SPEECH

BY GOVERNOR LARS ROHDE AT THE VL SUMMIT 7 JUNE

DANMARKS NATIONALBANK

CHECK AGAINST DELIVERY

7 June 2018

EUROPE – AN ECONOMIC POWERHOUSE IN THE FUTURE?

Thank you for inviting me to speak at this summit.

It is a great pleasure to have the chance to share my views on how to foster sustainable growth in Europe.

The subject is more important than ever.

Let me start by emphasizing one thing: Despite imperfections – the European Single Market has been an engine of growth.

It has acted as a catalyst for trade and the free exchange of labour, capital and knowhow.

At a time when anti-globalization draws headlines, these fundamental rights should not be taken for granted.

In fact, I believe they are at the core for making Europe more prosperous in the future.

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[Slide 2: Key messages]

Today, I would like to highlight four observations:

First, Europe is better than its reputation.

Economic performance keeps abreast with other advanced economies.
The rumours of its demise are simply exaggerated.

Second, all major advanced economies will have to adjust to lower potential growth.

It's a fact, as headwind from slowing productivity growth and ageing kicks in. Europe is no exception.

Third, free global competition is the main driver of innovation.

Europe suffers from an R&D gap relative to global hotspots. But innovation is not a zero-sum game:

Prosperous neighbours do not make Europeans worse off. In fact, productive rivalry stimulates new ideas.

Finally, Europe needs a fully developed Single Market for financial services.

The Single Market has been an engine of growth for decades but is still incomplete.

The Banking Union is an important step towards allowing consumers and businesses to reap the benefits from cross-border competition. It will also be the case for Denmark – if we join.

Please allow me to expand on these points one by one.

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[Slide 3: Europe is better than its reputation]

The organizers of this debate asked us to answer the question: How can Europe crack the code for getting back on the growth track?

Well, it implies that we somehow went off track. But is Europe really doing that badly? I don’t think so.

I will argue that the recent growth performance in most parts of Europe is in line with that of other advanced economies. No better, no worse.

The European Union is home to a diverse set of countries. They are at quite different stages of economic and institutional development. Just looking at averages is too simplistic.

[Slide 4: Europe is a tale of three]

Europe is tale of three stories: North, South and East.

The enlargement of the European Union towards the East has been an economic success. But it has not been without challenges.

But the level of prosperity in the new member states has been converging towards that of the core.

And it has supported the overall growth in Europe.

There is certainly an element of catching up behind this. And moving up the value chain will become increasingly important to keep momentum.

The South is the main source of Europe's dismal economic reputation. It has been a clear growth laggard over the past decade.

Countries in the south have been drifting away from Germany's GDP per capita since the financial crisis.

While much has been done to restore competiveness, many challenges have been left unaddressed.

There is still a clear need to tackle structural imbalances, rigid labour markets and weak productivity dynamics.

The North is home to the most prosperous and competitive economies in Europe. Their economic performance over the past ten years has kept abreast with the USA and other major advanced economies.

While the Nordic region is in good shape, it will have to remain on the toes to stay ahead in the future.

When taking stock of these three stories, it is not evident to me that Europe is underperforming.

GDP growth in the European Union reached 2.4 per cent in 2017. Not since the boom period in the mid-2000s we find higher growth rates.

In sum, Europe is better than its reputation.

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[Slide 5: Ageing will weigh on future growth]

The growth observed last year might be as good as it gets.

Ageing populations and weak productivity gains will weigh on growth in advanced economies. Europe is no exception.

We have to adjust our expectations accordingly.

Demographics will shape the growth potential of Europe.

The share of Europeans above 65 years went from 12 per cent in 1970 to 20 per cent in 2015. And it is expected to exceed 30 per cent by 2050.

Other advanced economies, most notably Japan, face even greater challenges from an aging population.

This demographic transition has important implications for economic growth.

Our estimates suggest that workforce ageing can reduce GDP per capita growth in Europe by 0.5 percentage points each year over the period 2020-2050.

The demographic headwind can to some extent be mitigated by working longer. The spotlight should be turned to policies that foster productivity gains.

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[Slide 6: Europe faces an R&D gap]

Advanced economies have turned towards sectors where productivity gains are harder to achieve.

The development of new ideas is therefore essential for unlocking future growth.

Historically, Europe has produced some of the most successful companies in the world.

