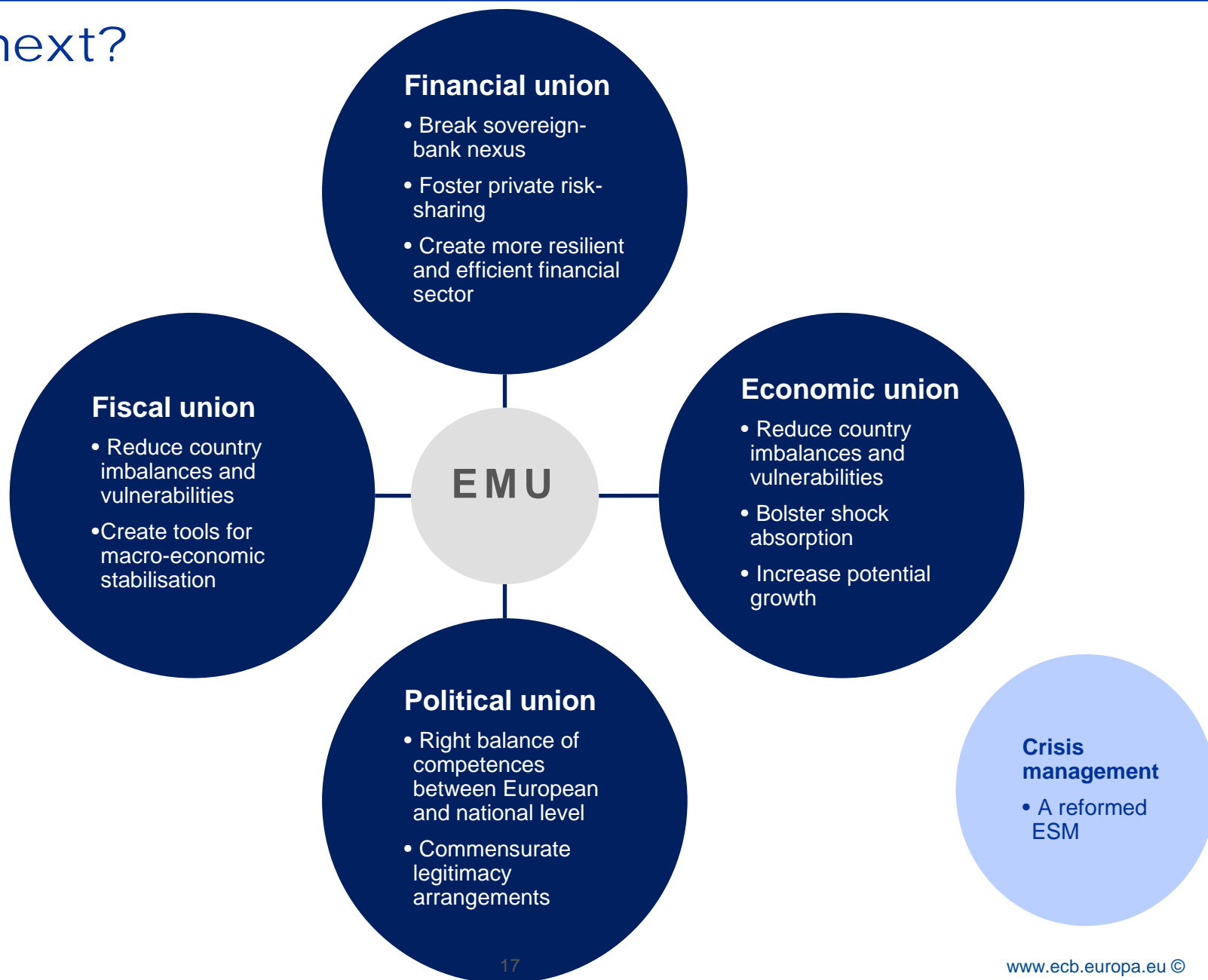
Only 11 months to the next European elections



Topics on the Brussels agenda in the year ahead

- **Completing EMU**, incl.
 - reform of the European Stability Mechanism (ESM)
 - Backstop to the Single Resolution Fund;
 - (potentially) European Deposit Insurance Scheme (EDIS)
- **EU multi-annual financial framework 2021-2027**, incl.
 - Reform delivery tool and convergence instrument
 - Investment stabilization function
- **Financial legislation**, incl. current legislative discussions on
 - Prudential regulation of investment firms
 - Covered bonds
 - Non-performing loans
 - European Supervisory Authorities review
 - Files related to market infrastructures and central clearing, in particular review of the European Market Infrastructure Regulation (EMIR2) and recommendation to amend Article 22 of the ECB/ESCB statute
- **Brexit**, Trade, anti money laundering

What next?



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Innovations since the crisis

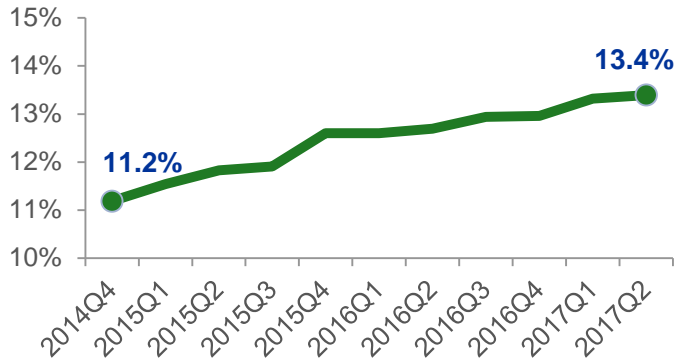
- **Single Supervisory Mechanism** fully established and performing
- **Single Resolution Board:** in place and successfully tested in a few first cases
- **Single Rulebook:** Strengthened capital requirements and move towards “bail in” paradigm
- **Improved macro-prudential framework**
- **Significant progress in risk reduction**
- **Roadmap for progressing with European Deposit Insurance Scheme**
- **Action Plan on Building a Capital Markets Union**

The agenda ahead

- **Complete the missing elements of a genuine European banking union**
- Foster cross-border private risk sharing through an **ambitious Capital Markets Union agenda**

