José Luis Escrivá: Challenges and opportunities for the financial future of Europe

Speech by Mr José Luis Escrivá, Governor of the Bank of Spain, at a meeting of the Spanish Banking Association, Madrid, 14 March 2025.

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Good morning everyone.

I would like to begin by offering my heartfelt thanks to the Spanish Banking Association and in particular to its Chair, Alejandra Kindelán, for kindly inviting me to this event. I would also like to acknowledge the insightful speech by Commissioner Maria Luís Albuquerque, whose sentiments I share entirely.

We live in a time of profound change. The reshaping of the geopolitical landscape – marked by growing tensions between the United States and China, the protracted impact of the war in Ukraine and global trade fragmentation – is generating a climate of uncertainty that demands a clear and resolute response from Europe.

Against this backdrop, Europe cannot afford the luxury of hesitation. This is not the time for fragmentation or paralysis. On the contrary, it is the time for unity across all domains, but very particularly in the economic and financial realm. In the face of external uncertainty, Europe must negotiate and act from a position of power and embrace its relative strengths, with robust institutions and a financial market equipped to foster growth and stability.

With this overall picture in mind, I would first like to emphasise that our currency, the euro, must become a key driver of economic sovereignty, especially when other regions make unpredictable decisions that could generate significant disruptions in areas such as banking supervision, payment systems and trade policy.

Against this deeply complex geopolitical backdrop, Europe needs concrete initiatives to strengthen its strategic position. One area where this is particularly evident is in payments, through the role played by the central digital bank currency in both the retail and wholesale realms.

We are clearly on an irreversible trend towards increasingly digital money, incorporating new technologies such as tokenisation. We must ensure that money's essential attributes are not lost along the way, such as the assurance and security provided by the central bank's backing, its issuance here in Europe and its distribution by institutions under our supervision.

On the retail side, we have made significant progress since the inception of the euro and the creation of the Single Euro Payments Area (SEPA), particularly in transfers and direct debits. However, in electronic payments at the point of sale, whether physical or digital, we continue to lag behind. We lack truly European solutions. 72% of card

payments in Europe rely on international networks, leaving us highly dependent on non-European actors. This model comes at a growing cost: fees are estimated to have increased by around 35% in the last eight years.

This situation has been compounded by the emergence of new players, such as digital wallet providers, which have further narrowed margins. Apple Pay, for instance, charges 0.15% per transaction. And an even greater challenge is looming: the possible expansion of dollar-denominated stablecoins, a model actively backed by the current US Administration, which could deepen our dependence on foreign big tech firms. Although private initiatives such as EuroPA and Wero have sought to address these challenges, their reach remains insufficient.

It is in this context that the Eurosystem is developing the digital euro, which aspires to complement cash and provide a foundation for and impetus to private initiatives.

We are aware of the banking sector's concerns regarding balance limits and adaptation costs. However, in this challenging geopolitical context the digital euro should be regarded not as a problem but as a solution.

This is a historic opportunity to fully complete the Single European Payments Area, lessen our external reliance in a critical sector and retain income from commercial payments within Europe. It will also ensure that we are better equipped to address future risks, such as the rapid expansion of dollar-denominated stablecoins.

On the wholesale front, for some years the central bank digital currency has played a crucial role through TARGET infrastructure. Now the challenge is to adapt these systems to recent technological advancements. Asset tokenisation and the use of distributed ledger technology (DLT) offer potential benefits in terms of efficiency, transparency and security. We in the Eurosystem are already working on concrete solutions to ensure interoperability between DLT-based private platforms and TARGET services.

This same strategic approach should guide the review of our regulatory framework. In recent decades, regulators and supervisors have worked, in collaboration with the banking sector, to address the structural weaknesses brought to light by the 2007 financial crisis.

As a result of the initial Basel III reforms, which were implemented in Europe in 2013, today the European banking system is clearly more resilient. According to the Basel Committee on Banking Supervision, on the latest data available, since 2011 the average CET1 ratio has risen from 6.4% to 14.5%, while the leverage ratio has increased from 2.7% to 5%.[1] The liquidity indicators (LCR and NSFR) are also comfortably above the required minimum of 100%.

Notwithstanding the monetary policy measures taken by central banks or the actions taken by governments, this greater resilience of European banks has been evidenced by their ability to smoothly overcome recent crises, including exogenous ones, such as the pandemic. Moreover, implementation of the 2017 Basel reforms continues to build up financial stability.

Europe's firm commitment to Basel III is all the more important in the current setting, and I hope it helps the jurisdictions still tackling the implementation process to take the steps necessary.

But we must not be complacent. Financial stability calls for a sound and solvent financial sector and for a regulatory and supervisory framework that is more simple, stable, predictable and efficient.

There is growing consensus about excessive regulatory complexity in Europe, which not only hampers financial institutions' operations, but also overloads the supervisory function and could fragment the market. This is why a holistic review and streamlining of our regulatory and supervisory framework is essential. I am not talking here about deregulation, as we are not seeking to lower requirements or remove the regulations that ensure the system's stability. Rather, the aim is to simplify the regulations overall, to make them more effective.

We must consider European regulations as a whole, including level 2 and 3 standards, to avoid overlaps and unnecessary complexity. We also need to analyse whether regulatory zeal in level 3 may, in some instances, have gone beyond the intentions of the legislator, and to take measures if necessary.

The current economic setting reinforces the need for these measures. Europe continues to grow, but it does so with a worrying structural weakness: a historical gap in private investment. In the euro area, productive private investment accounts for 12.3% of GDP, compared with 15% in the United States and 27% in China.