Its starting point is not bad.

But Europe suffers from an R&D gap relative to global hotspots. It spends less than 2 per cent of GDP on research and development each year.

This is significantly below the Americans and about half of what the frontrunners in South Korea invest.

[Slide 7: Global innovation is the engine innovation]

The vanguard of innovation is not in Europe. The hotspots dominating global patent applications are Tokyo, Shenzhen, San Francisco, Osaka and Seoul.

The top European region – Munich – is number 13. Back in 1989 seven European regions were in top 20. Today, it is down to three.

Asia is increasingly the innovation centre today. But the relative decline of Europe is not a problem in itself. Prosperous neighbours do not make Europeans worse off.

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I said earlier that Europe is a tale of three stories. When it comes to patent applications, there are clear regional differences as well.

[Slide 8: Regional dimension to European innovation]

The most innovative clusters are located in Central Europe and Scandinavia. They will have to generate growth by pushing the frontier.

Free global markets and competition are the best catalysts for companies looking to spur new ideas.

They keep businesses on their toes. They are the real drivers of innovation.

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I see two key challenges to innovation in Europe.

Europe faces shortage of skills. Eight out of ten innovating companies consider the lack of skilled staff a barrier to investment.

Well-trained workers are essential for creating an economic powerhouse in the future.

Strengthening venture capital would support creative disruption. An OECD study suggests that the US venture capital market is significantly larger than the European.

Patterns are changing in investment finance. Europe is a bank-based economy.

But bank credit is not always ideal for intangible investments. These investments are riskier and harder to collateralize.

Access to a broad range of financing sources provides companies with better opportunities for innovation.

In this respect the Capital Markets Union Initiative has an important role to play by stimulating alternative sources of risk financing.

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The decision of the United Kingdom to leave the European Union is regrettable.

But Brexit has had at least one positive side effect: It has increased the awareness in the remaining 27 EU member states of the significance and benefits of the Single Market.

[SLIDE 9: EU needs a single market for financial services]

The Single Market provides the citizens and the companies in the EU with incredible opportunities.

It provides access to purchase and offer goods and services freely in a huge market place.

Via Brexit, it has become crystal clear just how big an advantage this is.

It now seems to be more widely accepted, that the maintenance and continued development of this market is a key driver for economic growth in our countries.

The Single Market is far from fully developed in all sectors. One example is the banking sector.

There has been a tradition to see banks as companies requiring special protection – and ultimately government support in order to survive.

With the Banking Union a big step has been taken in the direction of allowing banks to function on market terms – without compromising financial stability.

The Single Supervisory Mechanism and the Single Resolution Mechanism go a long way in establishing a level playing field for banks.

It opens up for much wider cross border competition in financial services.

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[Slide 10: A level playing field for banks is important]

Furthermore, the common framework for recovery and resolution of banks (the BRRD) is essential for ensuring that a failing bank – as any other kind of private company – may be resolved without the use of government funds.

In other words: Give banks the right to fail!

The Danish government has announced that a decision on Denmark's participation in the Banking Union will be taken by the autumn of 2019.

While fully acknowledging that it is a political decision, it is our view in Danmarks Nationalbank that it would make good sense for Denmark to join.

Danish banks face competition in the Nordic region but in reality not on a European scale.

We are making a great effort to handle the challenges arising from cross border banking in the Nordic countries through numerous arrangements and agreements between relevant authorities.

The Banking Union provides a solution to these challenges on a European scale.

Furthermore, the increased competition following from joining the Banking Union would be healthy for the Danish financial sector.

In the Banking Union Danish banks would compete on harmonized terms in a much larger market.

Increased competition is the path to more growth – and indeed to more favourable conditions for consumers and non-financial companies. If you ask the telecom industry today, they might tell you that the life was cosier before the liberalisation of their industry.

We have seen this in many areas, for example in telecommunications.

This is a key reason why we recommend that Denmark joins the Banking Union, Joining the Banking Union would mean that we fully join the Single Market for banking services.

It would be to the benefit of citizens and companies, but not necessarily to the banks.

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EUROPE – A POWERHOUSE IN THE FUTURE?

