Ladies and Gentlemen,

I am pleased to welcome you to Frankfurt, to the second ECB Central Banking Conference, entitled "The transformation of the European Financial System". This event is the largest and most important open ECB conference and is held every two years.

The first ECB Central Banking Conference took place in November 2000. It focused on price stability, which is the ECB's primary objective, and that of many other central banks worldwide. It was a successful event, and I am convinced that this year's conference will be too.

Indeed, looking around, I am happy to see that this second conference has evidently aroused much interest and attracted researchers from leading institutions, officials from most of the major central banks, from ministries of finance, various European and international bodies and the media. In view of this year's topic, we also decided to invite representatives from commercial financial institutions and from supervisory authorities. I should like to extend a special welcome to the representatives of the central banks of the countries that are negotiating to join the European Union; these negotiations will hopefully be concluded fairly soon. I should, of course, also like to thank the speakers, discussants, panellists and chairpersons of the sessions.

Since the early days of the ECB and the first ECB Central Banking Conference, sufficient time has passed for us to assess whether we at the ECB have made an effective contribution to the relationship we have with the academic world. The academics here today should be the first to be asked this question. From our side, I am inclined to say that we have been effective. I am in particular referring to the success of our Graduate Research and Visitors Programme. In this context, I should like to announce the establishment of five fellowships for young researchers working in top-priority fields within the Financial Research Network. The Executive Board has decided to call these fellowships the 'Lamfalussy Fellowships', in honour of the first President of the European Monetary Institute (EMI), who has made an impressive contribution to the process of European monetary and financial integration.

Another example of successful co-operation and exchanges of information between the academic world and the ECB is the launching of a series of conferences and research networks. Of these, the ECB-CFS research network on "Capital markets and financial integration in Europe" has the closest ties to the theme of this year's conference – the transformation of the European financial system. Some of you may have attended the initial workshop here in Frankfurt last April. It's a European initiative; future workshops are to be held at the Bank of Finland in Helsinki, in March next year, and at the Bank of Greece next November. Also related to the present theme is the Eurosystem monetary transmission mechanism network.

Why have we chosen the transformation of the European financial system as our subject on this occasion?

The establishment of Economic and Monetary Union (EMU), almost four years ago, and the introduction of the euro banknotes and coins were real milestones. In respect of the Maastricht Treaty, they appear to mark the completion of the process of monetary integration in Europe. But we shouldn't regard Monetary Union as an end in itself. The introduction of the euro will have – and already has had – a powerful influence on the development of financial markets in Europe and their integration, as we will learn and discuss today.

The implications of these developments are manifold and profound, in particular for central bankers, but also for other policy-makers. Let me mention a few examples.

First and foremost, the transformation of the financial system has an impact on the conduct of monetary policy. For example, the emergence of new financial instruments and changes in the use of existing ones affect the choice, behaviour and interpretation of forward-looking financial indicators of underlying economic variables, such as consumer price inflation and GDP growth. Moreover, the implications for the transmission mechanism of monetary policy are of supreme importance to the
ECB. But I’ll say no more on this matter now, as my colleague Otmar Issing will cover it in greater
depth in his dinner speech this evening.

Second, financial system transformation affects the implementation of monetary policy. I will give you
an example. Our weekly main refinancing operations with money market counterparties are conducted
on the basis of repurchase agreements (“repos”). This requires a list of eligible collateral for such
operations. In a changing financial environment, a central bank has to ensure that eligible collateral
allows market participants to have efficient and equal access to central bank liquidity.

My third example of the importance of financial system transformation to central banks relates to the
payment systems function. Most central banks in industrialised countries run a large-value payment
system and are involved in the oversight of other payment and securities settlement systems. For
reasons of efficient liquidity management by private banks, the Eurosystem’s TARGET system allows
for intra-day overdrafts that are fully collateralised. For TARGET to perform efficiently, it is therefore
very important that securities settlement systems are interlinked or consolidated in a way which allows
a smooth flow of collateral across the euro area.

Fourth, past experience has shown that structural change in financial systems may have an impact on
financial stability. Hence, the structure and modus operandi of the authorities responsible for
supervising financial markets and institutions must be designed to prevent any instability from arising.
This is, as you are aware, quite a topical issue in the European Union. Central banks have a genuine
interest in this issue, which clearly has its origins in the Treaty on European Union. The Treaty states
that the European System of Central Banks (ESCB) shall “contribute to the smooth conduct of policies
pursued by the competent authorities relating to the prudential supervision of credit institutions and the
stability of the financial system”. These and related issues will be considered in tomorrow’s policy
panel discussion, which will start off on the basis of a paper contributed by my colleague Tommaso
Padoa-Schioppa.

Structural change in the financial system is important not only to central bankers but to other
policy-makers as well. For instance, all policy-makers should have a clear interest in a further
integration of European financial markets. The economic literature tells us that an integration of
financial markets is very likely to contribute to economic growth by making the allocation of capital
more efficient. The paper by Jean-Pierre Danthine in our third session tomorrow will address this
issue. This is why the freedom of capital flows is one of the “four freedoms” at the heart of the
Europe’s single market. Indeed, increasing financial integration has always been a major item on the
European political agenda. In this context, also the establishment of Economic and Monetary Union
should be regarded as giving an important impetus to European financial integration. As things stand
now, it is clear that full integration of European financial markets, to the extent possible of course, has
not been achieved yet, despite the introduction of the euro. Although in some areas, such as the
unsecured money market or the bond market, the euro seems to have boosted market integration, in
other areas, such as repo and equity markets, the impact has been much weaker. The need for further
efforts in this direction is fully recognised by many institutions, including the ECB, and is at the heart of
the European Union’s initiative to create a truly integrated market for financial services. The Vice-
President will address this issue tomorrow in his summing-up.

The second ECB Central Banking Conference is structured very much like the first one. Today and
tomorrow, there will be three sessions covering a number of issues related to the general theme of this
conference, and based on research papers and contributions from discussants. A policy panel will
follow these sessions.

The first session will deal with developments in European banking. The paper by Jean Dermine takes
a look at how the European banking system has changed since the Treaty of Rome in 1957. It then
asks a provocative question: how “real” is the single banking licence? The second session, tomorrow
morning, will address the changing character of European finance, and in particular consider to what
extent Europe is shifting from bank financing to market financing. In their paper, Luigi Zingales and
Raghu Rajan will assess recent developments in this respect, and impediments to a further shift to a
more market-based financial system. Our speaker in the third session, Jean-Pierre Danthine, will
illustrate the benefits from the discipline that economic theory can impose on our thinking when
analysing European equity market integration. He will also present a generalised approach to
estimating the importance of country and sector effects in portfolio allocations. One of his discussants,
Bruce Carnegie-Brown, will draw on his experience as a market expert to interpret for us recent
developments in bond markets. Finally, as already mentioned, the policy panel, which will be the final
session of the conference, will discuss the role of central banks in the maintenance of financial stability
against the background of the transformation of the European financial system. I am particularly pleased to see that we have been able to bring together such highly esteemed policy-makers and academics for this purpose.

Ladies and gentlemen, I should like to finish at this point and hand over to our first speaker. I sincerely thank you again for coming here today. I wish you a very interesting and stimulating discussion, and I look forward to hearing about the results of the second ECB Central Banking Conference.