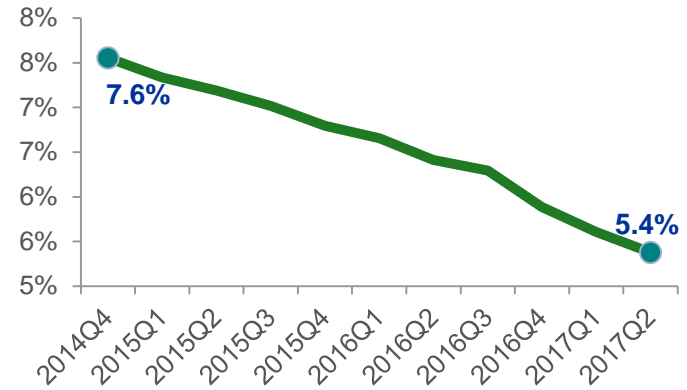
Significant risk reduction since 2014 (start of SSM)

Evolution of fully loaded Common Equity Tier 1 (CET1) ratio



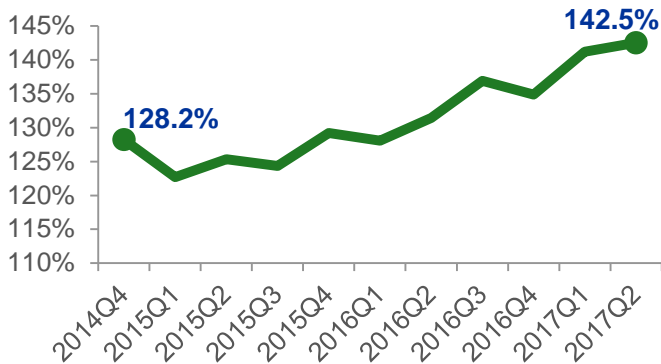
Source: COREP, ECB calculations.

Non-Performing Loans ratio



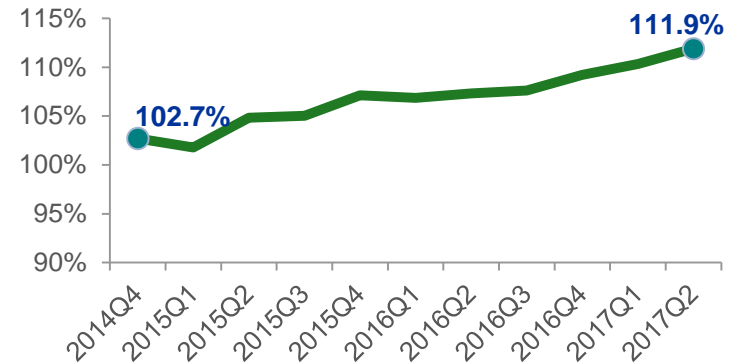
Source: FINREP, ECB calculations.

Liquidity Coverage Ratio



Source: COREP, STE data, ECB calculations.

Net Stable Funding Ratio

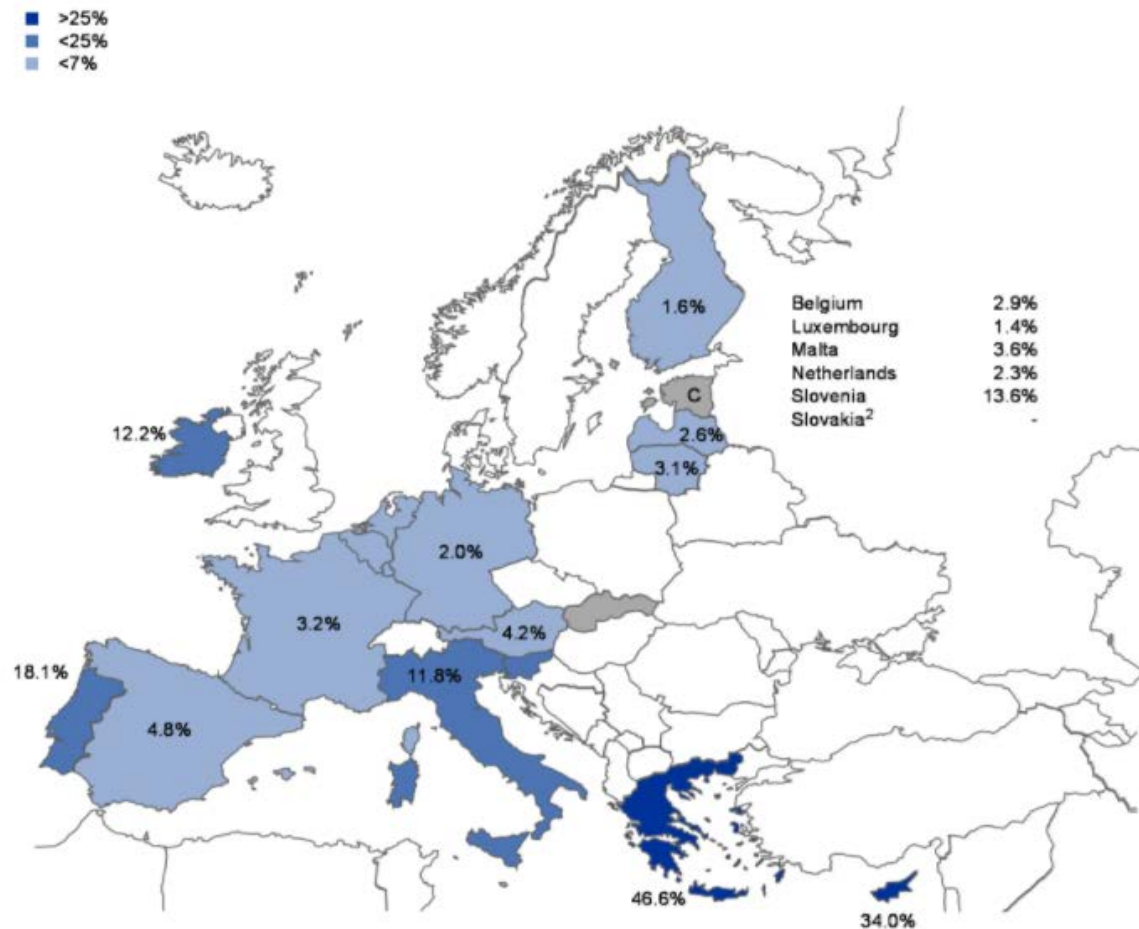


Source: STE data, ECB calculations.

