

European banking union

EU recovery fund deal revives hopes for eurozone banking union

Central bankers welcome joint debt issuance agreement as a potential breakthrough



Some central bankers say the EU's €750bn recovery fund will be a vital step towards the creation of a common deposit insurance scheme © REUTERS

Martin Arnold in Frankfurt JULY 24 2020

The EU's new €750bn recovery fund will revitalise long-stalled efforts to complete the eurozone's banking union, according to central bankers who predict it will be a vital step towards the creation of a common deposit insurance scheme.

Olli Rehn, head of the Finnish central bank, told the Financial Times that the EU plan to become one of the region's largest bond issuers to fund its [coronavirus recovery package](#) "may create conditions for a genuine European safe asset".

"This is potentially one of the most significant effects of this European recovery fund," said Mr Rehn, a former EU commissioner for economic and monetary affairs. "Some cynics would say that is a long stretch — but analytically it can help pave the way for a eurozone deposit insurance scheme and a fiscal backstop."

The vast increase in [debt issuance](#) planned by Brussels is "good for banking union", Yannis Stournaras, head of the Greek central bank, told the FT.

"Now EU leaders have reached agreement on the creation of a eurobond . . . the banking union is a sequel," he said.

Providing the eurozone with a large commonly guaranteed pool of debt to rival German Bunds could break the deadlock on banking union, according to both Mr Rehn and Mr Stournaras, who are members of the European Central Bank's governing council.

Mr Stournaras said that “after the coronavirus the quality of banking assets will weaken — both in the north and the south — so there is a need to make progress on banking union”.

However other experts warned that progress towards a common eurozone deposit insurance scheme was not inevitable. “The latest deal doesn’t move it one way or the other because of the underlying politics — as always,” said another ECB council member.

The ECB and other European authorities have long called for the creation of an EU scheme to protect savers, which they say would foster confidence and help to reduce the fragmentation of the zone’s banking market.

Olaf Scholz, Germany’s finance minister, [proposed a way](#) to end the stalemate over banking union late last year by agreeing to drop Germany’s resistance to creating a common deposit insurance scheme in return for reforms to reduce risks in the banking sector.

But the idea fizzled out after some countries, notably Italy, objected to Mr Scholz’s call to break the “doom loop” that ties banks to the fates of their domestic governments by reducing the incentives for them to own high levels of their home country’s sovereign debt.

Italian officials said they would only accept such reforms if there was a eurozone safe asset that could provide an alternative way for banks to invest their reserves securely.

Now that the [EU plans](#) to sell €750bn of its own highly rated bonds — becoming the region’s fourth-largest debt issuer — it could provide the kind of sizeable eurozone safe asset that enables policymakers to break the deadlock on banking union.

The Italian central bank said it was “too early” to determine if the new EU recovery fund would unlock progress on banking union. But Ignazio Visco, governor of the Banca d’Italia, told the FT: “It is difficult to overestimate the economic and political importance of this agreement.”

“From an economic viewpoint, for the first time in its history the EU is endowed with a substantial common borrowing capacity to be used to counter an adverse macroeconomic shocks and to attain commonly agreed objectives,” said Mr Visco.

He added that EU leaders had provided “a strong signal” of their “determination to strengthen the European project”.

[Copyright](#) The Financial Times Limited 2020. All rights reserved.