Mario Draghi: 2011 World Savings Day

Address by Mr Mario Draghi, Governor of the Bank of Italy and Chairman of the Financial Stability Board, at the 87th World Savings Day, organized by the Association of Italian Savings Banks, Rome, 26 October 2011.

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The crisis

Economic activity in the euro area is expanding at a very modest pace, curbed by the slowdown in world demand, the fall in the confidence of firms and households, and the adverse effects on financial conditions of the strains in some sovereign debt markets. The risk of a further deterioration of the growth outlook is significant, in a context marked by pronounced uncertainty.

The worsening of the crisis is a world and a European phenomenon, but Italy's particular vulnerability has domestic roots: the large public debt, the doubts about the prospects for the growth of our economy, the hesitancy and delay with which steps to correct imbalances have been taken and measures to foster growth adopted. After declining in August, the gross yield on ten-year BTPs has returned to a very high level (more than 5.9 per cent yesterday).

After six months of virtual stagnation, in the second quarter of this year Italy's GDP began to grow again, but at a very modest pace. Although they continue to sustain economic activity, exports have been affected by the less vigorous growth in world demand. In their responses to surveys, firms report a worsening of their short-term outlook and a deterioration in their assessment of investment conditions. Domestic demand is weighed down by the weak trend in households' disposable income, the slow recovery in employment, and the uncertainty about the economy's prospects. The leading forecasters have reduced their expectations for growth next year; according to the International Monetary Fund, it will barely be positive.

The Eurosystem is preventing, with its use of non-standard measures, the malfunctioning of the money and financial markets from obstructing the monetary transmission mechanism. With the provision of liquidity and the allotment modes used for refinancing operations, we are continuing to ensure that banks are not constrained on the liquidity side. We have announced a programme for the purchase of covered bonds. All the non-standard measures adopted in response to the financial strains are, by their nature, temporary. It remains essential to ensure price stability, anchoring inflation expectations in the euro area in line with the objective keeping inflation below, but close to, 2 per cent over the medium term.

The interventions prevent the imbalances from worsening; on their own they cannot overcome the underlying causes. At European level there is an urgent need for a governance in which budgetary discipline and solidarity are mutually supportive; there is also an immediate need to implement the instruments of financial support for managing the crisis. But without a decisive and lasting response from appropriate domestic policies that, by promoting growth, remove the imbalances in the public finances, the first objective is unattainable, the second a palliative.

The work begun with the first report of the Financial Stability Board in April 2008 has proceeded to good effect. Much has been done, both in implementing it and in drawing up new regulations. It is now necessary to continue with the transposition of the new rules into national legal systems. International coordination has been a key factor in imparting impetus to the reform of international finance; it remains crucial to its implementation. The contribution of the G20 leaders has been fundamental.

To crown the process, the Financial Stability Board will submit a report to the next G20 summit in Cannes in November with specific recommendations regarding systemically important financial institutions, the limits to be imposed on the shadow banking system, and the reduction of the systemic risk associated with OTC derivatives business.

The Italian banks

Italy's banks have to face the impact of sovereign risk on their funding, on the value of the collateral they provide for refinancing, and on their capital market.

But our banks' exposure to Greece, Ireland, Portugal and Spain is modest, amounting to about 1 per cent of total system assets. Their investment in Italian government securities is substantial.

Although the banks' short-term liquidity position continues to be in balance as a whole, it is affected by the persistence of strains, particularly on the wholesale markets, where fund-raising has slowed markedly since the summer. The Bank of Italy continues to ask banks to maintain balanced liquidity positions; these positions undergo careful monitoring at weekly intervals by the Bank's supervisory area.

Though diminishing, the rate of growth in lending to both households and firms remained higher in August than the rates for the euro area. In September the three-month growth came to 3.9 per cent on an annualized basis. However, surveys of firms find a tightening of lending standards and growing difficulty in obtaining credit. The bank lending survey conducted by the Eurosystem also finds signs of a tightening of supply conditions by Italian banks, limited for now to requests for higher interest rates.

