Navigating a changing political environment: Climate change, digitalisation and trade tensions - speech by Kalin Anev Janse

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What a summer! While we were hoping for a refreshing summer break, we have been shaken up by market moving events. The situation in Hong Kong, an intensification of US-China trade tensions, an inverted US bond yield curve, and economic contraction in the UK and Germany. Major economies enjoying historically low unemployment levels, but in Europe, deep negative yields as well. It is understandable to ask ourselves whether we are moving towards a turning point in the world economy and whether it is time to let some steam off.

Even if the outlook is pointing towards a downturn, which is the opinion of an increasing number of market participants, it is important to recognise that we are in a different – and better world – than a decade ago. Certainly in Europe.

Let me give you my top three items to watch.

1. **High hopes for Europe's new team**

First of all, this year's European elections saw pro-European parties continuing to dominate, although in a more fragmented Parliament. The success of Liberals and Greens showed that European citizens want more of Europe, not less, but also reminded us that issues like climate change should be on top of the political agenda. Let's also not forget that support for the euro is at 76%, which is an all-time high.

For the first time, two top EU posts will be held by women: the Presidencies of the European Commission (EC) and the European Central Bank (ECB). With the new Commission, new Parliament and changes in institutions like the ECB, we have a new and refreshing leadership in Europe ready to face the challenges of the third decade of the 21st century. The expectations are high and I am sure they will deliver.

The new leaders start with a very strong legacy. Over the last decade Europe has tremendously strengthened its financial architecture. Just to mention a few examples: we moved the supervision of the largest 130 banks to the newly created Single Supervisory Mechanism, we created a Single Resolution Mechanism and Fund for failing banks and we created the crisis resolution mechanisms ESM and EFSF with a total lending capacity of the €700 billion. Furthermore, macro-economic imbalances of Eurozone countries are much smaller than 10 years ago. So we are far better prepared for future crises.

This brings me to my second point: what the new leaders should focus on.

2. **Geopolitics, markets and a stronger Europe in the world**

The world around us is rapidly changing. We live in a challenging geopolitical climate. There are growing concerns about the impact of international trade tensions and challenges to multilateralism. We in Europe should step up our game. These rough waters call for bold actions to maintain and strengthen Europe's global role.

There are a handful of areas we have to focus on in the coming half decade to deal with the future challenges: from geopolitical threats to a possible economic slowdown.

First of all, in the security space, we should start thinking about **European defence**: from EU cyber defence to defending and building critical European infrastructures – including market infrastructure. With Ursula von der Leyen – former defence minister in Germany and the new European Commission President - we might have the right person in place to lead Europe in that direction. We have to protect the core interests of 440 million EU citizens.

In addition, we should strengthen the role of Europe in the world's capital markets. It starts with making the **Capital Markets Union** (CMU) a top priority for the next Commission. It should harmonise, integrate and deepen European capital markets in order to be globally competitive.

Completing CMU will ensure deeper and more liquid financial markets for investors willing to put their money in European assets. A closer integration of Europe's fragmented capital markets would make financing of European companies easier and less costly: from venture capital to private equity and then deep debt and equity capital markets. Last but not least, reducing the share of bank financing would improve macro stability by limiting the impact of bank failures.

Furthermore, we need to complete the **Eurozone reform**. Here we have made a lot of progress. In June, there was an agreement to **strengthen and upgrade the**

ESM. The most prominent features of the ESM's new mandates are providing the backstop in bank resolutions carried out by the Single Resolution Fund (SRF) and having an enhanced role in preparing new financial assistance programmes. In collaboration with the European Commission, the ESM will design, negotiate and monitor future assistance programmes. In the coming half decade, we should also focus on a Eurozone budget and a European Deposit Insurance Scheme to complete the Eurozone reforms.

