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Ignazio Visco

Beyond the Horizon of the Italian Presidency: A Central Banker's Perspective

The views expressed are those of the author and do not necessarily reflect those of Narodowy Bank Polski.

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About the *NBP Biannual EU Presidency Lecture*

The initiative of the NBP Biannual EU Presidency Lecture cycle has been established to provide an opportunity to present the views of the central bank governor of the EU Member State currently holding the Presidency of the Council of the European Union on the Presidency priorities and key economic issues. The lectures are addressed to the participants from Polish financial and economic sector, among others representatives of the diplomatic representations, public administration, private sector, academia, independent research institutions.

The fourth lecture entitled Beyond the Horizon of the Italian Presidency: A Central Banker's Perspective, was presented in Warsaw by Mr Ignazio Visco, the Governor of the Bank of Italy, on July 11, 2014, during the Italian Presidency.

Ignazio Visco

Governor of the Bank of Italy

Ignazio Visco was appointed Governor of the Bank of Italy in November 2011, after a long career with the Bank that began in 1972. He is also a member of the Governing Council and General Council of the European Central Bank and the Board of Directors of the Bank for International Settlements. From 1997 to 2002 he was Chief Economist and Head of the Economics Department of the OECD. Mr Visco graduated from the University of Rome and obtained a Ph.D. in Economics from the University of Pennsylvania. The author of numerous articles and books on economics and finance, he also taught Econometrics and Economic Policy at "La Sapienza" University of Rome.

Ignazio Visco

Governor of the Bank of Italy

Warsaw, July 11th, 2014

Ladies and Gentlemen,

I first wish to thank President Marek Belka for his kind invitation and you all for being here tonight. This is a series of lectures and I'm very glad to continue it.

Let me start by talking about the priorities of the Italian Presidency of the EU Council. We must recognize that we are in a transition phase following the recent European Union elections, and this implies that the Presidency will be operating at full speed only towards the end of this semester, when the new Commission will take office. The role of the Italian Presidency is thus somewhat different. It is not just about completing a number of projects, which are in the portfolio of the Union; it is also about trying to push forward a number of more general ideas on how these coming years should be exploited to strengthen the Union.

The outline of my presentation is as follows. After briefly illustrating the agenda of the Italian Presidency, I will provide a few background thoughts on key developments in the last few years, defined by the sovereign debt crisis in the euro area. Since returning to strong, sustainable and balanced growth in Europe is essential, I will touch upon what I see as the key preconditions for growth, namely investment and financial stability. I will then focus on the latter by elaborating on its relationships with monetary policy and the Banking Union. In my concluding remarks, I will sketch out some issues that I hope will receive attention beyond the Italian Presidency.

I. Priorities of the Italian Presidency

The Italian Presidency believes that, in order to regain the full trust of European citizens in the EU project and institutions, a new European policy agenda should be based on structural reforms that foster the recovery of growth and create jobs.

Reforms and the ensuing innovation are major drivers of growth; their impact is magnified if the reform process is wide-ranging at national level and even more so

if it is accompanied by analogous efforts in other countries. The reform agenda put forward by the Italian Presidency envisages a common policy effort and benefits from joint action, as mutually beneficial spillovers are best triggered by contemporaneous reforms in EU members.

The agenda is based on three pillars. The first is the review of the EU2020 strategy for growth and employment, which is seen as the opportunity to refocus policy objectives and instruments on the key drivers of growth as well as on the investment and structural reforms that are most effective to this purpose. These reforms affect such areas as public administration, labour market, institutions at large and the Single Market with a view to advancing integration.

The second pillar relates to an array of initiatives aimed at increasing finance for growth: here the objective is to reverse the large crisis-driven fall in private and public investment, ultimately raising potential growth at EU level. These initiatives include a more "friendly" regulatory framework for long-term investment; the development of new financial instruments and markets to support private investment, also leveraging EU funds through the European Investment Bank (EIB), national promotional banks and institutional investors; ways to mobilize resources to increase public investment.

