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Keynote speech at the Association for Financial Markets in Europe European Financial Integration Conference - Europe at cross-roads

Good morning,

Adam, John,

Thank you so much for organising this key event, which I already had the pleasure to join at its first session in 2021. I am very pleased to see AFME and OMFIF have continued this series.

A very warm welcome to the Deutsche Bank headquarters. It is an honour to be hosting this conference and to have so many high-profile speakers and experts here at Taunusanlage. I'm looking forward to an insightful day, with key themes for the panels all close to my heart. And they are becoming increasingly urgent as Europe is at a crossroads.

Europe needs to reinvent itself to remain a global player – across all fronts, not just from a financial sector perspective.

This comes at a time of enormous, prolonged volatility. Volatility—that is caused not only by the long-term consequences of the Covid pandemic and by the war in Ukraine, but also by excessively high inflation across the world along with rapid shifts in monetary policy to curb it.

We are continuing to support all our clients during this time, building on the resilience the European banking industry has earned over the last one and a half decades, not least a result of stricter regulation. Europe's banks showcased this resilience during the recent turmoil in the financial markets, which emanated from regional banks in the US and did NOT trigger contagion in Europe.

So we are now stronger and more resilient, but we need to think bigger. We need to think about how we can create an environment in which European banks and financial markets are strong enough to help Europe secure a lasting leading role in the world. Recent geopolitical developments have made it clear that the EU must seek greater strategic autonomy.

If there was ever a time to develop the right strategy, it is now.

The war in Ukraine has brought terrible suffering to the people, but it has also mercilessly exposed Europe's weaknesses: Europe depends on its major NATO partner, the United States, for its defence. And many European countries – Germany in particular – were reliant on Russian energy, just as they depend on China for other commodities.

At the same time, the decades-long rise of globalisation and the international division of labour that contributed to our continued prosperity has now given way to a global trading environment that is increasingly characterised by protectionism and national interests.

And while Europe is seeking its place in this new regime, others are pushing hard to expand their positions. This applies, of course, to the US, whose Inflation Reduction Act and two other subsidy programmes sent a clear message to the world. They are striving for leadership in future industries, and they are doing so without regard for longstanding partners. America First is probably the only thing that both parties in the US agree on.

Meanwhile, the rivalry between the US and China continues to grow. China has recovered strongly from the Covid downturn and our economists expect GDP to grow by 6% this year.

This will undoubtedly give China the confidence to further raise the stakes in the competition for global market leadership. It wants to stand up to the US – and it also wants to stand up to emerging economies that sense great opportunities in the West's efforts to “derisk” from China.

Just think of India. With a population now larger than China, India has a far better demographic future than China. The country has invested massively in infrastructure and is beginning to attract significant volumes of foreign investments from sophisticated firms, like Apple.

India's increased self-confidence is reflected in the fact that it has recently been very active in representing the interests of the Global South – a wider region that has more than two-thirds of the world's population, that generates almost half of the world's GDP and is – as a result – gaining in global relevance and clout.

All this shows that the world is in flux. We are at a point where the balance of power can shift sharply and permanently. In this environment, Europe needs to step up and focus on its growth strategy in order to truly achieve strategic sovereignty.

Europe has benefited from the rise in globalisation during recent years like no other region; Germany especially so. This ideal world no longer exists, and this means that Europe needs to reposition itself in order to accelerate growth. This includes stepping up efforts to:

- secure a long-term energy supply at competitive prices and to maintain access to crucial raw materials;
- significantly reduce the amount of bureaucracy and create a faster decision-making process;
- and, last but not least, to build a robust and strategically well positioned financial market.

To achieve this, we need to work towards a model in which the private and public sectors truly collaborate to achieve greater open autonomy. The European Parliament Elections in June 2024 and the subsequent institutional change-over should be used as an opportunity to strengthen this approach.

What should the priorities for the next European legislative cycle be?

1. Rethinking European capital markets

I am not telling you anything new here when I say that European capital markets remain fragmented along national borders. This leads to an inefficient allocation of capital across the EU, hampering the EU's cross-border financing capacities.

Time is running out because Europe's capital markets continue to fall behind. The latest data (New Financial research) shows that the global share of EU27 capital markets has fallen from 19% in 2006 to 10% in 2020 and is expected to fall to 9% in 2022.

EU equity markets are only a quarter of the size of their US counterpart, yet the EU has three times as many exchanges, 18 central counterparties (CCPs), and 22 central securities depositories (CSDs), while the US has only one of each – consolidation of Europe's infrastructure would greatly reduce fragmentation and deepen financial markets.

Next to this step, every EU member state should simultaneously be looking at how to improve its own capital market, i.e. bottom-up like we are doing in Germany with the Zukunftsfinanzierungsgesetz. This needs to happen in parallel to the European capital markets union action plan.