Finally, we need to strengthen the **international role of the euro** and increase Europe's independence from other economic powers. In the face of trade tensions, Europe needs a globally stronger euro**.** This would provide market participants with additional choice for payments, investment and funding. It would make the international economy less vulnerable to shocks due to the dominance of one currency in many sectors. A concrete step to strengthening the euro and mitigating dependence risks is the initiative for a **European Debt Distribution Instrument – EDDI**. This initiative put forward by the ECB and strongly supported by the ESM aims at providing a neutral, pan-European and harmonised channel for the issuance and initial distribution of debt securities. It is important to have a strong and independent European market infrastructure, which is of course connected to global markets.

Also a **European Safe Asset** will help. The creation of such a safe asset would increase the size of the high quality bond market that is crucial for investors such as banks, insurance companies and pension funds. Of course, we have safe assets in the form of German bunds, as well as bonds from the Netherlands, Finland, the EIB, ESM/EFSF and some others. But their overall size has declined due to the improvements in national budgets. By comparison, the US has much higher volumes of treasury bonds. Safe asset debt securities issued by the federal government amount to nearly 80% of GDP in the US, compared to just above 30% of GDP (AA-rated) issued by national governments in the Eurozone. Size is important to be a global safe asset. It will also bolster the geopolitical strength of Europe globally.

If the new European leadership manages to implement these ideas in the coming half decade, Europe will have a much stronger geopolitical role.

3. **Climate change and navigating to a sustainable economy**

This brings me to my final point. A sustainable economy. Like the rest of the world, Europe needs to tackle the challenges that stem from climate change and the transition towards a green and social economy. We have just experienced the hottest July in recorded history. There is an issue out there. And even if you are a climate change sceptic, focussing on environmentally friendly solutions will not hurt.

A lot of work is ongoing in the context of sustainable investments and funding. We are following the progress on the EU Action Plan on sustainable finance and related standard setting efforts with great interest. Also active in this area are the working groups at the International Capital Markets Association and the United Nations-backed Principles for Responsible Investments. We support the objectives of these initiatives, which will lead to greater market transparency and the growth of the Environment, Social and Governance (ESG) sector.

Clear classifications and standards for green bonds, currently being developed by the European Commission, will attract investors. But we should avoid narrowing the criteria down to climate and direct use of resources. As important as these subjects certainly are, there is more to it.

Institutions like the ESM bring social stability to the European economies. When the ESM issues a bond, it is to provide financial assistance loans for economic and social stability in euro area countries.

The ESM disburses loans only if beneficiary countries implement extensive reforms. This helps these countries to return to long-term financial stability and prosperity:

- The EFSF/ESM have disbursed €295 billion to Ireland, Greece, Spain, Cyprus, and Portugal – which has positively impacted the lives of 73 million European citizens.
- The Greek budget saved €13 billion in 2018, representing 7% of the Greek GDP, thanks to our loans with very long maturities and very low interest rates. Greece has made similarly-sized savings in the past years and will continue to enjoy these savings for many more years.

This makes the ESM bond an ESG of its own kind. We need to better explain to investors that all our bonds contribute to social stability. It is good that investors look more and more at the issuer of bonds and their contribution to ESG instead looking at one specific transaction. This will give stronger support to all ESG activities and finally also help to satisfy investor appetite by broadening the product landscape.

The ESM also promotes ESG in its own investments (more than €80 billion):

- Entities, such as governments, public agencies, and supranationals with a significant social and environmental contribution represented more than 69% of the ESM's invested paid-in capital in 2018.
- Out of these investments, €475 million had a further targeted purpose such as the financing of social housing or environmental projects, i.e. bonds labelled green and social.

There are a number of signs indicating the priorities of EU citizens: the electoral victory of parties with a strong environmental agenda, climate activist Greta Thunberg's movement, and surveys showing that Europeans rank climate change as the second most important issue facing the EU at the moment. As we have seen, if we don't take this issue seriously, our kids will continue the "Fridays for Future" protests, asking us to take care of their planet.

In my opening remarks, I laid out the significant challenges ahead of us. But over the last decade, we have proven in Europe that we can fight off large crises together. With a new team for Europe, strong dedication and an ambitious agenda for the future, we can do even more.

I am optimistic that together we can achieve much of what has been outlined over the next five years.

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