Strong capital bases enable banks to cope with the cyclical worsening, and to contain the cost of fund-raising on the markets. On more than one occasion we have insisted that the banks should carry out capital increases. The response has been prompt so far and we trust it will continue to be so in the future.

At European level, the largest banks are expected to equip themselves with adequate buffers of high-quality capital by the middle of next year. The amount is determined for each bank taking its exposure to sovereign risk into account.

The request for temporarily higher capital ratios is necessary in order to address investors' current worries, with benefits for banks' funding on the wholesale markets.

Our banks are up to this new challenge. We are fully confident that, as in the past, the banking foundations will shoulder their share of responsibility. If necessary, adequate backstops will be identified and put into operation in a timely manner.

The difficulties that the Italian banking system finds itself facing today have origins that lie beyond it. In the longer term, the problems can be solved at the root only by increasing the growth potential of the Italian economy as a whole and acting on the sustainability of the public finances. The September budgetary package needs to be implemented completely and swiftly, in particular by rapidly setting up and carrying out the envisaged public expenditure revision.

Savings and young people

Historically, the capacity to save has always been a resource for the Italian economy. Last year Italian households' net wealth was equal to eight times their disposable income, a value that is higher, sometimes considerably higher, than the ratios in the other leading advanced countries. For Italy, excluding government securities held directly or indirectly by households changes this ratio only marginally.

Today's accumulated wealth, however, is the product of the saving of the past. Unless it is fed by new inflows, it will soon be dented.

The risks are not lacking. Since the turn of the century the propensity to save has fallen by about 4 percentage points, down to 12 per cent of income in 2010, almost 2 points below the euro-area average. The decline has been sharpest among the less affluent families, who have found it harder, in the face of stagnating disposable income, to reduce spending on essential goods and services. ACRI's latest survey of Italians and savings found that only 13 per cent of those interviewed – the lowest value ever recorded – hope to save more next year.

In part, the decline in the saving rate is due to the ageing of the population. It is accentuated not only by the diminished relative size of the younger generations but also by their diminished capacity to save. The deterioration of labour market entry-level wages, not offset by more rapid career advances, has helped to compress the propensity to save among households headed by young people.

The share of young families with nil or negative saving has risen. Among those headed by persons under 35, it increased from 26 per cent in 2000 to 32 per cent in 2008. Heightened income instability also affects young people's savings opportunities and decisions.

In the absence of more equitable intergenerational redistribution of resources, young people today will have to contribute more heavily than in the past to the public finances. For a 35-year-old in 1990, the incidence of taxes and social security contributions on income, calculated on the basis of remaining life expectancy and net of the value of social benefits, was equal to approximately 20 per cent; for someone 35 years old today, it exceeds 25 per cent. A factor in this increase has been the excessively slow transition to the contributions-based pension system. The older generations have been less severely affected.

The recession has exacerbated economic difficulties above all for the young. The unemployment rate of Italians aged 15–24 rose by nearly 7.6 percentage points between 2007 and 2010 (nearly 3 points more than the average for the EU-15) and that of those aged 25–34 by 3.6 points; in the 35–64 age-group, the increase was 1.8 points. One source of difficulty has been the marked dualism of the labour market. Young people who lose their jobs are relatively unprotected by the existing income support programmes.

Attenuating the segmentation that now exists in the labour market and making income protection programmes more universal, as well as more effective and rigorous, would help equalize employment opportunities and income prospects, which are now heavily tilted in favour of the older generations. Contracts providing for protection that builds over time and the introduction of a modern system of unemployment benefits would make the labour market more fluid and efficient, as well as more equitable. Well-designed measures along these lines could also help stimulate labour market participation. In addition, this would benefit the propensity for forms of saving more oriented to the long term, which in turn, suitably channeled, could facilitate the birth and growth of new enterprises with greater potential for innovation.

Reforms for growth

Policies that stimulate growth and economic dynamism expand the opportunities for young people. At the same time, the measures required to impart renewed impulse to growth will hinge on young people, easing the constraints on their contribution.