The third pillar focuses on providing incentives for reforms. It rests on the premises that the revised EU framework of economic governance provides enough flexibility so as to take into account pronounced cyclical downturns; the framework should also provide the right incentives to increase the growth potential, notably by implementing structural reforms and encouraging productive investment. The European Council of June 26-27 recognized the need to make the best use of the flexibility that is built into the existing rules of the Stability and Growth Pact. It is critical that these rules do not end up acting as impediments to reforms but rather as facilitators.

The overall view is that supportive financial conditions will help boost investment, thus complementing and reinforcing the impact of structural reforms. In turn, stronger investment will consolidate the recovery, placing the European Union on a more robust growth path.

The Presidency will continue working towards strengthening the regulation of financial markets, with a view to facilitating credit flows to the real economy and maintaining confidence in the sound and efficient functioning of financial markets and intermediaries.

Several financial services files are pending. Most of them are also being followed by the Bank of Italy, as the national competent authority or for our expertise in these

fields. Some dossiers were brought to an advanced stage by the Greek Presidency. Others, for which proposals were published in late 2013 or early 2014, are still at an initial point.

Key financial services dossiers are those related to: the funding of firms; the efficiency of the payment systems and services; the shadow banking system; the banking structural reform Regulation published by the Commission last January, following up on the Liikanen Report.

On the funding of firms, the Italian Presidency could contribute to modernizing the framework for long-term investors, as also suggested in the Commission's Green Paper on Long-term Financing of the European Economy. The Greek Presidency was able to reach an agreement on a general approach within the Council on the European Long-Term Investment Funds (ELTIFs), a new category of private funds for investors who want to invest money into companies and projects for the long term. The Italian Presidency will lead the negotiations within the trilogue with the Commission and the Parliament with view to a final agreement by year-end.

In Europe, banks are the main institutions that finance both firms' working capital and investment but we know well how fundamental is to have complementary sources of financing, the most important among them being equity capital for the small- and medium-sized enterprises. In certain European countries, SMEs' financial structures show low equity and high debt, and this bias has to be rebalanced.

On the efficiency of payment systems, the Greek Presidency made some progress on proposals for the Payment Service Directive II (PSDII), without, however, reaching a final compromise text, while negotiations for the Regulation on interchange fees for card–based payment transactions (IFR) did not start. The Italian Presidency considers these dossiers extremely important for enhancing competition and innovation in the internal retail payments market, in line with the strategy outlined in the Digital Agenda for Europe. It will, therefore, try to finalize the PSDII in the Council and time permitting, will begin negotiations within the trilogue. On the IFR, the Italian Presidency has started negotiations in the Council so as to advance the dossier and, if possible, to reach an agreement.

With regard to the shadow banking system, the Regulation on securities financing transactions (SFTs) proposal aims at increasing the transparency of such transactions and at providing relevant information on the shadow banking sector. The Italian Presidency will aim to negotiate some material issues (e.g., scope, frequency of the reporting, granularity of the information) and to reach an agreement on a general approach. The Presidency will also try to advance negotiations as much as possible

on proposals for Regulation on benchmarks for financial instruments and contracts and Regulation on money market funds.

Finally, work is at the very beginning for the Regulation on the banking structural reforms, following the Commission's proposal of last January. Due to its importance for the future shape of the EU banking system, and considering the initial positions of member states, it can be expected that negotiations will be rather complex. The Italian Presidency could reasonably aim to negotiate some key issues (e.g. scope, interaction with other regulatory issues, metrics, home-host questions) before handing over the file to the next Presidency.

II. The sovereign debt crisis in the euro area

Following the global financial crisis of 2007-09, over 2010-11 Greece, Ireland and Portugal needed to undertake macroeconomic adjustment programs jointly financed by the European Union and the International Monetary Fund. In the second half of 2011 the euro area sovereign debt crisis became systemic, affecting countries such as Italy and Spain in the aftermath of the European authorities' decision to involve private-sector investors in the restructuring of Greece's public debt.

