

REMARKS

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Financial markets and EMU IBC - Conference on "Single European Currency"

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Today, I will not go into any detail about our payment system and the measures being taken to adapt it to Target . That would be a rather time-consuming task. Moreover, these issues and facts are quite well documented in papers published both by the EMI and by ourselves. Concerning the RIX-system, I might add that we will shortly be publishing a booklet describing the system. Instead, I will focus on some structural developments in the financial sector in the light of the EMU.

Economic integration within the EU is, in a sense, a two-sided matter: First, we have the EMU, which may be described as integration on the "macro"-level; second we have integration on the "micro" level, expressed in terms of the "single market". Of course, these two sides are interrelated; for example, EMU might well be interpreted as an important further step to a true "single market". Still, they represent somewhat different angles in approaching the European economy.

Looking at the financial markets in Sweden and elsewhere in Europe and their development in recent years as well as what is likely in the years to come, it is not easy to tell to what extent changes have been and will be driven primarily by the "single market", or by the preparations for the EMU or, for that matter, by factors which are "global" rather than specific for Europe.

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However, I think it is fair to say that the implementation of the single market has been the most important factor, at least so far, behind the restructuring of the financial markets that we have witnessed in recent years. But I believe that the preparations for the EMU and the creation of various financial infrastructures to support the EMU - such as the Target system - is playing and will play an increasingly important role as a driving force for structural change. When the EMU is in place, this completion of the Single Market is likely to boost the restructuring process even further.

In Sweden, we are, as most of you know, in the midst of a restructuring of the banking sector. We have seen mergers between Swedish banks, between Swedish banks and foreign banks, between banks and mortgage institutions and between banks and insurance firms. Part of these activities can of course be seen as an aftermath of the banking crisis of the early '90s, but it is obvious that the "European perspective" in general and the EMU in particular is an important explanation behind the steps being taken. This motive has also, in most cases, been stated explicitly by the banks involved. The same process is taking place in other European countries as well, and also in other parts of the financial sector. e.g. in the case of stock-exchanges and derivatives exchanges. The latter phenomenon has been observed in for example Germany, Holland and Finland.

In my view, there are good reasons for the measures being taken - the EMU will lead to important changes in the business environment for European financial institutions. It is also important to note that the introduction of the Euro will affect the Swedish financial market profoundly, despite the fact that Sweden will not participate in the euro area from the start - being "out" does not mean "status-quo". The effects will be different in some respects due to the "out"-situation, but I believe the overriding structural tendencies will be largely the same among "outs" and "ins".

The EMU and structural change

At present, capital markets in Europe are fragmented. Domestic banks and insurance companies dominate in most countries and Sweden is no exception. The background is not just the existence of different currencies but probably still more the tendency for customers to stick to the banks they know, together with the banks' accumulated fund of knowledge about credit risks and local markets.

The arguments in favour of a national base for operations will continue to apply for quite a long time after the introduction of the common currency, especially in the "retail" sector. However, in the case of corporate services - particularly for large companies - there is reason to believe that the effects may be fairly large quite soon.

Over time countries with the single currency can be expected to become increasingly integrated. Since a common currency affects the very core of a financial system, this will naturally be particularly marked in the financial sector.

Therefore, the large, intergrated, more transparent and more competitive european financial market we will see in the future will certainly promote a continuation of the financial markets' rapid development.

This means new instruments, cross-fertilisation and a concentration of some specialist functions. It also means that competition in traditional banking is likely to be even more intense, accompanied by rising long-term demand for financial services and increasingly sophisticated customers, be they firms, local authorities or households. Full-service banks have already become fewer but larger. No doubt one can also expect a continued growth of niche banks and other financial enterprises that concentrate on a small selection of services or outlets. The downward tendency in traditional bank lending and deposits is likely to continue, accompanied by an increased supply and demand for market-based instruments. There is also reason to assume that some of the financial markets' products will be dropped and new ones introduced.

These developments have been clearly evident here in Sweden over the last few years, in parallel with the considerable improvement of profitability and competitive strength within the Swedish banking sector. Today, the Swedish banks are performing very well by international standards. Taking profitability and cost-efficiency, to mention two examples, Swedish banks hold a top position in a European context.

On account of economic convergence and a single anti-inflationary monetary policy, the monetary union will cause interest rates in high- and low-rate countries to converge. The absence of an exchange risk premium inside the euro area will also contribute to this. What will remain after the changeover process has been completed, is mainly liquidity and credit risks. With no exchange risk and a tendency for investment decisions to focus more on credit risk, it seems likely that well-developed and integrated European markets will be established for various types of bonds, e.g. corporate bonds and municipal bonds. Another contributory factor here is that investors will probably be interested in spreading risk by diversifying portfolios across more countries.

As an "out"-country, there is a risk of not being part of this process. Therefore, our challenge will be to manage our economic policy in a way that promotes such high confidence in the market that,for example, investments in assets denominated in kronor will be regarded as attractive, not "risky". If so, we might still be part of this process, in spite of being "out". In other words, staying outside the EMU leaves no room for lax policies. Such policies will harm us not only in macroeconomic terms, but in structural terms as well.

Changing the infrastructures

As to the infrastructure, the institutes mainly affected are, for securities, the Stockholm Stock Exchange, OM and the VPC, while for the handling of money and payments they are the banks and the Riksbank.

The fundamental practical problem for us as an "out" country, is that we have to prepare for a doubling of infrastructures in many different aspects, this will involve extra costs and thus give rise to potential problems of competition. The Swedish banks, the Stockholm Stock Exchange, the VPC and others are working actively today to seek solutions that are flexible and cost-efficient to handle this in the best possible way, but there are of course no cost-less solutions to be found. This also concerns the Riksbank, where we will have to manage two RTGS-systems - one for kronor and one for Euro, where the latter will be linked to Target. Concerning the Target, we also run a risk of de-facto discrimination in terms of a more or less restricted access to intraday liquidity in euro. Apart from this issue, I would say that in general, our payment system is fairly easy to adapt to the Target-environment, mainly because we have worked in a RTGS-concept longer than most other European central banks.

However, and coming back to structural changes, it is interesting to note that the Target-project has served as a catalyst for a number of changes in the Swedish payment system. This applies to operational issues as well as policy issues. To a certain extent it also includes the technical integration from RIX towards the banks and towards the VPC. The technical integration between RIX and the banks - based on SWIFT-communication - will probably lead to a lot more payment transactions being processed in a real-time, gross mode, and in a way that is cost-efficient. In my view, this is a good example of how changes in the financial infrastructure may kick off further changes.

Concerning the payments area, it should also be noted that efforts are being made to create networks on a private basis - the EBA-clearing is perhaps the most well-known example, but there are also a number of other initiatives, for example the newly announced cooperation between a number of European banks, named "TransEuropean banking Services". As a central banker, I do not see this as some kind of unwanted competition with Target - instead, we welcome such initiatives. Target will not, and shall not, be a monopoly in the field of cross-border payments.

On the securities' side there are also interesting moves towards integration, linking the different European depositories and clearing-houses together in a common network - I expect Mr Reveman from the VPC will give you more information about this later today. As I mentioned earlier, similar things are happening among e.g. the stock-exchanges in Europe. In other words, we see moves towards integration and standardisation covering the entire trading process; trade, clearing and settlement. All these changes in the infrastructure will give us all new playing fields and sometimes new roles to play. In this way it also will promote further structural change.