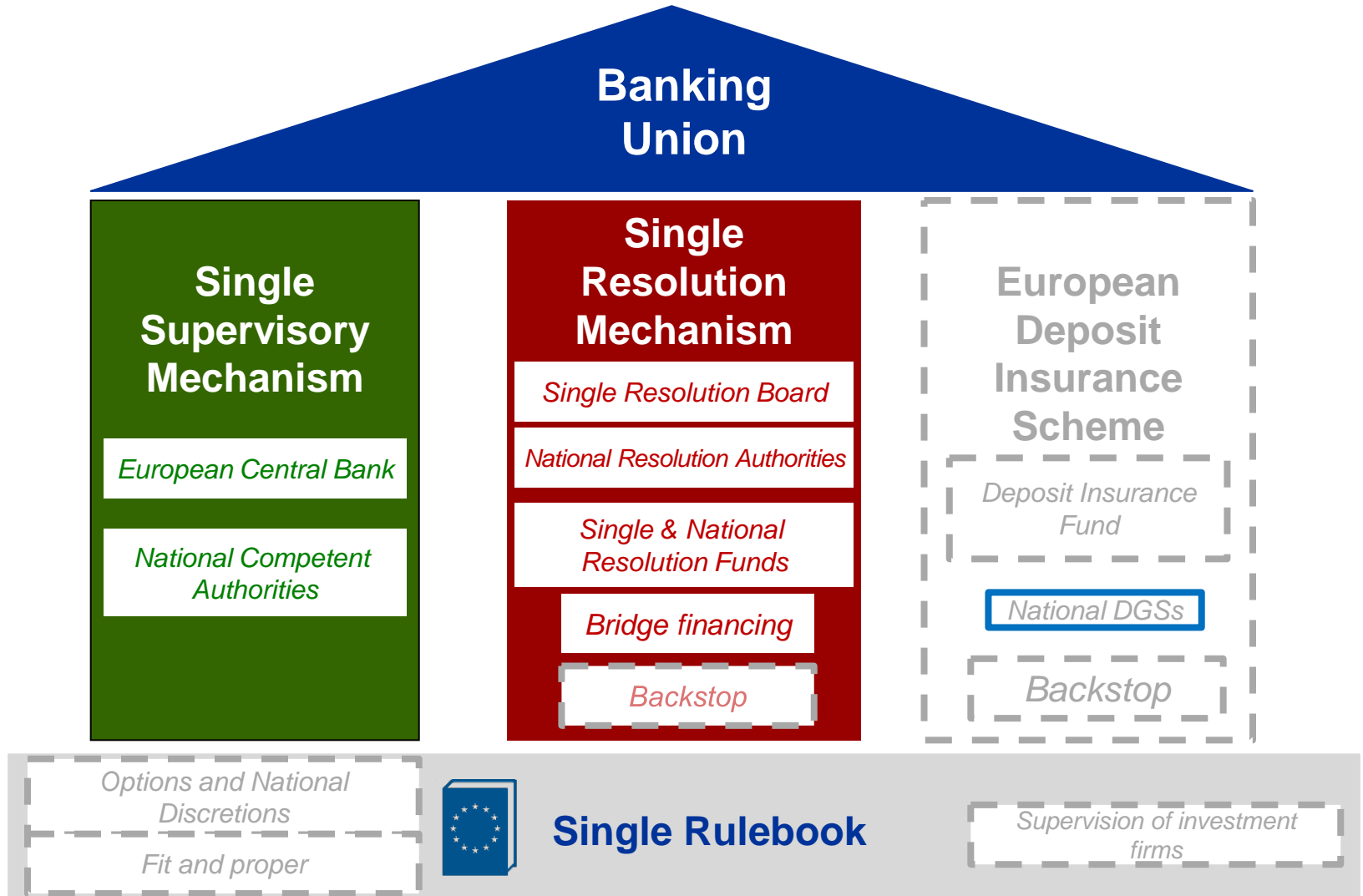
Notes: All weighted averages are weighted by the denominator. TS definitions, as in [Banking Supervisory Statistics](#). The analysis is based on a sample of 103 significant institutions (SIs) that reported RWA (COREP) and total assets (FINREP) in all time periods

Significant risk reduction (II): NPLs

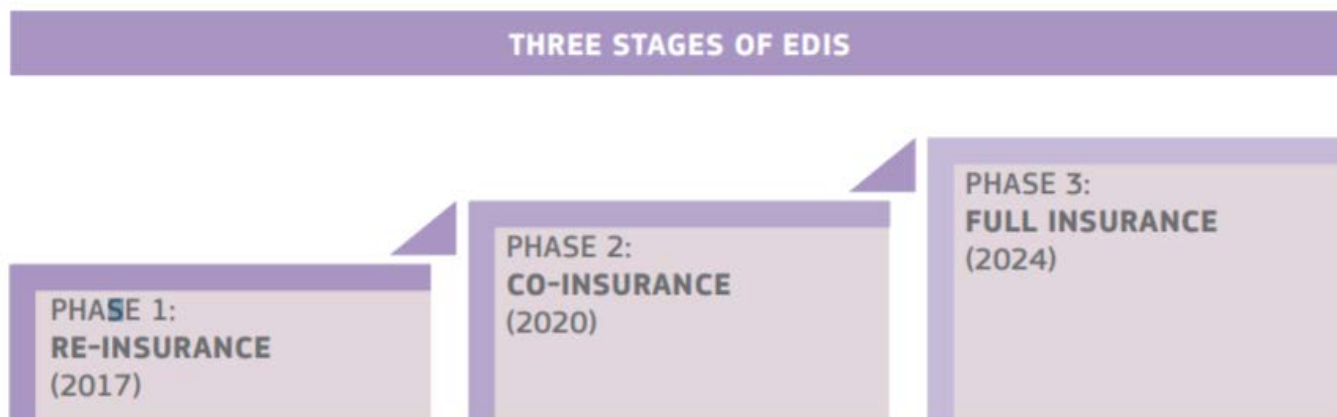
Non-performing loans and advances¹ – ratios by country, reference period Q2 2017



