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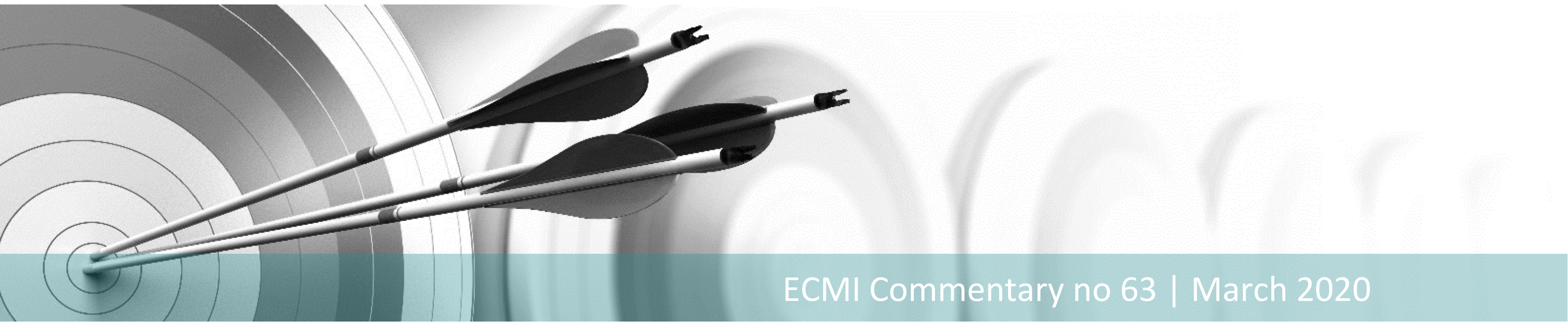

Can Europe's finance sector resist COVID-19?

Karel Lannoo

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We are back in crisis mode. In a matter of only three weeks, Europe has turned from boom to bust for markets and businesses. Von der Leyen's positive and strategic agenda has again been overtaken by the need to respond to the urgency of the moment and to try to keep the EU together. Still, the lessons from the 2008 financial crisis should not be forgotten, and all should now be done to ensure we do not go off track for years to come. This is certainly the case for Europe's financial markets.

The good thing is that much has been achieved since 2008. We now have over 2,100 people working full-time in financial sector oversight at the European level (the ESAs, ESRB, SRB and SSM). Prudential and market conduct rules have been harmonised and the soundness of banks can be compared instantly. Rules also provide for reacting to adverse events, and alleviating capital buffers, as the SSM announced on 12 March. And the SSM is part of the ECB, which allows for immediate sharing of information and awareness of liquidity concerns in the banking sector with the monetary policy authorities.

The bad thing is that there is still too much unfinished business in the banking and, above all, capital markets union initiatives. The Coronavirus crisis should be an urgent wake-up call. On the banking side, EDIS and the bank back-stop are formally the most important, but even more important is the immediate response to local credit constraints, as a result of the lockdowns, and the related re-emergence of spreads and of the bank-sovereign nexus. The fiscally strong countries – France, Germany and the Netherlands – have immediately announced massive credit guarantee schemes for credit-constrained SMEs, with coverage levels of up to 80% to 90%, something which Italy or Spain cannot do on their own. The European Commission, as part of its state aid competences, should ensure that a single approach is followed throughout the Union, and that the experiences of the sovereign-debt crisis are not repeated. Fiscal support should apply evenly, and the level playing field needs to be maintained. But this appears not to be the case, as on 13 March the Commission announced quick and unconditional agreement on all national credit support schemes specifically related to the Coronavirus crisis.

Regarding capital markets, the action of national supervisors to limit short selling of banking stocks is a reminder of the just finalised but incomplete ESA Review. We again see, as a decade ago, a variety of national actions, but not really a European-wide action – a sign of fragmented markets. Related to this is the continuing overdependence in Europe on bank financing, and the very limited market financing. In the US, a vibrant commercial paper market allows firms to issue debt securities to finance short-term financial needs, as an alternative to bank financing. On 17 March, the US Treasury announced special support to the $1.1 trillion commercial paper market through the establishment of a Commercial Paper Funding Facility (CPFF) by the Federal Reserve Board. In Europe, such market mechanisms do not exist. True, the ECB also announced on 12 March that it would widen its QE programme, but the EU continues to have a national securities issuance approval system, which keeps markets fragmented. Attempts to create a fully single authorisation for issuance by ESMA were stopped by the member states in 2019. Brexit will just further aggravate fragmentation, and the constraints for EU-wide refinancing.

Furthermore, European banks, as already widely discussed before the crisis, are lagging behind their US counterparts in profitability and scope, and the immediate action by US Treasury to support local financial markets will further strengthen the edge of US banks. Moreover, actions by the Trump administration to ease post-crisis rules have still not found echoes in Europe.

In these crucial days for Europe and financial markets, it is of utmost importance that the mistakes of the previous crisis are not repeated. The EU has managed to achieve more unity over recent years, which should be maintained. With the huge human suffering of this crisis, citizens' reactions will go much deeper. Policymakers will need the resolve to match.

European Capital Markets Institute

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