The large increases in yield spreads of euro area government bonds reflected two components: a national one, linked to the weaknesses of some countries' economies and public finances ("sustainability risk"), and a European one, related to the incompleteness of the European construction and the attendant fears of a break-up of the monetary union ("redenomination risk").

The relevant pre-crisis progresses towards integration of the euro area financial system, most evident in the case of wholesale markets such as the interbank market, were reverted and gave way to the fragmentation of financial markets along national lines. Fragmentation impaired the uniform transmission of the single monetary policy across member states, ultimately posing risks to price stability for the area as a whole; it called for a comprehensive response by the ECB, including via unconventional measures.

Resolute action by the ECB, including the announcement of the Outright Monetary Transaction in the summer of 2012, provided a bridge to support major reforms of the European governance (including instruments to manage a sovereign crisis and the establishment of the Banking Union) as well as to facilitate progress by member states in consolidating public finances and advancing structural reforms. While reforms needed time not only to be implemented, but also to be fully

recognized by markets, ultimately this multifaceted response to the crisis has laid the groundwork for stabilization and recovery of the euro area.

In fact, financial conditions have improved greatly in the euro area since mid-2012. First Ireland and then Greece and Portugal have once again been able to place government securities on international markets. Yields on Italy's ten-year BTPs have fallen to below 3.0 per cent, less than half the peak figure recorded in November 2011. The yield spread with German securities is now close to 150 basis points; it had hit 550 points in November 2011 and was still above 450 points in July 2012.

A recovery has been ongoing since as early as end-2013 although at a moderate and uneven pace: in the first three months of this year euro area real GDP rose by 0.2 percent on a quarterly basis, weaker than expected; recent surveys signal very moderate growth also in the second quarter, as balance-sheet adjustments in the public and private sectors likely continue to weigh on the pace of the recovery.

In June, the Eurosystem revised its projections down for both annual real GDP growth (from 1.2 to 1 percent) and HIPC inflation (from 1 to 0.7 percent) in 2014.

Financial fragmentation has been strongly reversed but not eliminated. Market-based bank funding conditions have greatly improved, underpinned by continued bank balance sheet repair and decline in sovereign debt yields. Improvements relate to both the availability and the cost of market funding: banks' debt issuance activity is more broad-based; average spreads on bank debt have tightened across instruments. The overall repayment rate of LTRO funds increased from about 40 percent at end-November 2013 to over 50 percent at mid-May 2014.

Within the package of measures decided upon by the ECB Governing Council on June 5, two 4-year Targeted Long Term Refinancing Operations, to the tune of €400 billion, will support lending to the private sector, to be followed by six more operations through mid-2016; intensified work related to outright purchases in the ABS markets is explicitly aimed at further enhancing the functioning of the monetary policy transmission mechanism.

All in all, despite improvements, the legacies of the crisis are still all too evident: moderate growth, unacceptably high unemployment, high private and public debt levels and inflation well below the 2 percent value consistent with the ECB's definition of price stability.

Moreover, concerns about euro area banks' asset quality still linger and credit conditions remain impaired. The annual rate of change in MFI loans to non-financial corporations has been negative since early 2012, largely reflecting the deleveraging

needs of both the financial and the non-financial sectors. Recent months saw a stabilisation of the pace of contraction but no clear signs of a turning point have been detected yet.

III. Preconditions for growth

On the basis of ample empirical evidence, it has by now been established that financial crises are followed by slower recoveries where employment takes a longer time to return to pre-crisis levels. A clear example comes from the US when we compare the pace of labour market recovery across the most recent recessions: following the global crisis, it took six years for employment to return to the pre-crisis peak of January 2008, whereas the recovery was faster in the aftermath of previous recessions. In the euro area, employment is still below the pre-crisis peak.