The missing elements of Banking Union



European Deposit Insurance Scheme

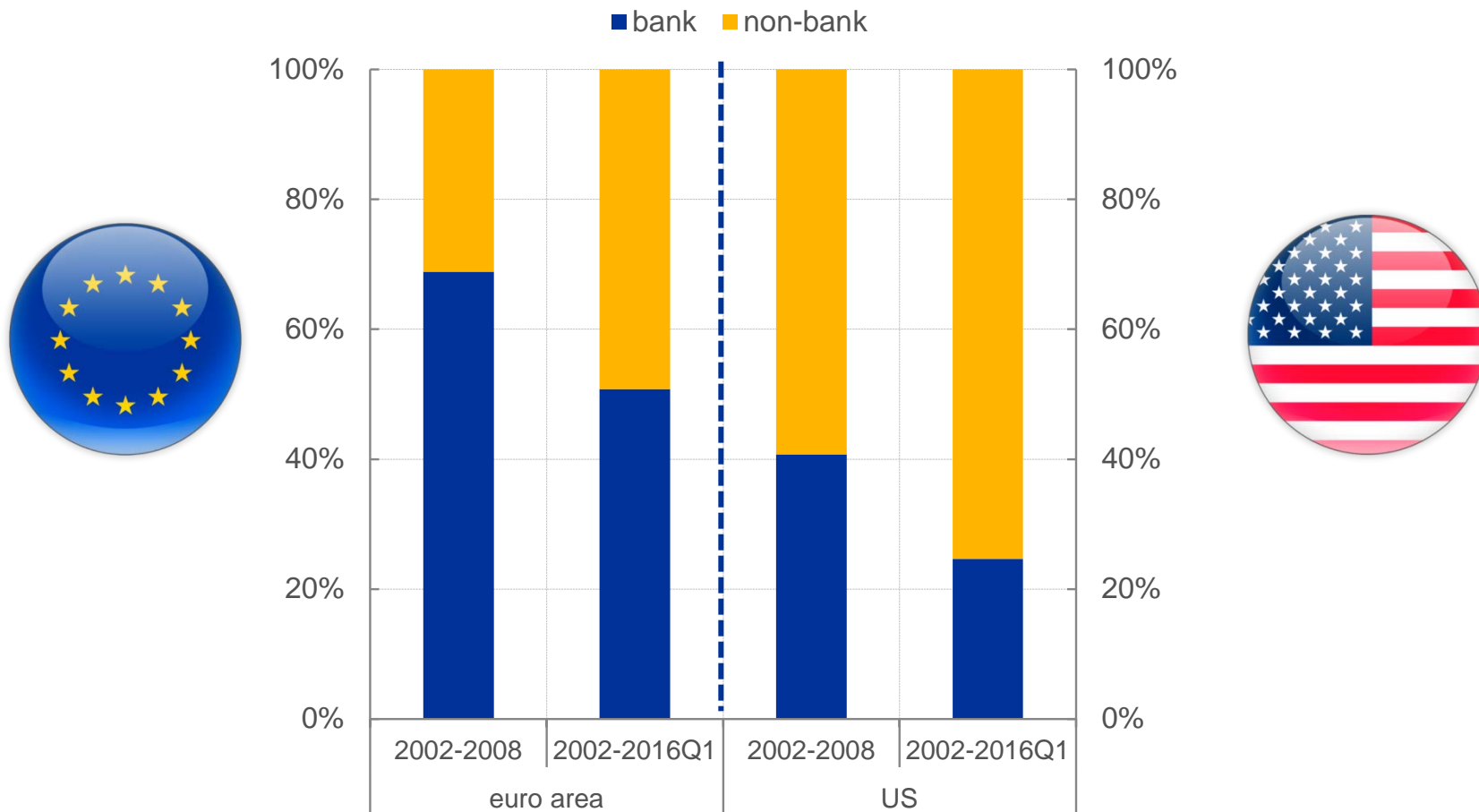


3rd pillar of Banking Union – final component to remove national bias and weaken link between banks and sovereigns

- Politically controversial: legacy issues, moral hazard; sequencing issues over risk reduction vs risk sharing. Roadmap for starting political discussions on EDIS under preparation.
- Significant and thus sufficient risk reduction has been achieved, to unlock negotiations and frame roadmap with milestones towards EDIS
- Conditions for operationalising the backstop to the Single Resolution Fund are now within reach.

