Banking Union or Capital Markets Union?

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ECMU Conference
House of Finance, Frankfurt
18 March 2015

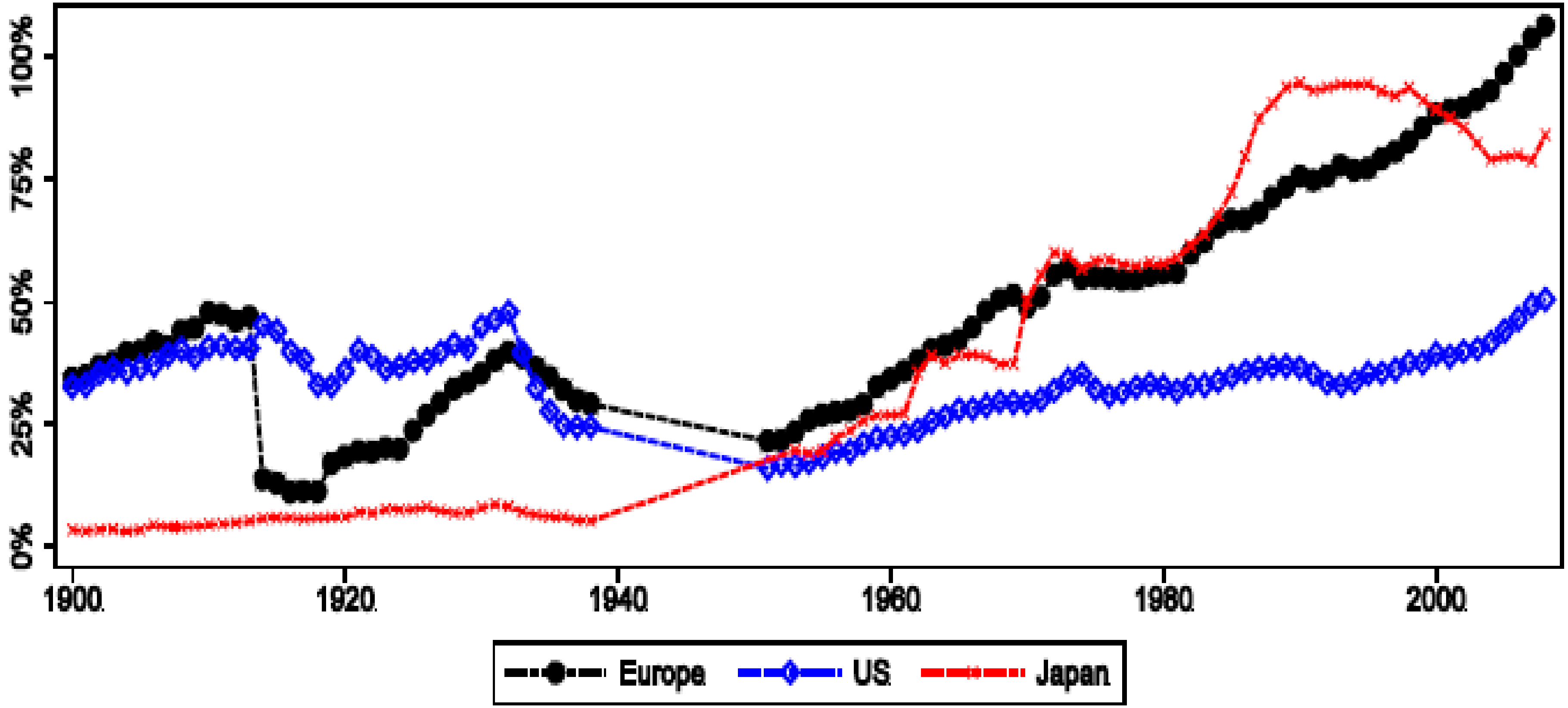
Agenda

1. Banking Union
   - Is Europe overbanked?

2. Capital Markets Union
   - Alternative channels (e.g. corporate bonds)
   - Need for infrastructure
   - How to stimulate institutional investors?

Is Europe overbanked?