These dynamics are also shaped by major underlying forces such as globalization, the ICT revolution and digitalization, and demographics; they all combine to exert dramatic consequences on labour markets, workers' skills, job opportunities, and income distribution. On the policy front, a key lesson to be learned from the crisis is that monetary stability is a necessary but not sufficient condition for stable and sustained growth; the latter also requires financial stability, along with sustainable public finances and structural reforms that support investment.

Ensuring adequate credit flows to the real economy is paramount to reinforcing growth. To this end, in the euro area, given its stronger dependency on bank financing, completing bank balance sheet repair is the priority to overcome impaired credit conditions, financial fragmentation and consolidate financial stability.

In order to ultimately severe the adverse sovereign-bank links, progress is needed towards strengthening the institutional architecture of the European Union so as to eliminate the component of sovereign spreads that reflects the redenomination risk. The Banking Union is instrumental to achieving the above goals through its three components: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and a harmonized system of deposit insurance. Complementary actions towards sustained financial stability should aim at broadening the sources of financing through capital markets; reviving a market for "high quality" securitization needs to be part of this effort.

Boosting public and private investment is also critical at this juncture. Both have collapsed since the beginning of the global crisis, in the euro area by 20 percent in real terms over 2007-13. In Italy the investment collapse was even larger than

the euro area average, by over 25 and 30 percent, respectively, for private and public investment.

A number of causes have played a relevant role in holding back a recovery of investment, offsetting the stimulus expected from accommodative monetary policy: unsatisfactory output dynamics; widespread uncertainty about prospective demand growth; deleveraging by over-idebted firms. Difficult access to credit, because of balance sheet repair in the banking sector, and higher cost of capital in stressed countries, owing to financial fragmentation, also bear major responsibilities for the postponements and cutbacks in investment by firms.

As far as public investment is concerned, there is broad agreement that investment, being the most productive component of public expenditure, is a necessary complement for fiscal consolidation to be growth-friendly. This notwithstanding, actual fiscal consolidation has often implied massive cuts in public investment (as measured by government gross fixed capital formation).

There is now ample consensus that inverting these trends is needed in order to support the recovery and avoid undermining future potential growth. Investment is the linkage between today's demand and tomorrow's supply. Given appropriate external conditions, investment is the demand component that reacts most promptly to changes in expectations, while it bolsters supply capacity by exploiting technical progress and responding to the globalization of markets and production processes.

The investment debate revolves mostly around what modalities should be pursued so as to reinvigorate capital expenditure, taking advantage of the current favorable financing conditions. More precisely, we can frame this debate around two main dimensions.

First, discussions relate to whether and how to support more public investment at a national level while abiding by the existing European fiscal rules - notably the preventive arm of the Stability and Growth Pact - which have been strengthened as a response to the crisis.

European institutions acknowledge the need for balancing, within the existing fiscal framework, the productive investment needs with fiscal discipline objectives. Following requests from the European Council, in July 2013 a letter from commissioner Olli Rehn announced an "investment clause" by which the European Commission could allow temporary deviations from the structural deficit path towards the country-specific MediumTerm Objective (or from the MTO for member states that have reached it) if:

- the economic growth of the member state remains negative or well below its potential;
- the deviation does not lead to a breach of the 3 percent of GDP deficit ceiling and the public debt rule is respected;
- the deviation is linked to the national expenditure on projects co-funded by the EU with positive, direct and verifiable long-term budgetary effect.

Second, acknowledging the constraints to national public investment, various proposals call for coordinated European initiatives, which include the use of public investment as either a cyclical stabilization tool or a lever to mobilize private investment and revert its dramatic fall.