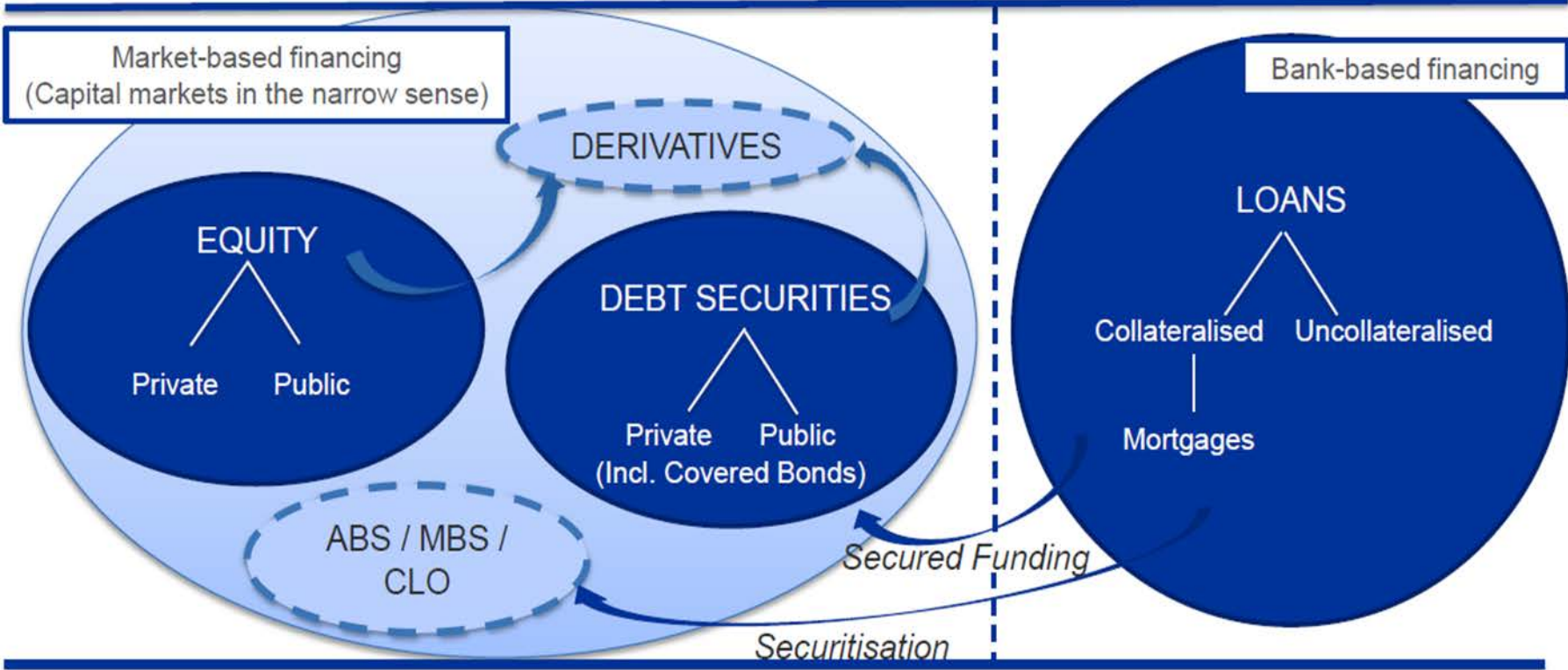
Capital Markets Union: beyond a bank-based economy

Share of bank and non-bank financing in total non-financial corporation financing
(cumulated transactions, percentages)



Source: ECB, Federal Reserve System. Notes: Calculations are based on cumulated transactions since 2002. Latest observation: Q1 2016.

