Mario Draghi: Continuity, consistency and credibility

Introductory remarks by Mr Mario Draghi, President of the European Central Bank, at the 21st Frankfurt European Banking Congress "The Big Shift", Frankfurt am Main, 18 November 2011.

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Ladies and gentlemen,

It is a privilege and a pleasure for me to be here today.

As you know, this is the first time I'm speaking publicly as President of the European Central Bank outside the ECB. I could not think of a more appropriate occasion than the European Banking Congress in the ECB's home town.

I understand that this congress was established about 20 years ago to strengthen the position of Frankfurt as a European financial centre, and thereby make the city attractive as a location – first for the European Monetary Institute and now for the ECB. Well, I am pleased to see how successful it has been!

Before discussing the shift towards a much greater role of emerging economies, which is the theme of today's congress, let me elaborate on the current situation in the euro area.

I. The euro area situation and ECB monetary policy

Activity is expected to weaken in most of the advanced economies. This is the result of a weakening of various components of aggregate demand, both domestic and foreign. And it is evident in "hard" data as well as survey data.

In the euro area, downside risks to the economic outlook have increased, and the weaker degree of activity will moderate price, cost and wage pressures.

This is why the ECB decided to reduce its key interest rates by 25 basis points on 3 November, acting in full compliance with its mandate to maintain price stability in the medium term.

We are aware of the current difficulties for banks due to the stress on sovereign bonds, the tightness of funding markets and the scarcity of eligible collateral. We are also aware of the problems of maturity mismatches on balance sheets, the challenges to raise levels of capital and the cyclical risks related to the downturn.

In the money market, we see rising spreads between secured and unsecured segments, and a widening of repo prices between different types of collateral. Interbank activity remains subdued and concentrated in the very short-term maturities. This limited activity is reflected in increased recourse to our liquidity-providing operations, as well as to our deposit facility.

So far, the ECB has taken several non-standard measures to ensure that short-term funding does not represent a problem for euro area banks. The most important non-standard measures are the fixed rate full allotment procedures and the longer-term refinancing operations. We have also implemented three additional US dollar operations, which cover the end of the year, and we have launched a second covered bond purchasing programme.

Let me use this occasion to dwell a bit further on monetary policy in the current environment. Three principles are of the essence: continuity, consistency and credibility.

Continuity first and foremost refers to our primary objective of maintaining price stability over the medium term.

Consistency means to act in line with our primary objective and with our strategy both in time and over time.

Credibility implies that our monetary policy is successful in anchoring inflation expectations over the medium and longer term. This is the major contribution we can make in support of sustainable growth, employment creation and financial stability. And we are making this contribution in full independence.

Gaining credibility is a long and laborious process. Maintaining it is a permanent challenge. But losing credibility can happen quickly – and history shows that regaining it has huge economic and social costs.

These three principles – continuity, consistency and credibility – are at the root of the Governing Council's outstanding record during the past 13 years in terms of price stability and anchoring inflation expectations.

National economic policies are equally responsible for restoring and maintaining financial stability. Solid public finances and structural reforms – which lay the basis for competitiveness, sustainable growth and job creation – are two of the essential elements.

But in the euro area there is a third essential element for financial stability and that must be rooted in a much more robust economic governance of the union going forward. In the first place now, it implies the urgent implementation of the European Council and Summit decisions. We are more than one and a half years after the summit that launched the EFSF as part of a financial support package amounting to 750 billion euros or one trillion dollars; we are four months after the summit that decided to make the full EFSF guarantee volume available; and we are four weeks after the summit that agreed on leveraging of the resources by a factor of up to four or five and that declared the EFSF would be fully operational and that all its tools will be used in an effective way to ensure financial stability in the euro area. Where is the implementation of these long-standing decisions?

II. The shift towards a much greater role of emerging economies

Let me now turn to the "big shift" in the global economy that is the theme of today's congress: the much greater role of emerging economies.

Their performance in the aftermath of the crisis has been impressive. Diverging economic performance between the emerging economies and the advanced economies had been evident for at least a decade. But after the crisis, there was a dramatic widening in the divergence.

Initially after the "Lehman shock" of September 2008, economic activity contracted sharply in both advanced and emerging economies. But a two-speed recovery quickly became evident. The emerging economies have returned to their pre-crisis economic dynamism very rapidly, while the advanced economies have experienced the slow pace of growth that is typical for recoveries following profound financial crises.

To this day, most of the advanced economies are only close to, or have just recovered, their production levels pre-Lehman. In contrast, output in the main emerging economies is now already 20% higher than it was before.

In the past, shocks in advanced economies often caused enduring drags on emerging economies. The Latin American debt crisis of the 1980s was a prominent example. But now, economic reform and strengthened institutions in the emerging world have changed this pattern. Generally, these economies have built enough financial, fiscal and external buffers to dampen international spillovers.

The second feature I would like to highlight is the asymmetry between the rising role of the emerging economies in trade and their still lagging role in finance. They are giants in trade, but their financial linkages to the rest of the world are still developing. Indeed, they are much more open in terms of trade: trade openness is close to 60% of GDP, whereas the same measure based on financial flows is less than 15% of GDP.

The third feature is the relevance of emerging economies for the euro area. They account for roughly one third of our external trade, up from a quarter ten years ago. Interestingly, this increase in the weight of emerging economies has improved the price competitiveness of the euro area, because on average they have had higher inflation than us. At the same time, their higher inflation has not fed into higher euro area prices, because their goods were much cheaper to begin with and because of an increasing share of imports from these countries.

The euro area also benefits from trade with emerging economies in terms of product specialisation. We have a comparative advantage in mid-technology exports, while the most dynamic emerging economies focus on either high-tech or low-tech good. Thus, those economies compete more directly with exports from the United States and Japan or other emerging economies.

The euro area is also helped by the composition of demand in emerging economies. This is tilted more towards goods than services, matching the composition of euro area exports better than that of other large advanced economies.

Therefore, in macroeconomic terms, the euro area's trade relationship with emerging economies has been generally positive.

Conclusion

In spite of the decoupling experienced in recent years, the fortunes of advanced and emerging economies are intimately linked. The growth of emerging economies has brought a much higher level of economic prosperity to hundreds of millions of their people. And their rising role means that today they share responsibility for global economic performance in half with the rest of the world. They account for almost 50% of global GDP measured in purchasing power parity terms (or just over one third of global GDP measured in market exchange rates).

In today's global economy, advanced economies can face some of the same distress that was earlier associated with emerging economies: profound fiscal challenges, sudden stops in capital flows, macroeconomic retrenchment and forced reform. At the same time, and going forward, the emerging economies will be confronted with the challenges that have long concerned advanced economies: population ageing and, perhaps, reform fatigue.

In spite of the current challenges faced by the global economy, we must resist temptation to resort to unilateral policies, and we must work together to ensure that the gains achieved are firmly secured for future generations.

Thank you for your attention.