Lars Rohde, Chairman of the Board of Governors, at the VL Summit, 7 June 2018

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Key messages

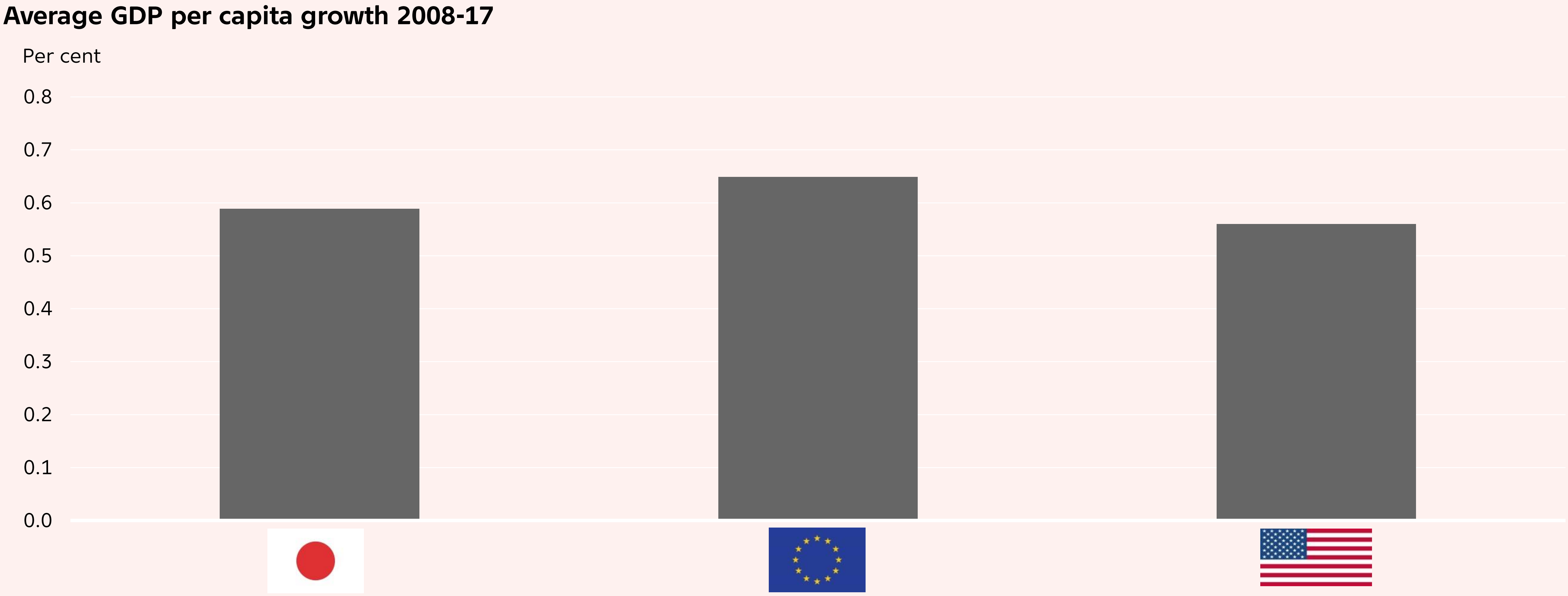
Europe is better than its reputation

Ageing will weigh on future growth

Competition is the engine of innovation