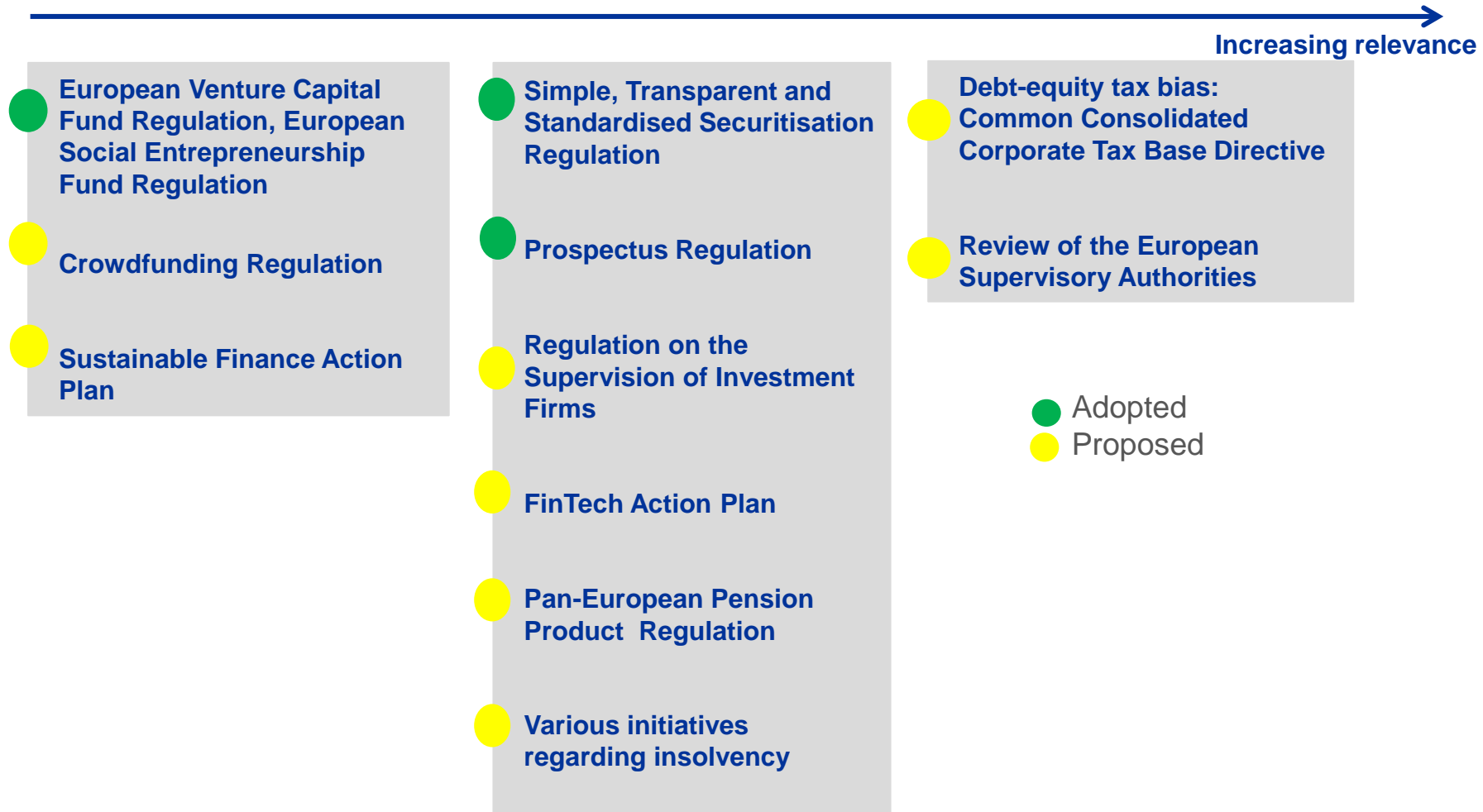
Capital Markets v. Bank Financing



ABS = asset-backed securities
 MBS: mortgage-backed securities

CLO: collateralised loan obligation

Capital Markets Union initiatives



→ 19 initiatives under the CMU umbrella

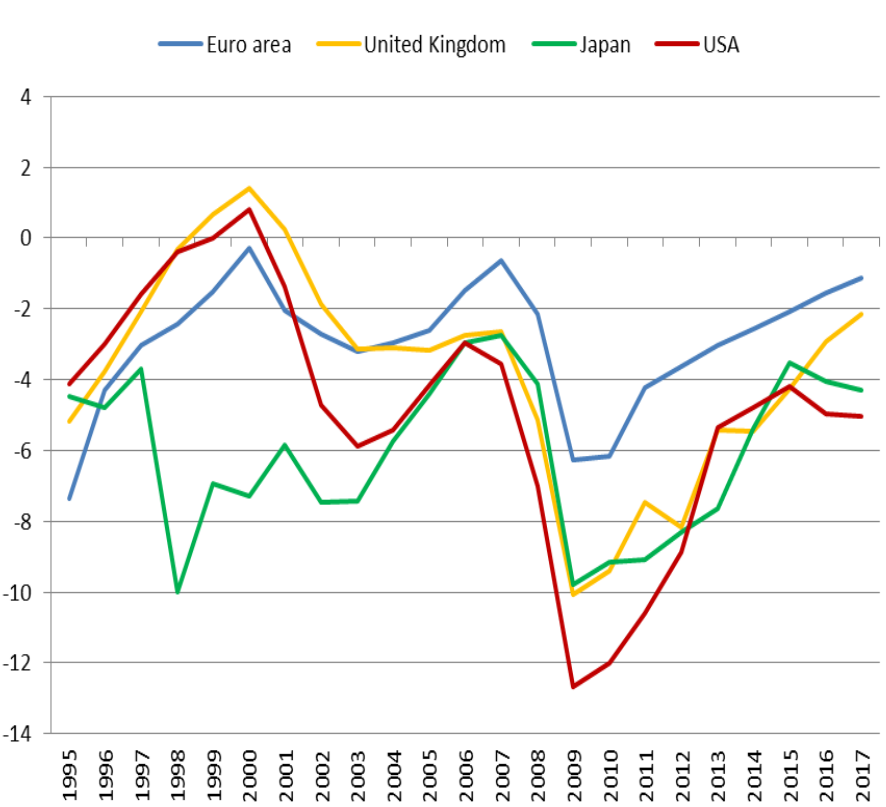
→ All initiatives supposed to be finalised by 2019

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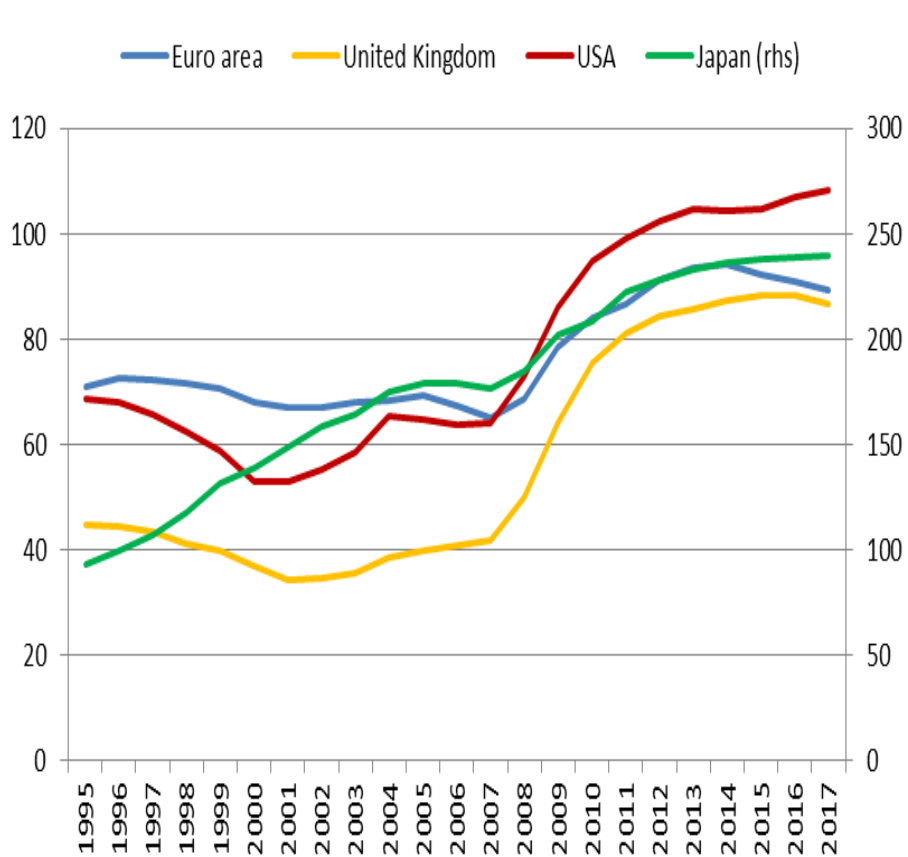
Challenges to public finances in the crisis

General government budget balance
(1995-2017, percentage of GDP)



Data source: European Commission, Autumn Forecast 2017.

General government gross debt
(1995-2017, percentage of GDP)



Innovations on the Stability and Growth Pact

- **Reform of the framework:** stronger emphasis on structural balances, expenditure and debt rules
- **More flexibility of the SGP**
- **Stronger role for the Commission:**
- **Introduction of Fiscal Compact**
- **A self-standing discussion on the euro area fiscal stance**
- **An independent European Fiscal Board**