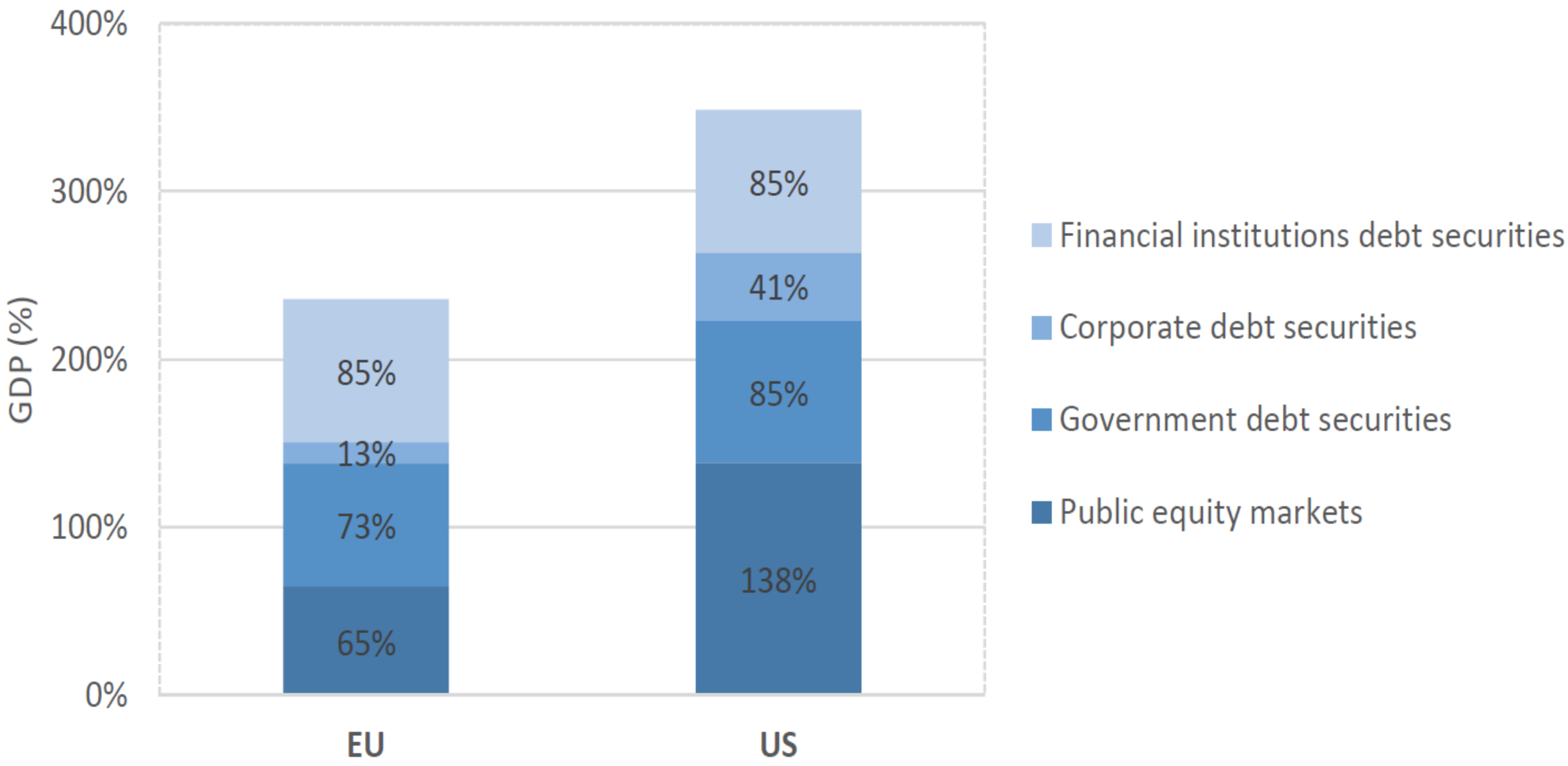
Figure 1: Bank loans to GDP in US, Japan, and Europe



Source: Schularick and Taylor (2012). Notes: Bank loans refers to resident banks' loans to the domestic private sector (households and non-financial corporations). The data therefore exclude foreign (and foreign currency) loans; and loans to the financial and public sectors. Europe represents an average (weighted by GDP) of DK, DE, ES, FR, IT, NL, SE and the UK.

Has Europe too little capital markets?

Figure 1. Capital markets structure – EU vs US (end December 2013)



Source: ECMI Statistical Package (2014).

