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Welcome address

Banco de España-SUERF Conference "Financial Disintermediation and the Future of the Banking Sector"

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Good morning. I would like to welcome you to the conference “Financial disintermediation and the future of the banking sector”, hosted by the Banco de España and co-organised with SUERF.

Let me start by thanking our colleagues from SUERF for their participation and involvement in the conference. SUERF is a unique institution that has been very successful in creating an active network of academics, financial practitioners and policymakers for the analysis and discussion of monetary and financial issues. Its outreach is achieved through the organization of international events, such as today´s conference, publications and a very active sponsoring of research.

It is well known that capital markets in Europe are less developed than in the United States. This is related to the more significant role played by banks in Europe for the provision of funding to firms than their US peers. To illustrate this, let me give you some figures. In 2017, the ratio of financing through fixed-income securities to total debt financing was 12% in the euro area versus 43% in the United States. Also, the ratio of equity market capitalisation over the domestic credit provided by banks to the private sector was almost four times larger in the United States than in the euro area at the end of 2016 according to the latest data provided by World Bank DataBank.

There is not a consensus in the academic literature on what source of financing has a higher contribution to financial stability and economic growth.[1] On the one hand, banks, through their interaction with firms, manage private information which benefits the allocation of credit and favors a better and cheaper access of firms to financing when the bank-firm relationship is well developed.[2]

On the other hand, liquid and efficient financial markets offer the possibility of allocating households’ savings to long-term projects without the need of monitoring these savings.

Although financial intermediaries and markets have been generally considered as alternative and competing ways of overcoming frictions between savers and investors, they can be also considered as complementary sources to achieve an optimal allocation of capital. In fact, there is some evidence in the economic literature that a proper diversification of firms’ funding leads to more investment[3] and to a lower vulnerability to financial shocks.[4] These results suggest that financing structures based exclusively in one of the two sources of funding are probably suboptimal.

Certainly, the experience of the recent global banking crisis clearly shows that firms relying only on bank financing had more difficulties in their access to external funding than companies with a richer diversification of their liabilities. This problem was even more acute in the case of those firms, mainly SMEs, that relied in only a limited number of lenders facing

[1] Beck, T., and Levine, R. (2002) “Industry growth and capital allocation: Does having a market- or bank-based system matter?”, Journal of Financial Economics, 64, 147 – 180; Gambacorta, L., Yang, J., and Tsatsaronis, K. (2014) “Financial structure and growth”, BIS Quarterly Review, March 2014, 21 - 35.
[2] López-Espinosa, G., Mayordomo, S., and Moreno, A. (2017) “When does relationship lending start to pay”, Journal of Financial Intermediation, 31, 16-29.
[3] Tengulov, A. (2016) “The Impact of Borrowing Diversity on Firm Value, Financing and Real Decisions”, Working Paper SSRN 2361401.
[4] De Fiore, F. and Uhlig, H. (2015) “Corporate Debt Structure and the Financial Crisis”, Journal of Money, Credit and Banking, 47, 1571-1598.

financial problems since their ability to switch to a new lender was not always easy due to asymmetric information problems.[5]

Given the generally low level of diversification of liabilities of European firms, and the risk this poses for the corporate sector to face shocks affecting the bank lending channel, there seems to be some room for a higher role of capital market financing in Europe.

Moreover, European financial markets not only are less developed than their US counterparts but they are also less integrated. Apart from the aforementioned implications in terms of the low diversification of firms' financing sources, this situation has also implications for the ability of households and firms to hedge against country-specific sources of risk to smooth income, consumption or investment growth.

The evidence for United States shows that cross-ownership of assets all over the country, and especially equity securities, has played a key role in smoothing state-specific shocks[6]. By contrast, this mechanism is less powerful in Europe since the cross-border ownership of assets is still limited.

The project of the Capital Markets Union (CMU) aims at the developing and integration of capital markets in Europe. In my view, the CMU project is an important step forward to reach the goal of correcting some structural deficiencies of the EU capital markets in terms of their relative underdevelopment and fragmentation.

CMU Action Plan was launched in 2015 by the European Commission by setting out a list of over 30 actions and related measures to establish the building blocks of an integrated capital market in the European Union by 2019. So far the implementation of these measures has been slow.

In any event, in recent years the role of European capital markets as a source of funding for firms has increased. For example, the ratio of financing through fixed-income securities to total debt financing has grown from 8% in 2007 to 12 % in 2017. A similar trend has also been observed in other advanced economies including the United States.

Understanding the driving forces of this trend is important in order to assess its main implications. Some factors are possibly of a transitory nature. Among these factors are the post-crisis monetary policies and their implementation. In particular, the introduction in mid-2016 of the Corporate Sector Purchase Programme (CSPP) as part of the ECB Asset Purchase Programme, has contributed to lower the cost of firms' financing through the issuance of fixed-income securities relative to the cost of bank funding, thus encouraging

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[5] See Bentolila, S., Jansen, M., and Jiménez, G. (2017) "When Credit Dries Up: Job Losses in the Great Recession", Journal of the European Economic Association, 16, 650–695, and Martínez-Pagés, J. (2014) "Impact of restructuring plans on lending to non-financial corporations" Economic Bulletin Banco de España, July – August 2014.