For example, the European think tank Bruegel suggests establishing a European investment programme carried out by the EIB (to be further recapitalized beyond the €10 billion agreed in 2012). The German Institute for Economic Research (DIW Berlin) proposes the creation of a temporary €100 billion fund, within the framework of the EIB, to promote investment for small and medium-sized enterprises. The newly proposed fund should be allowed to issue its own bonds, which would be backed by guarantees from the EU member states in order to obtain favorable funding terms to be passed on to private companies.

The EIB Europe 2020 Project Bond Initiative, jointly devised with the European Commission, aims at stimulating capital market financing for large-scale infrastructure projects in such sectors as transport, energy and ICT. For its part, the IMF too favors higher infrastructure investment in euro area creditor countries, to be complemented by structural reforms that improve competitiveness in debtor countries. Other proposals, which I share, call for boosting private investment by developing capital market sources of finance and non-bank financial intermediaries, with a view to providing alternatives to bank lending and helping European firms rebalance their financial structures towards more equity and lower debt.

IV. Financial stability and the Banking Union

The Banking Union provides important contributions for maintaining financial stability, a precondition for stable and sustained growth. To begin with, it helps break the perverse bank-sovereign loop by strengthening the euro area's institutional architecture, thus thwarting the redenomination risks that unfoundedly raised sovereign spreads during the crisis. Moreover, the SSM reinforces crisis prevention as more effective and uniform supervisory practices, a single rulebook and macroprudential instruments and powers entrusted to the ECB can better identify and counter emerging risks at an early stage.

The SRM and the Bank Recovery and Resolution Directive's rules and tools, notably bail-ins, make banks' recovery and resolution credible alternatives to publicly-funded bailouts, while also promoting market discipline. Finally, the ESM instrument of direct recapitalization of banks can also contribute to breaking the adverse bank-sovereign links, even if its activation might be hindered by the procedures recently agreed-upon by the Eurogroup.

The new European supervisory system relies on some basic but effective principles: emphasis on close integration of on- and off-site controls, quantitative and qualitative assessment of risks, and close linkage between the results of analyses and remedial action.

The ECB's comprehensive assessment of the most important euro area banks aims to enhance the transparency and reliability of bank balance sheets, strengthen capital and liquidity ratios and increase the market's confidence in the soundness of the European banking system, thereby contributing to the recovery of lending to the economy. It is telling that since mid-2013, when discussions about the comprehensive assessment intensified, significant banking groups in the euro area have bolstered their balance sheets by about €100 billion through equity issuance and other measures.

The key aspects of the comprehensive assessment are an asset quality review and a stress test of bank balance sheets. The exercise under way is of unprecedented complexity, both in terms of the volume of activities to be carried out and of their concentration in a short period of time. It considers a wide range of bank assets, ranging from loans to households and firms to government securities and complex financial instruments, so-called level-3 assets.

The credibility of the exercise and its success in restoring confidence in the soundness of the European banking system require that instruments of public intervention be available to act as financial backstops, as established by the European Council in June 2013 and reaffirmed by the Ecofin Council in November. They will have to conform to the basic principles of national and European law, with the ultimate objective of ensuring financial stability.

The SRM will come into operation in 2015. The handling of banking crises will involve numerous national and European institutions participating in the context of a Single

Resolution Board. Provision is made for recourse to a fund made up of contributions paid in by the banks themselves. Even though the decision-making process appears complex and the pooled resources limited, the compromise reached is a further step towards the completion of the Banking Union.

V. Financial stability and monetary policy

The crisis has prompted a rethinking of the central banks' proper attitude in the face of risks to financial stability coming from excessive credit growth and asset price booms. Monetary policy is increasingly being called upon to be conducted in a more pre-emptive, or "macroprudential", way and a "leaning-against-the-wind" use of the policy rate no longer captures only a minority of views.

In my opinion, this development owes less to stronger theoretical arguments than to the greater importance now assigned to crisis prevention in the light of the very painful economic and social costs of the financial crisis. In fact, the practical obstacles to a pre-emptive use of the policy rate are no less relevant now than before the crisis: the difficulty of timely and reliable detection of asset price bubbles and the lags in the transmission of monetary policy impulses. But perhaps the crucial objection was that the policy rate is too blunt a tool.