EU needs a single market for financial services

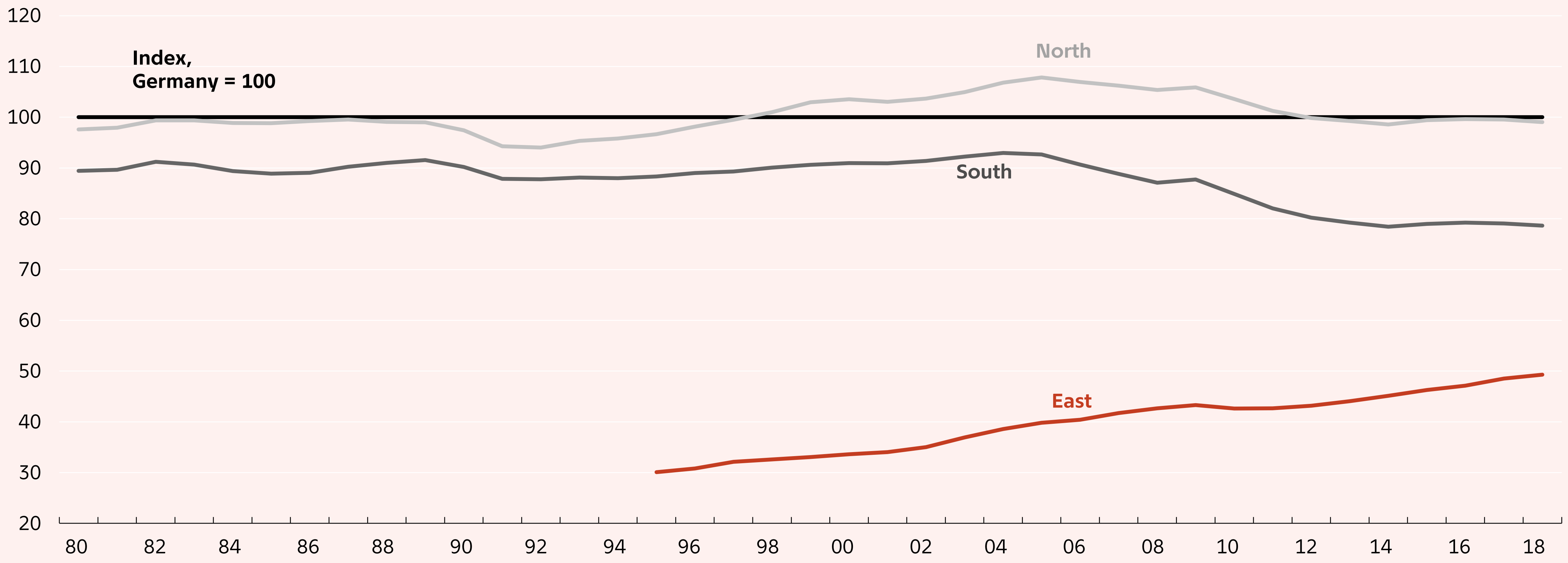
Europe is better than its reputation



Source: IMF.

Europe is a tale of three

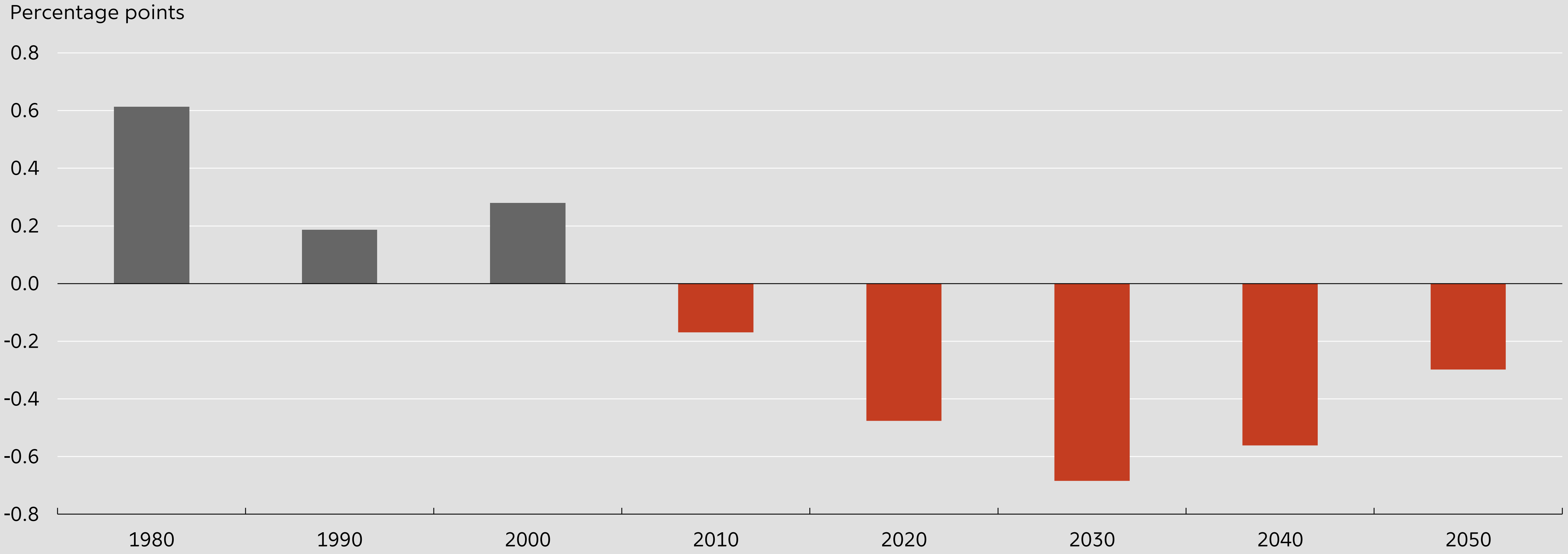
GDP per capita 1980-2018



Note: GDP is measured at purchasing power parity.
Source: IMF.