Removing the barriers to economic activity by lowering the cost of forming and running new enterprises will increase economic participation by the younger generation. New enterprises – in which economists place their hopes both for their high potential for innovation and for their capacity to stimulate efficiency in others – are mostly in the hands of entrepreneurs under the age of 40. And they tend to employ younger workers. But they will be more dynamic and competitive only if the work force has a suitably high level of educational attainment, which is an essential factor for growth in the "knowledge-based economy."

In the short term, macroeconomic policy measures can help to support growth. The composition of fiscal revenue can be modified, shifting the burden from levies on labour and productive activity to taxes on property and consumption.

But above all the durable achievement of faster sustainable growth requires the structural reforms invoked for so long, broadly endorsed but as yet unimplemented: heightening competition in the product markets, especially in the service sector; creating a more enterprise-friendly administrative and regulatory environment; stimulating the accumulation of physical and human capital; and raising the levels of labour market participation.

Such measures imply the substantially recasting the priorities and overhauling the modus operandi of public policy and administration. They must not be allowed, under the pressure of vested interests, to leave particular areas untouched. Properly designed and communicated, these measures can have an immediate propulsive impact, enhancing business confidence and expectations, increasing the propensity to invest, and narrowing the spread on Italy's public debt.

This is my last official speech as Governor of the Bank of Italy.

I end my term amidst a confused and dramatic situation at home and abroad on both the political and the economic fronts.

When I took the floor in this venue six years ago, incidentally with a speech on growth, the situation was very different. Its apparent tranquility, the generally indulgent, indeed admiring, attitude towards finance as the engine of growth concealed the seeds of the future disaster.

Italy bore none of the blame for the crisis. But because of never redressed structural weaknesses Italy was overwhelmed by it, penalized more than others, to the point that today, owing to its slowness in overcoming its own crisis, Italy itself has become a cause of general crisis.

Nevertheless, the gravity and complexity of the situation must not make us forget our strengths.

The first of these is our Head of State, whom I wish to thank both personally as a citizen and institutionally on behalf of the Bank of Italy. He is a beacon, an inspiration, an example.

The second strength comes from looking back on what has been accomplished. In these six years we have done a great deal. The Bank of Italy has made outstanding contributions at domestic and international level to the efforts to cope with the crisis, to revamping supervisory action, to the design and management of European monetary policy, to the formulation and implementation of the reform of European and global regulation. The autonomy of the Bank of Italy has been essential for all this.

The Bank's autonomy is not an end in itself. It is an essential element of the way in which the Bank exercises the powers and performs the duties defined in its Statute, the Italian Constitution and the European Treaty. In exercising these powers, the Bank is called upon to safeguard the common good, for it is always perceived as impartial and not subject to external controls or interventions. The General Council does not represent private interests; it does not intervene in matters for which the Bank or its top management is alone responsible; it oversees the Bank's administration, its management and its choices.

I now take leave of the Bank with a peaceful mind, with, I believe, your warm feelings that will accompany me to Frankfurt. The new governor epitomizes all the best that the Bank has produced in its tradition of training authentic central bankers. The Bank's organization is sound and strong.

But you too – Italy's banking foundations and banking system – have done much in these years to cope with the crisis by increasing resources, making sacrifices, changing operating rules, and aligning incentives with results, and you deserve ample credit for this.

It is, then, from the strength of some of our institutions, from the awareness that we have succeeded in accomplishing things that seemed impossible, that we draw courage, security, the belief we will succeed.

But we are experiencing a historical discontinuity. We are moving towards a new European pact, towards a shared management of the underlying problems of our economies in which each is called on to shoulder more responsibility in serving the common good.

Although the forms may be mortifying, the substance of the problems to be solved does not depend on the person who enunciates them. It is in the interest of the individual member states to recognize this substance, to recognize the ways to go forward – and without hoping in others – to trust in themselves, their own strength, their own history – to save themselves in Europe.

This is the fundamental lesson of the crisis: to build the future in Europe together. Only by doing so will we be able to remake Italy.