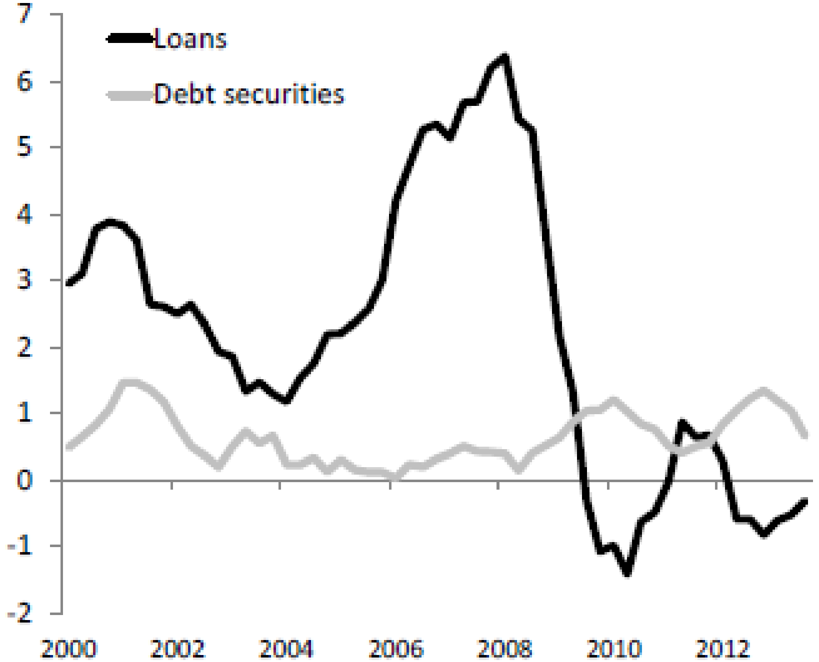
Macro effects

- After banking crisis (ASC Report, No. 4)
  - Drop in bank lending – deleveraging (credit channel)
  - Drop in asset values (collateral channel)

- After corporate default crisis (Giesecke *et al*, JFE 2014)
  - Corporate bonds less volatile (credit channel)
  - Increase in bank lending (substitute channel)

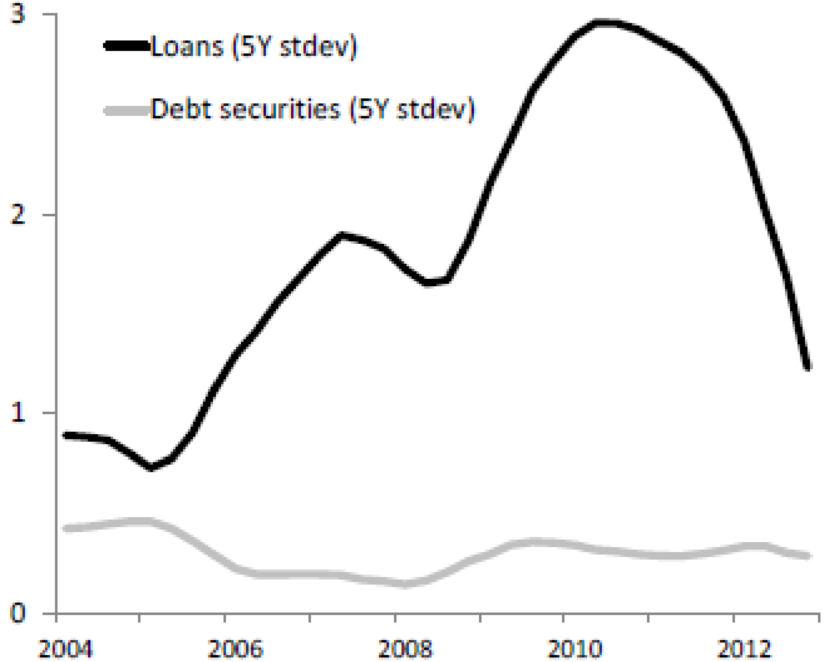
Corporate bonds are more stable than loans

Figure 28: NFCs' financing in loans and debt securities in the Euro Area
(four-quarter moving sums of flows, as % of GDP)



Source: ECB (Euro Area "Flow of Funds" Accounts). The chart plots the year-on-year change in NFCs' outstanding external liabilities (broken down as loans and debt securities) divided by nominal GDP. Loans excludes intra-NFC loans.

Figure 29: Standard deviation of NFCs' external financing in the Euro Area
(rolling 5 year window)



Source: ECB (Euro Area "Flow of Funds" Accounts).

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Capital Markets Union

- Equity
  - Venture capital for start-ups
  - Equity funds for SMEs

- Debt
  - Corporate bonds
  - Securitisation: ABS
  - Funds for SME financing

Deepen capital markets

- Current trading of corporate bonds
  - Bonds have final-live (equity not)
  - Multiple issues
  - Decentralised: dealer network
- Proposals to deepen corporate bond market
  - Centralised platform (exchange + clearing)
  - Standardise corporate bonds (and ABS)
  - Big issues with multiple tranches (like gov bonds)
  - Pooling bonds of small companies

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Institutional Investors

- Large players in Europe
  - Insurers €8,300 bn of assets (end-2013)
  - Pension funds €3,600 bn of assets (end-2013)
  - Large bond portfolio to match LT liabilities

- Shift in bond portfolio
  - Less government bonds (due to ECB buying)
  - More corporate bonds?

Conclusions

- Move from banking lending to capital markets
  - ➢ Better for macro stability
- Demand: Corporate bonds
  - ➢ Institutional investors preference for bonds
- Supply: Broader trend in retail (precautionary) savings
  - ➢ From deposits to insurance and pension claims

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References

- Advisory Scientific Committee (2014), Is Europe Overbanked?, Reports of the ASC, No. 4, European Systemic Risk Board, Frankfurt.

- Giesecke *et al* (2014), Macroeconomic effects of corporate default crisis: A long-term perspective, *Journal of Financial Economics*, 111, 297-310.

Thank you for your time

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