

**Mr. Duisenberg speaks on changes in European financial systems and the contributions of the ECB** Remarks delivered by the President of the European Central Bank, Dr. W. F. Duisenberg, at a conference on “Monnaie unique et fiscalité de l'épargne: quelle Europe financière?” organised by the European Parliament in Brussels on 23/9/98.

### 1. Introduction

I would like to express my appreciation for the interesting exchange of views which has taken place during this round table. As was made clear during the discussion, the structure of financial systems in Europe will evolve as the single currency is created. The ECB has already contributed to this evolution in many ways and will continue to do so in the future. I would like to make a few remarks on this topic.

### 2. Changes in European financial systems

European financial systems are evolving within a global environment, which has become more liberalised, international and concentrated. Changes of particular importance in the euro area include technological innovation in payment systems, the supply and trading of new derivative products, and the improvement and diffusion of new risk management techniques. Moreover, the environment of European financial systems is characterised by the Single Market, with new harmonised pieces of regulation and practices developed on the basis of, notably, the Banking Co-ordination Directives, the Capital Adequacy Directives and, importantly in the context of this Conference, the Investment Services Directive.

The scope and organisation of financial activities in the euro area will also change as a result of the creation of the euro. First, money markets are going to be unified. Second, the focus of foreign exchange activities will of course shift to currencies outside the euro area. Third, the behaviour of participants in equity and bond markets is likely to be driven less by country-specific considerations and more by precise, sector-specific or issuer-specific considerations. This latter development is what some commentators have called the development of a “credit risk culture”. This development is likely to improve the effectiveness of price formation on European bond and equity markets. This, in due time, will contribute to the smooth functioning of the financing of the euro area economy, as savings are likely to be channelled more efficiently and swiftly through the economy. As such, the development of a “credit risk culture” will therefore be a welcome product of European Monetary Union.

### 3. Contributions of the ECB

Let me now turn to the contributions that the European Central Bank has made, and will continue to make, to support the efficient working of financial markets in the euro area.

#### Price stability

The first and foremost contribution that the ECB aims to make is price stability. The European System of Central Banks will pursue its primary objective of maintaining price stability with determination. This should facilitate the formation of price expectations by market participants and contribute to financial stability in general.

This environment will be beneficial to the efficiency of savings allocation amongst the various sectors of the economy of the euro area. There are several reasons for this. First, the achievement of price stability should help to reduce the uncertainty relating to the future path of inflation. This should enhance the information content of real and financial asset prices and improve the capacity of economic agents to select investment options efficiently. Second, price stability will contribute to protecting the value of savings, thereby avoiding the undesirable wealth re-distribution effects that inflation may cause. Third, in the long run, increased financial stability may contribute to reducing the likelihood of occurrence of asset price bubbles.

### Payment systems

A second contribution of the ECB relates to the field of payment systems. The EMI, and now the ECB, have developed the TARGET system, which will be made available to market participants as from 4 January 1999. The system will ensure the unification of money markets in the euro area. It will reduce transaction costs for cross-border payments and greatly enhance security with regards to settlement risks and possible payment gridlocks.

The ECB has also prepared, and is about to publish, a set of minimum standards which securities settlement systems should fulfil in order to be used in ESCB credit operations. This publication and other initiatives taken by the ECB have fostered the increased co-operation between securities settlement systems and depositories of the euro area.

### Market rules and practices

A third contribution of the ECB relates to market rules and practices. Many commentators have recognised that European Monetary Union will contribute to the furthering of the harmonisation of market rules and practices. In accordance with the mandates given by treaties and statutes, the European Monetary Institute has taken, and now the European Central Bank takes, an active role in the promotion of adequate new market conventions and rules for the euro area, bearing in mind the principles of free competition.

### Monetary policy framework of the ECB

Finally, financial markets will need to take into account the monetary policy framework of the ECB. The monetary policy framework of the ECB has been built so as to be very efficient for transmitting monetary policy, while at the same time being as neutral as possible with regard to financial structure. The neutrality and, indeed, market-friendliness, of the ECB's framework is apparent in a variety of ways.

First, neutrality is apparent in the way open market operations are conducted. Almost all of the ECB's open market operations will be executed through tenders, to which a broad spectrum of counterparties may submit bids. This will be a transparent and fair process. Fine tuning open market operations may also be conducted through tenders, the so-called "quick" tenders. The ECB and the national central banks will aim at giving the opportunity to participate in fine tuning operations to all counterparties having an appropriate track record of activity in the money market, if necessary on a rotating basis.

Second, the consideration of neutrality has been a driving factor in the process of establishment of the list of eligible assets. Eligible assets are the assets which counterparties have

to post as guarantees for any credit received from the European System of Central Banks. The list of eligible assets comprises a wide variety of assets, which have been selected by the ECB according to area-wide uniform criteria relating to their credit standing in the whole euro area. In order to promote a certain degree of continuity at the start of the Third Stage of European Monetary Union, a sub-set (the so-called tier two eligible assets) includes assets of particular importance for certain national banking systems of the euro area. These assets have the same credit standing as the other assets.

For monetary policy operations, counterparties will be able to use any eligible assets, irrespective of where they are located in the euro area. To this end, national central banks will act as correspondents for each other so as to make cross-border use possible also for assets for which this service is not yet provided by securities settlement systems.

For the record, one may also mention the ECB's system of risk control measures. Risk control measures will ensure that the amount of assets provided is always sufficient. When designing its system of risk control measures, the ECB has paid careful attention to the best market practices in this area.

Finally, and perhaps most importantly, the minimum reserve system of the ECB has been developed so as to be as neutral as possible. The minimum reserve system has two main objectives. The first objective is to stabilise money market interest rates. This will be achieved by requesting that average reserve holdings be above the minimum reserve requirements over monthly periods of time. This will allow the banking system to absorb liquidity shocks easily. The volatility of money market rates will, as a consequence, be reduced. Also, fine tuning operations will not have to be used frequently, which will mean that markets are less affected by central bank interventions than they would otherwise be. The second objective of the minimum reserve system is to enlarge the demand for central bank money, so as to enlarge the liquidity deficit of the banking system vis-à-vis the European System of Central Banks. This will safeguard the role of the European System of Central Banks as a key provider of liquidity to the banking system.

In the minimum reserve system of the ECB, the reserve ratio will be rather small and reserve requirements will be fully remunerated. The reserve ratio will be set at between 1.5% and 2.5% and will be applied to the deposits, debt securities and money market paper issued by credit institutions, except for residual maturities above two years. Reserve holdings will be remunerated up to the required reserve level, at the rate of the ESCB's main refinancing operation (as averaged over a month).

It may be argued that a less than full remuneration of minimum reserves would increase the interest rate elasticity of central bank money demand. This notwithstanding, the European Central Bank has decided in favour of a full remuneration of minimum reserves in order to avoid the potential distortions to fair and efficient markets that a less than full remuneration could have implied. As a result, the minimum reserve system is unlikely to lead to any delocation of certain parts of the reserve base, hence of savings. Finally, it may also be useful to note that the European Central Bank has also decided not to exempt any credit institution of the euro area from the minimum reserve system.

#### 4. Conclusion

I am confident that the policy of the ECB has always been, and will continue to be, guided by the principle of equal treatment, the desire to foster the development of financial markets in the euro area and the need to avoid undue shifts in economic activity. This will also contribute to providing an adequate environment for an efficient allocation of savings in the euro area.