HOW CAN WE FINANCE THE EXTRA INVESTMENT NEEDED IN THE EUROPEAN UNION?

The investment required to meet the challenges of competitiveness and energy and technology transition in the European Union is huge, and the need for it is imminent (2025-2030). To this must now be added expenditure to strengthen the European Union's military capabilities. To finance this, the EU must of course speed up its roadmap towards a Savings and Investment Union. But given the urgency, it must also take account of its financial ecosystem and rely on its banks. The postponement of the FRTB (Fundamental Review of Trading Book) until 2027 and the European Commission's legislative proposal on securitisation, expected in June, are steps in this direction.

WHAT AMOUNTS ARE WE TALKING ABOUT?

Based on calculations made by the European Commission, Mario Draghi estimated in his September 2024 report to the President of the European Commission that the EU's financing needs for competitiveness and the energy and technology transition would be in the region of EUR 750 to 800 billion per year. According to our calculations, the ReArm/Readiness 2030 plan, approved by the European Council on 6 March, will add nearly EUR 190 bn per year[1]. Combined with the financing needs of the European economy that must continue to be covered (for which historical financing flows provide an order of magnitude), these additional needs will increase the overall annual financing needs of the EU economy to more than EUR 1.5 trillion until 2028, and then to almost EUR 1.4 trillion until 2030, i.e., more than double the flows observed between 2014 and 2024. Admittedly, some of these investments will replace other, pre-existing investments, but this proportion, which is contained overall, does not call into question the overall diagnosis of a colossal need for financing in the European Union.

GREATER INTEGRATION OF CAPITAL MARKETS: A NECESSARY BUT NOT SUFFICIENT CONDITION

The « Savings and Investment Union » is the focus of most hopes. The idea was initially launched by the European Commission in 2014 under the name of « Capital Markets Union ». Since then, several action plans and legislative and non-legislative acts have followed, but its realisation is still a long way off. The main obstacles to greater integration of capital markets include the heterogeneity of laws governing companies in difficulty and national supervision of financial markets. On 19 March 2025, the Commission published a communication aimed at relaunching the project, followed on 15 April 2025 by a targeted consultation, open until 10 June. Mario Draghi himself readily admits that however essential it may be, greater integration of the capital markets will not on its own make it possible to release the necessary sums. Moreover, the road to Savings and Investment Union is still a long one and, once its institutional existence has been established, its success will depend on investors' appetite for long-term, risky European assets. The European economy is characterised by abundant savings flows (around EUR 1.4 trillion), but above all by a strong preference among savers for liquid, low-risk assets. These preferences, dictated by historical and cultural factors, are deeply rooted and unfortunately cannot be changed by magic. In the medium term, they are part of the statement, as is the preponderance of banking intermediation in the financing of the economy, which echoes them.

THE IMPORTANCE OF BANKING INTERMEDIATION AS A SOLUTION THAT CAN BE MOBILISED IN THE SHORT TERM

Banking intermediation and capital markets should not be in opposition to each other, but rather mutually reinforcing. For example, channelling risky savings flows into the private equity and venture capital segments as a matter of priority would enable companies to raise more equity capital and increase their borrowing capacity. Similarly, the development of debt and securitisation markets would free up bank lending capacity which, in turn, would create a new monetary resource (deposit) that could circulate and be invested in the markets. Given the urgency of the needs, and given the European ecosystem, significantly strengthening the role of banks ultimately appears to be the most feasible short-term solution. In this respect, the Draghi report outlines three avenues for increasing the banking sector's capacity to finance the economy: relaunching the securitisation market, assessing the compatibility of banking prudential regulations (particularly Baset III finalisation) with the international competitiveness of the banking system, and finalising the Banking Union. Let's look briefly at these three avenues.

Securitisation. Securitisation could effectively stimulate investment by allowing banks to transfer risks to investors, thereby freeing up regulatory capital to grant more loans to households and businesses, including SMEs. Unfortunately, the European market never really recovered from the consequences of the 2008 financial crisis. Before the crisis, the European market (including the UK) was 75% that of the US. In 2024, the proportion will be around 15%. The new securitisation framework introduced in the EU in 2019 (which covers both simple, transparent and standardised (STS) securitisations and non-STS securitisations) has increased transparency and security. However, according to stakeholders[2] it has not allowed the market to recover and the investor base remains narrow. Measures to simplify and adjust requirements, particularly prudential and operational requirements, should be the subject of a new legislative proposal from the Commission, expected in June 2025. These measures would enable European banks to make greater use of securitisation as a risk management and financing tool.

Regulation. On the second issue –a level playing field between EU banks and their non-EU competitors– the European Commission is showing a degree of pragmatism. A recent illustration of this is the postponement of the application of the Fundamental Review of the Trading Book (FRTB). This concerns the Basel III recommendation on capital requirements for market risk. Efficient and liquid capital markets require market-making activities that should not be penalised by being subject to more stringent requirements than elsewhere.

1 *EU: Rearmament, energy and digital transitions - the scale of the effort,* G. Derrien and L. Quignon, Chart of the Week, 11 April 2025.
2 European Commission (2022), *Report of the Commission to the European Parliament on the functioning of the securitization regulation*, October.

By July 2024, some important jurisdictions had not yet finalised their rules or communicated their timetable for implementation, which had already led the Commission to postpone the application of the FRTB in the EU until January 2026. With the final US proposal on Basel III stalled and is unlikely to be implemented before 2027 or 2028, and with the UK and Canada also delaying the adoption of the final version of Basel III, the Commission has now confirmed the postponement of FRTB application in the EU by a further year, to 1 January 2027.

Banking Union. Finally, with regard to the finalisation of the Banking Union, Mario Draghi recommends decompartmentalising the circulation of liquidity within pan-European banking groups (the underlying idea being to channel it to the country where it is needed). He also advocates the creation of a deposit guarantee scheme specific to these cross-border banking groups, whose contributions would go exclusively into this fund. Banks with purely national activities would continue to be covered by national guarantee schemes. It is conceivable that the initial endowment of this fund could be partly « inherited » from the national guarantee funds to which the banking groups had previously contributed. This is a tempting idea and would perhaps overcome some of the reluctance of certain countries to pool national guarantee funds within the European Deposit Guarantee Scheme (EDIS), which is therefore struggling to get off the ground.

Faced with needs in the EU estimated to be staggering in relation to historical financing flows, no source of financing should be neglected. While the primary objective of the Savings and Investment Union is to make the allocation of savings more efficient within the EU itself, non-resident capital can also play an important role in kick-starting the process. Faced with the new geopolitical situation, the EU could benefit from the desire of certain international investors to diversify their assets in dollars and vis-à-vis the United States. To achieve this, the EU needs to strike while the iron is hot, and strengthen its attractiveness and competitiveness accordingly.

Laurent Quignon
laurent.quignon@bnpparibas.com