Finally, it will take some time to make progress – time during which we must explore as many opportunities as possible for funding Europe's transformation efforts. Securitisations are a key tool for bridging this time gap. Negotiations on the Capital Requirements Regulation can achieve one important quick win by reducing the so-called (p) factor, which will significantly free up funding space.

2. Strengthening the European banking sector

Strong and resilient European banks are a key factor for European sovereignty. I would even say that European banks should be seen as a strategically important sector within the EU framework.

Without a deep European capital market, banks are the first line of defence when it comes to closing the funding gap.

We should therefore work on simplifying the existing national buffer framework, on reassessing contributions to resolution funds (DGS and SRF) and on improving conditions for securitisations which can help to free up the capital our economy urgently needs.

3. Simplifying the sustainable finance framework

We need strong capital markets and banks to fund the enormous investments required to make Europe future-proof, and particularly for the green transition.

However, to make this happen, we also have to rethink our ESG standards. As they stand now, they divert investment away from the transition as the EU taxonomy currently covers only about 40% of the economic activities of EU companies, and targets activities with the highest emissions.

This so far affects only about 1% of financial market activities in Europe, which are estimated to be aligned with the taxonomy's strict criteria. With this narrow focus, the 2030/50 climate targets will not be met.

Unfortunately, our research shows that the implementation of EU ESG standards may be diverting financial investment away from the transition to a low carbon economy, where equity and debt investment to green companies' carbon intensive operations is so crucial.

This trend favours divestment over investing in the transition so that, in Europe, a large part of Article 8 and 9 funds are significantly underweighted in some of the fundamental economic activities of our existing economy. This not only jeopardises the climate targets, but also threatens to squander the great opportunities the green transition offers Europe's economy.

We need to step up our European efforts and focus on defining sectoral pathways and entity transition plans. This will assist in directing investments and financing of banks to those carbon intensive industries where the transition is so critical and thereby contribute the most to reaching Net Zero.

In doing so we need to act globally. The continuing growth in emissions by the developing Global South presents the main obstacle to achieving the goals of the Paris Agreement. Therefore, these sectoral pathways should also factor in how reduction can be achieved across the board.

4. Digitization: allow use of best-in-class providers, focus on AI and re-asses digital Euro

Finally, to achieve strategic autonomy, technology and digitalisation are of particular importance. Europe needs to stay best in class in digital innovation. I see three developments that impact this:

1. **EU Cloud scheme:** As part of the current work in the EU on a certification scheme for cloud services (EUCS), the EU is risking the exclusion of all non-European cloud service providers from providing services to EU corporates (including banks), but also to the public sector.

European corporates, not just the financial sector, would no longer have access to the highest quality of service or to input that would help them drive their own digital transformation.

It would furthermore also impact the public sector:

- The ECB is working with Amazon on the digital euro project

- The French government is working with Microsoft on building a platform to store health data
- The German Federal Police is storing video footage on the servers of Amazon

These kinds of ringfencing measures run counter to the goal of making Europe stronger, and thus, more autonomous. Strategic autonomy should not be about being more “autocratic” but about stimulating realistic EU alternatives.

2. **AI:** The introduction of Generative AI into general use at all levels in the economy and society is by a wide margin the single most important medium-term development to impact global economics and politics.

It is the most easily applicable General Purpose Technology to emerge since the steam engine, electricity, or smart mobile digital computing. Earlier technological advances replaced unskilled labourers; this development now puts white-collar jobs at risk. But although it will destroy jobs in the short run, it will create new high-quality jobs in the medium term as the applications of AI increase.

There should be a legislative and supervisory framework build around this, one that strikes the right balance between providing sufficient flexibility to innovate, but to prevent AI from being mis-used.

3. **Digital euro:**

The digital euro is another key development where we need to get the design right.

Like many other central banks, the ECB is exploring the use and application of a digital central bank currency. Many options are still on the table with regard to:

- the maximum amount permitted to be held in a digital wallet;
- the scope of payment services the ECB can and should provide;
- and whether banks can build services on top of the ECB digital euro, or not.

The outcome of the discussions can and will have a strong impact on individual banks and the wider banking and payment industry, this needs to be well thought through. We therefore need a very close dialogue and must ensure that all decisions are considered carefully.

That is also why we are looking forward to the proposals of the European Commission, which should provide clear guidance on these points as well.

Conclusion

My wish-list for Europe doesn't end there; I would like to see, for example, broader initiatives on education and immigration as well as a significant reduction in bureaucracy to make it easier to do business here and enable progress and growth. But I don't want to go into that in detail now, because you have a long agenda ahead of you.

Let me just conclude by reiterating that many of the future policies that are essential for achieving a more strategic open and autonomous Europe are relevant for many industries. And that also means that we, and by we I mean all private and public sector participants, have the shared responsibility to do something about this. So let's live up to that responsibility and work together on the common strategy.

If we don't, Europe might be choosing the wrong path at the cross-roads.