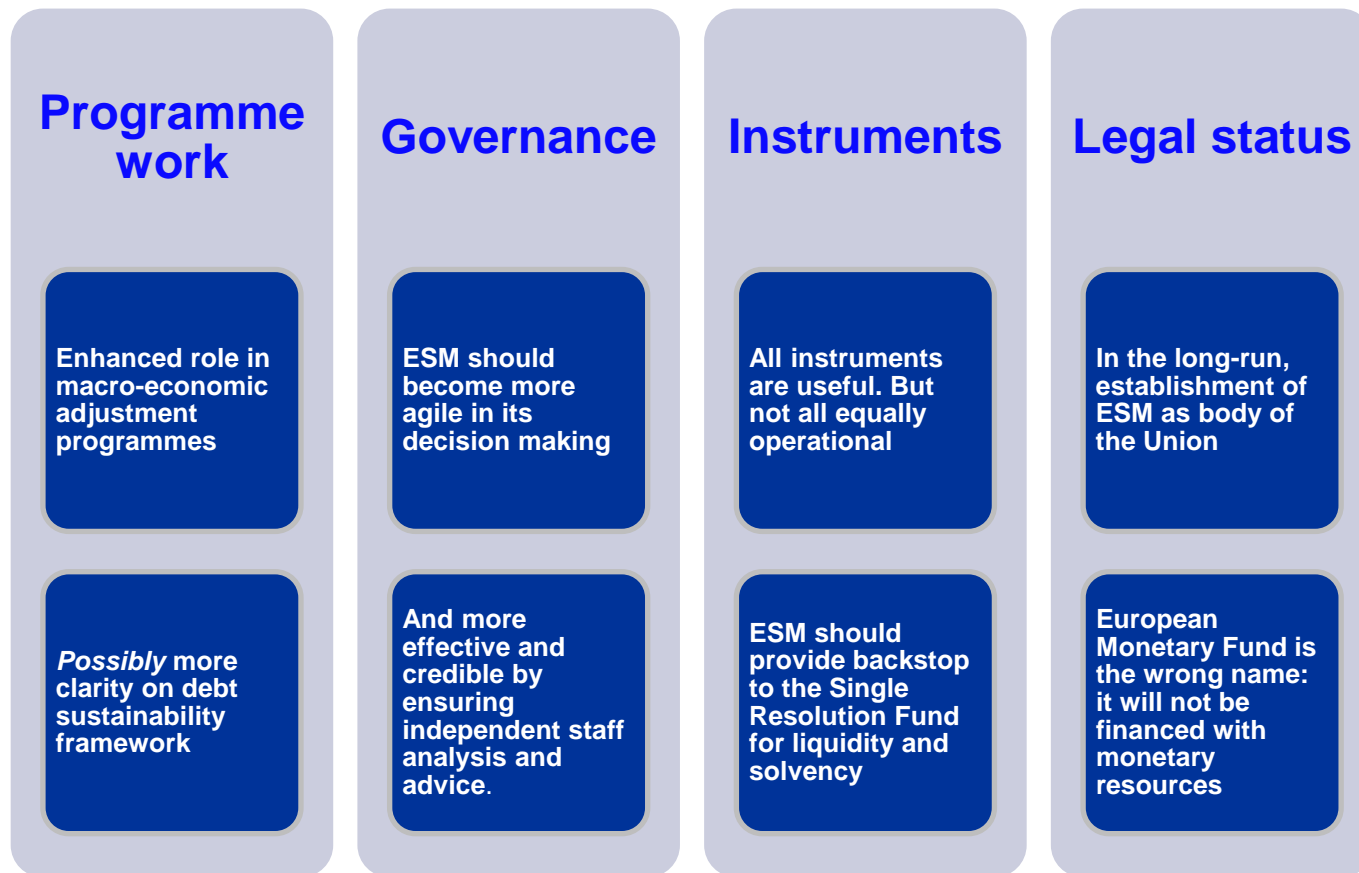
Beyond rules: a euro area fiscal capacity

- **Complement monetary policy in stabilising euro area economy**
- **Steering euro area aggregate fiscal stance**
- **Assist in dealing with asymmetric shocks**

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ESM reform



→ Agreement on ESM reform at June 2018 Euro Summit

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Economic union: governance framework

Innovations since the crisis

- **Macroeconomic Imbalance Procedure**
- **Various adjustment programmes**
- **National Productivity Boards**

The agenda ahead

- **New convergence process towards resilient economic structures**

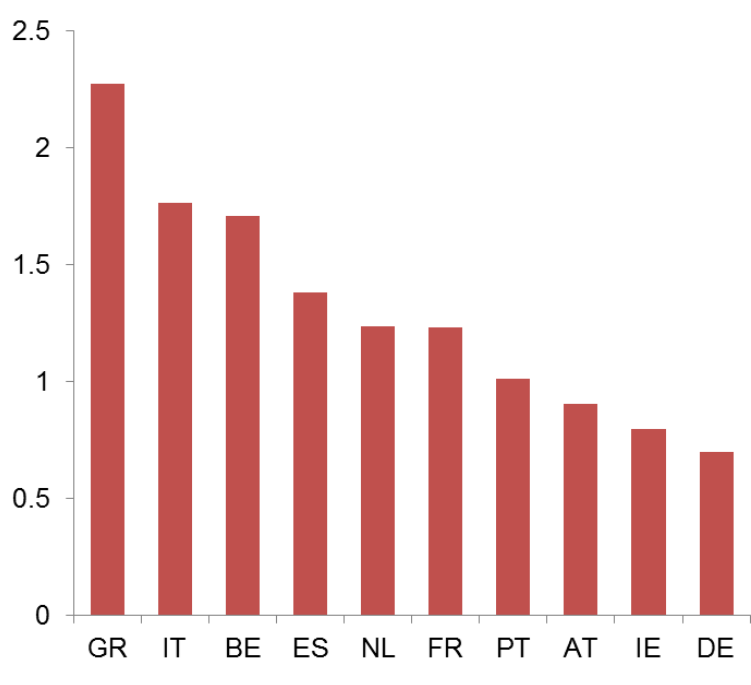
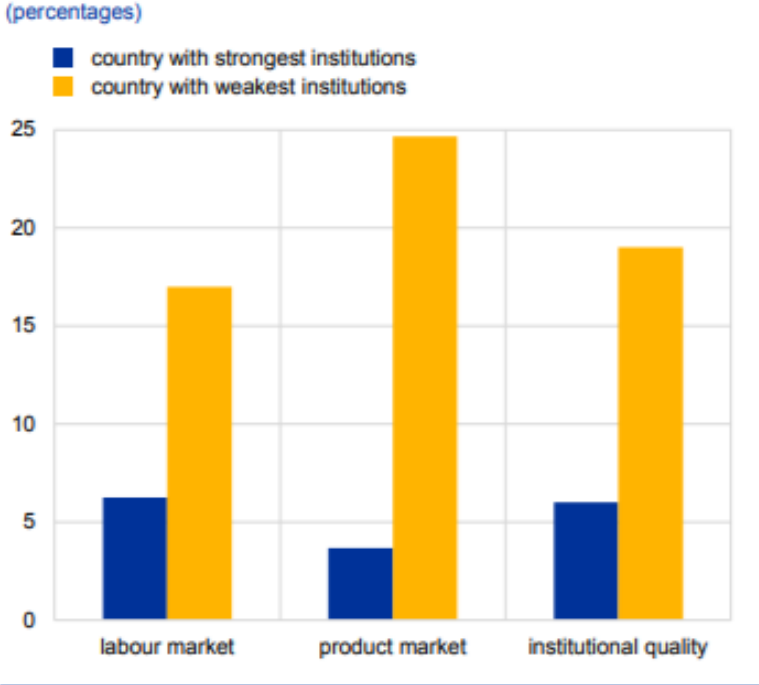
Euro area economies are far from the frontier in economic structures