[6] See Special feature A "Financial integration and risk sharing in a monetary union", in Financial Integration in Europe, ECB, April 2016 and Box 1 "What could enhance private financial risk sharing in the euro area?" in Financial Integration in Europe, ECB, May 2018. See also Asdrubali, P., Sorensen, B. and Yosha, O., (1996) "Channels of interstate risk sharing: United States 1963-1990", Quarterly Journal of Economics, 111, 1081-1110; Athanasoulis, S. and van Wincoop, E. (2001) "Risk sharing within the United States: What do financial markets and fiscal federalism accomplish?", Review of Economics and Statistics, 83, 688-698.

large companies to switch bank financing to bond financing. A recent Banco de España's research paper documents that this programme also had a positive side effect on the access of SMEs to funding given that banks reallocated the credit previously granted to bond issuers to smaller firms that do not have access to financial markets.[7]

Among the more permanent factors that could have contributed to the recent trend of financial disintermediation is the introduction of the new global banking regulation as a reaction to the financial crisis. The new regulation aims to improve primarily the resilience of banks to shocks and will have a positive impact on overall financial stability. However, as it has been documented in some papers, these regulatory measures might also reduce somewhat the ability of banks to compete in the intermediation of some financial flows[8].

But going forward, it is still under debate at the global level to what extent elements of the new regulatory framework should be also applicable to some non bank financing channels, as long as they might share with banking activities similar underlying risks to financial stability, such as maturity transformation and high leverage. If finally applicable, this might imply a more level playing field between banking and non bank intermediation.

Another permanent factor that is contributing to the development of capital markets in the EU is the launch of new markets such as the alternative stock and fixed-income markets aimed at attracting medium-sized companies, although the size of these markets is still relatively small.

It goes without saying that these changes in the structure of financial markets, in combination with the emergence of new technological advances, pose a challenge for banks. Particularly so against the current background of low profitability of the banking systems in Europe.

The arrival of new technologies has reduced the barriers to entry in certain traditional banking activities, creating the possibility for new competitors to banks, such as the FinTech companies, to access bank customers in a highly dynamic manner for a relatively modest investment outlay[9].

But the new technologies do not only pose threats for banks, they also offer opportunities for them in terms of potential efficiency gains. One example is the application of artificial intelligence and the systematic use of large databases with real-time information and a high degree of disaggregation (commonly known as big data) for both their commercial business and for regulatory compliance.

Apart from the potential efficiency gains for banks and for the financial system as a whole, the application of some of the new technologies in the financial sector could bring other

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[7] Arce, O., Gimeno, R., and Mayordomo, S. (2017) "Making room for the needy: The effects of the Eurosystem's Corporate Sector Purchase Programme", Banco de España Working Paper No. 1743.

[8] See Aiyar, S., Calomiris, C. W., and Wieladek, T. (2016) "How does credit supply respond to monetary policy and bank minimum capital requirements?", European Economic Review, 82, 142-165, Fraisse, H., Lé, M., and Thesmar, D. (2015) "The real effects of bank capital requirements", HEC Paris Research Paper No. FIN-2013-988, De Jonghe, O., Dewachter. H.. and Ongena, S. (2016) "Bank Capital (Requirements) and Credit Supply: Evidence from Pillar 2 decisions", National Bank of Belgium No 303.

[9] For detailed evidence on how P2P platforms compete with banks, see de Roure, C., Pelizzon, L., and Thakor, A. (2018) "P2P Lenders versus Banks: Cream Skimming or Bottom Fishing?", SAFE Working Paper No. 206.

benefits for the society, including a greater financial inclusion by reducing intermediation costs, which would improve the access to funding of households and SMEs.

In any case, at this stage, the ultimate impact of new technologies on the structure of the financial system is highly uncertain as it will depend on different factors including the regulatory treatment of the new players.[10]

Today´s conference will cover all these issues related to the recent changes in the structure of financial markets and their implications for the banking system. We have the privilege to have as speakers experts in those areas from academia, policy makers, think tanks and the banking industry. I am sure that we will have a very productive debate and that we will improve our understanding of these issues.

Finally, allow me to express once again my gratitude to the co-organizers of this event for making the conference possible, and to wish all the participants a very fruitful meeting and a pleasant stay in Madrid.

And without further due, let me now introduce our first speaker, Governor Philip Lane. It is a special honor for us to have him here today. He is especially suited to be our first Keynote Speaker in this event because he has a profound knowledge of economy and finance, as a result of his long and prestigious career as an academic, as well as a brilliant policy-maker.

His keynote speech today will verse about “Trends and Cycles in Financial Intermediation”.

Philip, you have the floor...

[10] For more information on the impact of FinTech on the finance industry see Philippon, T., “The FinTech opportunity”, NBER Working Paper, No 22476, 2016; and Huang, Y., Shen, Y. Wang, J. and Guo, F. , “Can the internet revolutionise finance in China?”, in Song, L., Garnaut, R., Fang, C. and Johnston, L. (eds.), China’s new sources of economic growth: reform, resources, and climate change, Australian National University Press, 2016, pp. 115-138.