Financial innovations are reshaping the financial sector to an extent that has not been experienced in the past. Electronic money, digital banking, crowd funding platforms, or distributed ledger technology are calling into question the role played by banks in financing the economy. These financial technologies (FinTech) are changing the types of financial services available, including who can access them, and how. Alternative finance, such as peer-to-peer lending, allows consumers to obtain loans without going through a bank. New payment methods, such as mobile device applications, allow making transactions with a smartphone. Distributed ledger technology (e.g. block-chain) enables new ways of recording and executing transactions. This paradigm shift in financial innovations can be critical in addressing weak productivity growth, which continues to plague the euro area.

But financial innovations may also impact the ability of central banks to implement monetary policy effectively and safeguard financial stability. Financial innovations may reduce the demand for banknotes and banks’ deposits and, thus, require a review of monetary policy transmission methods. FinTech data applications raise new issues for the measurement of monetary aggregates, since an increasing portion of financial transactions are counted outside established banks. Against this background, the (five) papers below prepared by the Policy Department A upon request of the ECON Committee for the May 2017 session of the Monetary Dialogue review recent developments in financial innovation and discuss prospects and potential challenges for euro area monetary policy and financial stability.
IN-DEPTH ANALYSES

In-Depth Analysis on 'Potential impact of financial innovation on monetary policy' by Marek DABROWSKI (CASE, Center for Social and Economic Research)
The recent wave of financial innovation, particularly innovation related to the application of information and communication technologies, poses a serious challenge to the financial industry's business model in both its banking and non-banking components. It has already revolutionised financial services and most likely will continue to do so in the future. If not responded to adequately and timely by regulators, it may create new risks to financial stability, as occurred before the global financial crisis of 2007-2009. However, financial innovation will not seriously affect the process of monetary policymaking and is unlikely to undermine the ability of central banks to perform their price stability mission.

In-Depth Analysis on 'Implications of the expanding use of cash for monetary policy' by Daniel GROS (CEPS, Centre for European Policy Studies)
Financial innovation seems to have had little impact on the oldest medium of transaction, namely cash. The ratio of currency in circulation to GDP has increased in most countries, independently of the continuing spread of cashless transactions. Currency is part of the monetary base. Its increase thus leads to an automatic increase in central banks’ balance sheets. This becomes relevant when the size of a central bank's balance sheet becomes a policy instrument. Taking account of the increase in cash holdings can lead to a different view of the monetary policy stance over longer periods of time. Holding the size of the overall balance sheet constant is equivalent to a gradual exit when currency holdings continue to increase.

In-Depth Analysis on 'Financial innovation and monetary policy: Challenges and prospects' by Salomon FIEDLER, Klaus-Jürgen GERN, Stefan KOOTHS and Ulrich STOLZENBURG (Kiel Institute for the World Economy)
Financial innovations are expected to gradually reshape the financial sector. This paper describes recent technological developments and their possible impact on monetary policy and financial stability. A focus is on the prospects for digital currencies, which potentially have the most profound implications for monetary policy. The paper finds that privately issued digital currencies could transform the present financial system substantially, if they gain considerable market shares, while there may be a benefit from currency competition in disciplining monetary policy. The introduction of a central bank digital currency would also challenge the present fractional reserve system at its core and could finally lead to a more stable financial system.

In-Depth Analysis on 'The implications of digital currencies for monetary policy' by Daniel HELLER (Peterson Institute for International Economics, Washington DC)
Numerous digital currencies have emerged over the past few years. This entirely new form of money has the potential to play a significant role in the payments landscape of the future. This paper provides an overview of the current relevance of digital currencies and assesses their impact on the ability of central banks to continue to implement monetary policy effectively.

In-Depth Analysis on 'Monetary policy implications of financial innovation' by Kerstin BERNOTh (DIW Berlin and Hertie School of Governance) and Stefan GEBAUER, Dorothea SCHÄFER (DIW Berlin)
The authors of the analysis argue that the financial innovations triggered by the FinTech industry have the potential to affect the transmission of monetary policy as well as the informational content of key monetary indicators. The growing FinTech industry could contribute to the emergence of nonbank finance as a substitute for traditional commercial bank finance. While the overall effect of nonbank finance on monetary policy transmission is not yet clear, regulators and policy makers need to closely monitor the potential effects of FinTech on monetary policy transmission and to adequately adjust financial sector regulation.
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2. Side effects of non-standard monetary policy: How long is the short-run? – Compilation of notes

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1. An assessment of the impact of Brexit on euro area stability - Compilation of notes
2. How do low and negative interest rates affect banks’ activity and profitability in the euro area? - Compilation of notes
3. Transmission channels of unconventional monetary policy in the euro area: Where do we stand? - Compilation of notes

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2. Financial market fragmentation in the euro area: state of play - Compilation of notes

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