To bridge this gap, Europe must drive an ambitious structural agenda. One priority is to further European integration through policies that strengthen the Single Market, which will enable European firms to scale up and compete globally. Deepening the Single Market calls for simplifying the regulatory and fiscal frameworks, by reducing fragmentation and red tape. Another priority is strengthening coordination between national industrial policies and European public investment programmes. Public investment must act as a catalyst for private investment, within the bounds of a State aid governance framework that preserves the functioning of the Single Market.

The banking sector continues to be an essential cornerstone in this process. To finance these significant investment needs, firms will continue to resort largely to external source of financing. And the European economy is still heavily banked.

At present, bank loans account for 92% of European firms' total indebtedness, which means that mobilising bank lending will be essential to bridge the private investment gap.

In this regard, the pivotal role played by European Central Bank (ECB) monetary policy should be highlighted.

In response to the inflationary surge in 2021-2022, the ECB raised its interest rates by 450 basis points (bp) between July 2022 and September 2023. This tightening cycle was unprecedented in terms of both the pace and the scale of the policy interest rate hikes.

This decisive monetary policy action prevented the deanchoring of inflation expectations and mitigated potential second-round effects. Euro area inflation was thus swiftly brought down and is now close to the medium-term target of 2%.

This situation paved the way for a normalisation of monetary policy, with a cumulative cut of 150 bp in the deposit facility rate since June 2024. The policy interest rate cuts have gradually passed through to bank financing costs for firms.

Between October 2023 and January 2025 the average interest rate on new lending to euro area firms decreased by 1.1 percentage points (pp), to 4.1%.

This reduction in the cost of financing spurs business investment by boosting loan demand. Indeed, in January 2025 the stock of bank loans to euro area firms saw 2% growth in year- on-year terms, compared with a 0.2% decline in October 2023.

In the current geopolitical environment, I would like to mention Europe's commitment to strengthening its defence capabilities. This commitment poses major challenges from the standpoint of both public and private financing. On the public financing front, reaching the proposed military spending targets will require significant additional fiscal efforts. On the private side, bank lending to the defence sector is at very low levels. In Spain, for example, credit specifically earmarked for armament and ammunition manufacturing has not exceeded 0.1% of total bank lending at any point in the last two decades.

Like other long-term investments, this type of investment is characterised by high levels of uncertainty, strict regulatory requirements and long technological development cycles. Against this backdrop, it is important to assess whether the current regulatory and supervisory framework provides the proper incentives to mobilise bank financing towards this type of investment, and to analyse how the banking sector could play a more active role in this strategic area.

However, bank credit alone cannot meet all the financing needs. The specific characteristics of the banking business, which is subject to stringent prudential regulations that were strengthened after the 2008 financial crisis, make it difficult for financial institutions to provide financing for very long-term projects, particularly risky or highly uncertain ones. Since the global financial crisis, European firms have slightly increased their non-bank financing by issuing debt securities, whose share in the stock of corporate debt has risen from 4.4% in 2008 to 8.1% in 2024. However, this figure remains much lower than in the United States, where this type of financing accounts for 39.3% of the total.

This is precisely why Europe needs to foster deeper and more integrated capital markets. Capital risk is crucial for financing innovative projects and strategic sectors, such as technology or the energy transition. However, European early-stage investment markets are six times smaller than those of the United States and they are concentrated in a handful of countries, such as Germany, France and Sweden. In this connection, the Swedish experience is particularly illustrative. Sweden has managed to develop the EU's deepest capital market, with a stock market capitalisation volume equivalent to 170% of its GDP, well above the average 60% for the EU or 40% for Spain. A key factor for this success was the integration of its stock market into Nasdaq-Europe, a

regional platform operating markets in Sweden, Finland, Denmark and Iceland. By using a dual model which combines a main market with a more flexible growth segment (Nasdaq First North Growth Market), Sweden has helped startups and SMES gain access to government funding, recording the highest number of new admissions to trading in the entire continent in recent years. This experience shows that, in addition to EU reforms under the Capital Markets Union (CMU) framework, there is room for strengthening the capital markets at national level.

Venture capital should be a priority in Europe. Public capital plays a key role in the early stages of innovation. For it to work effectively, it is necessary to develop agile investment instruments that can accurately assess projects' financial and technological aspects, harnessing the potential of European funds for co-investment and attracting private capital. These instruments must be accompanied by measures to reduce regulatory barriers and facilitate private capital participation. Additionally, fostering an ecosystem in which venture capital funds have clear incentives to leverage the opportunities arising from public support is essential.

This is why the CMU is an essential cornerstone of Europe's financial future. We must avoid the errors of previous initiatives and adopt a pragmatic approach, with clear objectives and efficient measures. The Banco de España strongly supports the Savings and Investment Union (SIU), a European initiative combining the complementary objectives of the CMU and the banking union. We are fully aligned with Commissioner Albuquerque's view of the importance of this complementarity.

One of the most urgent aspects within the SIU is the revival of the securitisation market.

Securitisation allows banks to transfer credit risk off their balance sheets towards non-bank investors, releasing capital for new loans. However, it is underdeveloped in Europe. In 2022 the volume of securitisations issued in Europe was 0.3% of GDP, compared with 4% in the United States.[2] Although there are particularities in both markets – such as the role of government mortgage agencies in the United States or the importance of covered bonds in Europe – this difference is significant and calls for urgent action.

We believe that the reform of the European regulatory framework should focus on reducing its complexity, introducing greater proportionality in transparency requirements for originators and in due diligence obligations for investors.

We also support the creation of a European securitisation platform to facilitate the issuance of standardised securitised bonds.

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[1] See the Basel Committee on Banking Supervision's latest Basel III monitoring report for 2024, with data available to 2023.

[2] See Mario Draghi's 2024 report on the future of European competitiveness, based on data from the Association for Financial Markets in Europe (AFME).