The quality of institutions affects resilience to shocks...

... and economic growth

Probability of crisis events occurring, conditional on the quality of institutions.

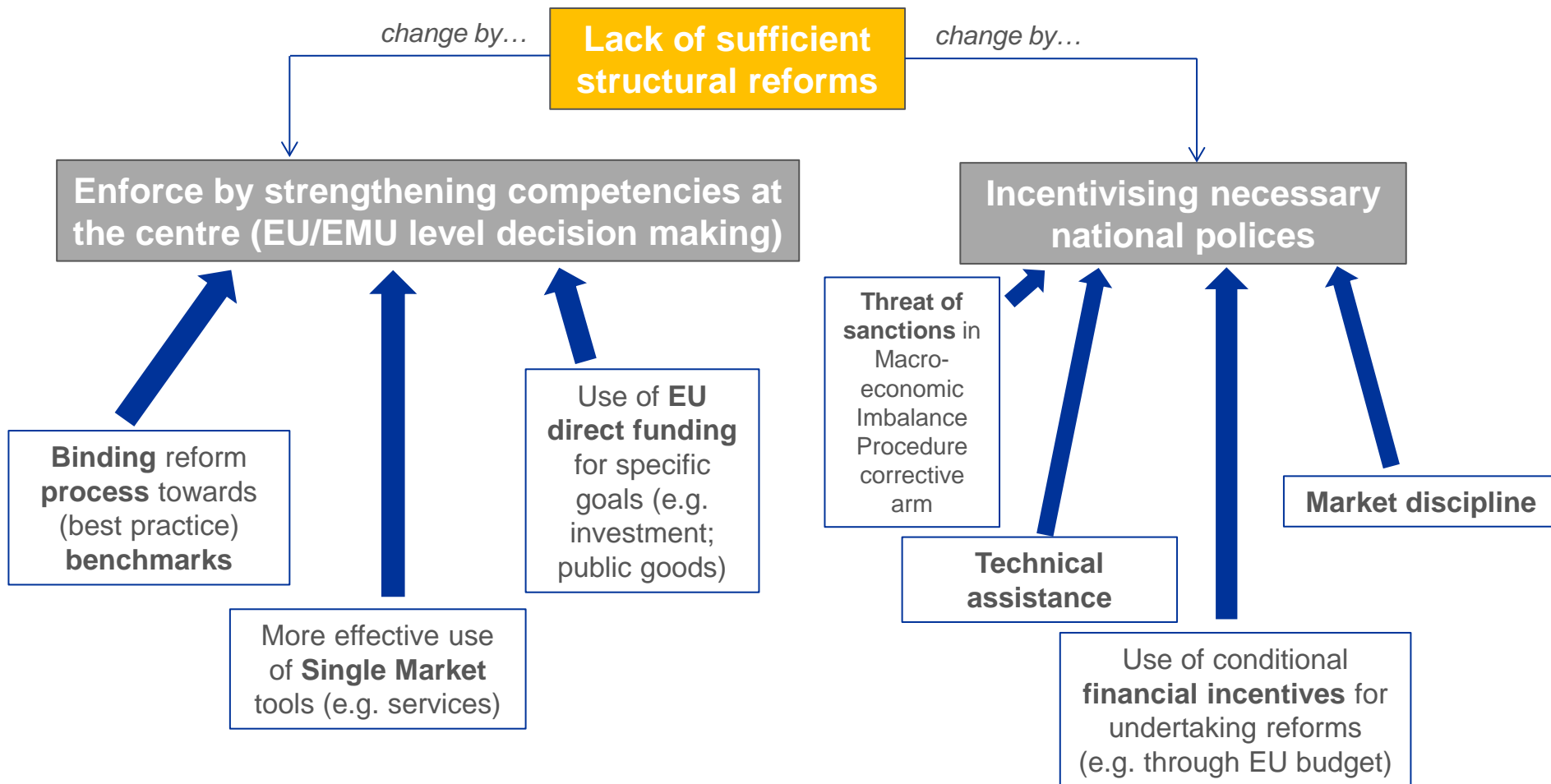
Potential growth of annual private sector investment (%) if half of the gap toward the best performing economic structures is closed.



Source : Sondermann (2018), Towards more resilient economies, Journal of Policy Modelling 40(1), pp. 97-117).

Source: ECB analysis

Economic union: policy channels to improve reform implementation



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Economic and Monetary Union

- A **single currency with an independent monetary policy** under the responsibility of the ECB
- **Coordination of economic policy-making** between Member States
- **Coordination of fiscal policies**, notably through limits on government debt and deficit
- **Single rules and supervision of financial Institutions** within the euro area under the responsibility of ECB Banking Supervision
- **Completing EMU** remains a policy priority, notably concerning
 - reform of the European Stability Mechanism (ESM)
 - Backstop to the Single Resolution Fund;
 - European Deposit Insurance Scheme (EDIS)