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The time is ripe to create buffer of a European safe asset

While the eurozone has made progress in reform, it so far lacks the ambition necessary to promote growth and jobs, increase economic stability and strengthen the international role of the euro.

Results have been achieved on banking union, capital market unions and reform of the European Stability Mechanism. However, key elements are still missing, including the existence of a shared safe financial asset.

The quest to create a genuine safe financial asset in the eurozone may have been going on a long time but the need is real. The current set-up with German government bonds, or Bunds, at its centre is a destabilising factor for the eurozone's financial system.

Thanks to Germany's budget surpluses, the supply of Bunds is increasingly slim just as investor demand for safe assets is rising.

In times of uncertainty, this scarcity creates an asymmetry of supply in the sovereign debt markets — with other governments selling more debt.

This imbalance enhances the danger of capital flight and the risks of instability in the financial system. All of this makes the work of the European Central Bank more difficult.

One way to address this might be for the ECB to offer central bank deposits to all market participants with long-term deposits possibly taking the form of tradable bonds. It is an option that has been widely discussed.

But this intervention by a central power would be a return to the old ways of conducting monetary policy that risks hampering the ECB's independence. We should instead examine what is needed to create a genuine safe asset.

First and foremost, any mutualisation of debt or transfer of risk from one country to another must be avoided, as it would simply kill the possibility of meaningful conversation on this issue.

Member states should remain fully responsible for their own debt. The focus needs to be on a new kind of safe asset.

This should be a common bond sold by a multinational organisation that would partially replace debt sales by member states. There is already a body capable of this: the European Stability Mechanism.

The ESM, which is backed by all eurozone states, already sells bonds and lends the proceeds to sovereign nations. Its current remit only extends to countries enduring financial stress. If its mandate was extended, it could lend more widely.

The creation of this new safe asset would help to stabilise financial markets in times of turmoil and contain volatility in the spreads between sovereign bond yields.

The debt would carry the same basic interest rates that the ESM would pay on its existing issuance and those interest rates would be equal for all.

There should be one main condition: do not beggar thy neighbour.

As a creditor, the ESM could be formally given a higher ranking than other lenders to eurozone governments.

This, and a limit to borrowing by the ESM, would protect its creditworthiness and be an incentive for governments to pursue responsible fiscal policies.

The supply of this new safe asset needs to large enough to meet demand and be liquid.

Sales by the ESM should be co-ordinated with national debt management offices and, importantly, a well-designed transitional period is required to prevent shocks to national bond markets.

It would bring important benefits, creating a truly European yield curve and bonds which would become a global benchmark and be the main asset bought by European banks.

This, in turn, would allow banks to gradually reduce their balance sheets' exposure to national debt without creating problems for member states.

The amount of national governments' outstanding bonds would fall over time as a significant part of the debt they need to roll over was funded by the ESM.

This would create the conditions to complete the banking union with a genuine European deposit insurance scheme, creating a stronger European financial system capable of supporting the single currency.

The scarcity of safe financial assets and the fragmentation of bond markets are crucial weaknesses of the eurozone.

If we are serious about reform that strengthens the eurozone and the international role of the euro, the time is ripe to evolve from individual sovereign bond markets through the creation of a European safe asset.

Paolo Savona is Italy's minister for European affairs and has recently been designated chairman of the Italian financial markets authority, CONSOB

There should be one main condition: do not beggar thy neighbour. Excessive borrowing must be limited

Paolo Savona

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