Notwithstanding a broader endorsement of a more pre-emptive approach, controversies remain over whether the policy rate should be used to lean against the wind, i.e. to directly address risks to financial stability or, rather, whether the risks are more appropriately tackled by microprudential and, above all, macroprudential policies, conducted either by the central bank itself or by a separate authority.

While the merits of a more active use of the policy rate are still being debated, one important legacy of the crisis is the broad consensus that macroprudential policy should complement monetary policy, ideally by acting as a first line of defense, in countering financial imbalances that pose systemic risks.

Macroprudential policy, in this view, would serve to address both the cross-sectional dimension of systemic risk, strengthening the resilience of the financial system to adverse real and financial shocks, and its temporal dimension, containing the accumulation of risk over the business or financial cycle (although we should be aware of the policy's possible limits in this regard).

Insofar as countercyclical macroprudential policy is effective in moderating the financial cycle, it can support monetary policy in stabilizing the economy.

Furthermore, by adding a systemic perspective, macroprudential policy can address the "fallacy of composition" emphasized by Andrew Crockett as early as 2000 and complement microprudential policies that preserve the stability of individual intermediaries.

The development of a macroprudential framework is still at an early stage and several aspects of these policies, most notably their operationalization, require further analysis. One major issue that I want to highlight is the potential for conflicts – what economists usually call "trade-offs" – between monetary, macro- and micro-prudential policies:

- Although as a rule monetary policy and macroprudential policy are best thought of as complementary rather than substitutes for each other, in recessions the latter can be subject to a lower bound similar to that faced by the former. For example, if "good times" are not successfully exploited to buildup macroprudential capital and liquidity buffers, these will not be available for countercyclical release in downturns. In this case, monetary policy would be left to shoulder most of the burden.
- In recessions, the macroprudential policymaker may want to release banks' capital buffers while the microprudential authority may prefer to strengthen them.
- From a governance viewpoint, the key question is whether there is a case for allocating monetary, macro- and micro-prudential policies all within central banks.

The ECB provides a concrete case of an institutional setting aimed at addressing interactions and tradeoffs between these policies by ensuring the required euro area-wide coordination in their application, so as to adequately address potential spillover effects.

The Regulation establishing the SSM assigns to the ECB not only microprudential tasks but also specific roles for macroprudential policy, notably the implementation of macroprudential measures set out in EU legislation (CRD IV/CRR), along with national authorities.

The SSM poses issues for the design of the framework for macroprudential decision-making. How should the macro- and micro-prudential functions be organized at the ECB so as to exploit complementarities and minimize potential conflicts?

The agreed upon decision-making framework for macroprudential policy within the SSM takes a pragmatic approach to these issues, striking a balance between

different considerations. It takes into account both the synergies that exist between macroprudential policy and monetary policy and also the strict interrelation of macroprudential policy with microprudential policy, not least in view of the legislative basis provided by the SSM Regulation. The conflicts of interest that may arise between the two policies can be quite significant and should be recognized.

VI. Concluding remarks

Exit from the crisis in the euro area cannot be achieved by the isolated actions of individual economic policy authorities. In particular, monetary policy alone cannot guarantee growth and financial stability in the area if the problems underlying the sovereign debt crisis are not resolved at both national and European level by further reforms of the European governance as well as by fiscal and structural policies that set the stage for resuming strong and stable growth.

Looking beyond the current issue of securing a robust and self-sustained recovery, one of the critical consequences of the crisis has been the much greater prominence of crisis prevention, which pertains not only to central banks but to the entire spectrum of macrofinancial policies. This emphasis requires reliance on the broadest possible set of policies and tools, together with careful consideration of the interactions, complementarities and potential conflicts among them, with the ultimate goal of building a more resilient financial system.