Ageing will weigh on future growth

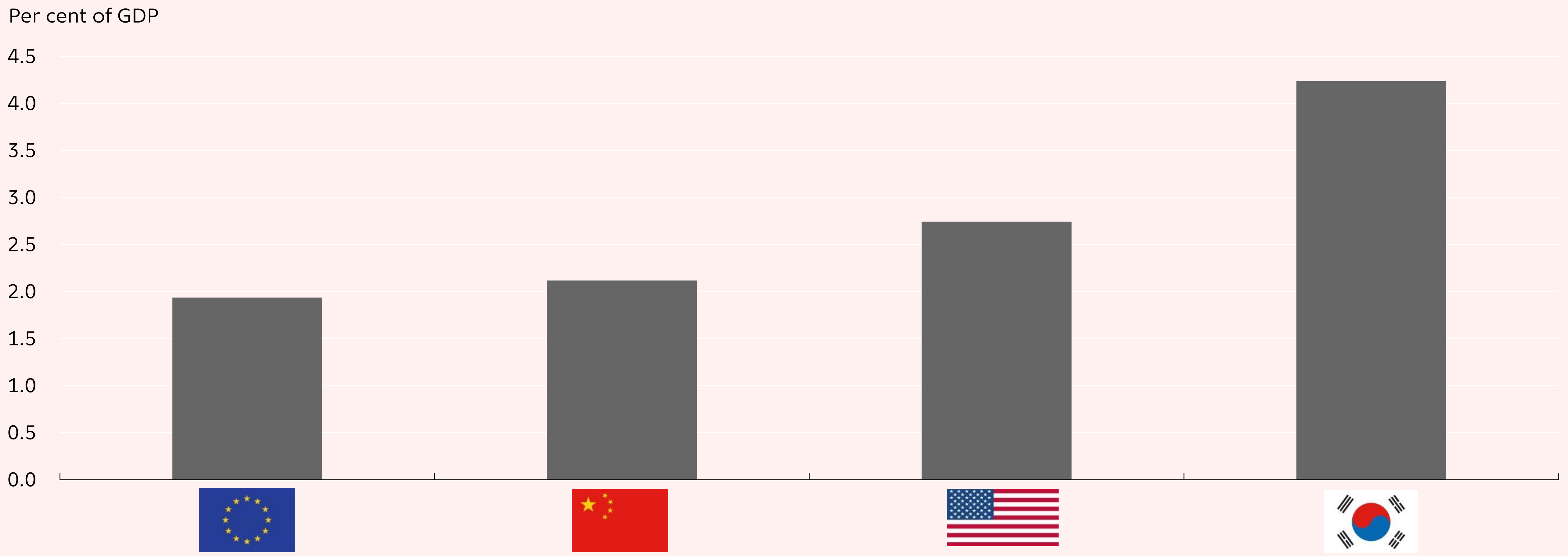
Demographic contribution to average annual growth in EU GDP per capita



Source: The estimates are based on the methodology in Jinill Kim, The Effects of Demographic Change on GDP Growth in OECD Economies, Board of Governors of the Federal Reserve System, *IFDP Notes*, 2016, and population projections from the United Nations.

Europe faces a R&D gap…
…but prosperous neighbours do not make us worse off

R&D expenditures



Source: OECD.

Global competition is the engine of innovation

Patent applications in top regions

Note: The bubbles are scaled to match the number of PCT patent applications. A larger bubble indicates more patents.
Source: OECD.

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Regional dimension to European innovation

Patent applications in top regions

Note: The bubbles are scaled to match the number of EPO patent applications. A larger bubble indicates more patents.
Source: Eurostat.

A single market for financial services – What's in it for you?

- Increases competition
- Free movement of financial services
- 500 million customers
- Improves efficiency and allocation of resources
- Reduces trade costs

A level playing field for banks is important