Crisis prevention should begin well in advance by closely monitoring leverage and credit aggregates, which more often than not are the immediate cause of soaring asset prices. Macroprudential policy can be most helpful in this regard; but microprudential policies too must be retained as instruments of choice for preventing risks. In fact, the relaxation of lending standards is normally a major contributor to rapid credit growth.

And it is certainly not a coincidence that a strong microprudential regulatory framework, accompanied by effective supervision – sufficiently intrusive and capable of "saying no" – is a distinguishing feature of the financial systems, including those of some large euro-area countries, that did not display such vulnerabilities as exposure to unsustainable booms in the real estate sector and large investment in toxic structured finance products, which proved to be the main causes of many bank failures and the subsequent large government bailouts.

As far as monetary policy is concerned, I believe that central banks should lean against the formation of financial imbalances and should not be timid in reacting against the early signs of systemic financial instability. The pre-emptive use of the policy rate at some point cannot be ruled out a priori. However, framing the discussion exclusively on whether the policy rate should be used to counteract an asset price or credit boom may be too narrow an approach.

The Banking Union is a major step forward towards preventing systemic financial crises. Preparations for the SSM, composed of the ECB and the national competent authorities, are proceeding apace. This complex feat of institutional engineering builds on the accumulated technical expertise of the national authorities so as to create a supranational vision based on best practices in supervisory methods, analytical models and banking risk assessments. A comprehensive assessment of the euro area's leading banks is currently being carried out in preparation for the launch of the SSM.

The favourable financial conditions that monetary policy and the Banking Union are ushering in must not be missed. The return to sustained and balanced growth requires broader economic policy action centered on investment – private and public, national and European – which is the linkage between supply and demand.

Concerted measures must be taken immediately to accelerate the building up of infrastructure, both tangible and intangible, indispensable to the formation of a true single market. A European strategy based on a common effort whereby measures are adopted simultaneously in each country is superior as it can maximize positive spillovers.

Looking beyond the Italian Presidency, in the near term it is essential to complete the Single Market as it provides a powerful tool to promote growth. In the medium term, Europe should progress with the improvement of the governance and the deepening of its integration, particularly of the Economic and Monetary Union.

While significant progress has been made in the field of financial stability and the Banking Union, decisive advances are needed with regard to the euro area capacity to absorb external shocks. The Italian Presidency will continue work towards strengthening EMU in accordance with the roadmap outlined in the four Presidents' report endorsed by the EU leaders in December 2012.

Beyond the Banking Union, the first pillar of the roadmap, we need to enhance the discussion on the other pillars, i.e. the fiscal union, the integrated economic policy framework and democratic legitimacy of the European institutions. Indeed, some progress has been made on the economic governance for the coordination of fiscal policies (notably the so-called six-pack and two-pack), which will be

reviewed by the Commission by end-2014. Starting to progress gradually towards the creation of a central fiscal capacity as an initial step towards a future fiscal union is of the essence. An independent fiscal capacity could be a first step to improving the resilience of the EU and the euro area, also allowing the creation of instruments for the absorption of external asymmetric shocks.

The road to European integration is a long and arduous one. In advancing resolutely along this road the diffidence found today between governments and between national communities must disappear. We have to look responsibly to the longer-term prospects, while also taking account of the sustainability of the sacrifices and the distribution of the benefits. It is important to continue resolutely along the path to a fuller Union. The benefits of strengthening European integration far outweigh the alleged advantages of weakening it. Choices must be made responsibly. We cannot fear only the risks of action and disregard those of inertia.

Let me conclude my remarks by quoting a few words from a speech by chancellor Helmut Kohl to the Bundestag in November 1991, a few months before the signing of the Maastricht treaty:

"Political union is the indispensable counterpart to economic and monetary union. Recent history [...] teaches us it is fallacious to think one can sustain economic and monetary union permanently without political union."

Thank you very much.

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