Mario Draghi: Hearing at the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Mario Draghi, President of the European Central Bank, for the Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 16 December 2013.

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Madam Chair,

Honourable members of the Committee on Economic and Monetary Affairs,

It is a pleasure for me to be back in your committee at such a decisive moment. The next days and weeks until the end of this legislature will show whether the euro area will be able to take another key step towards banking union. I believe your institution can play a crucial and constructive role in ensuring that this next step will entail a truly European dimension.

This is also the last time that I will discuss with you in detail matters related to the Single Supervisory Mechanism. Pending the appointment by the Council, Danièle Nouy will become the Chair of the Supervisory Board as of 1 January 2014. She will then also become your primary interlocutor with regard to the SSM.

Today, I will first review recent economic and monetary developments in the euro area. I will then explain in greater detail our more recent monetary policy decisions and will present the progress in the preparations of the SSM.

Economic and monetary developments

Since our meeting in September, incoming information has confirmed the ECB's assessment that underlying price pressures remain subdued over the medium term. The economic recovery in the euro area is fragile. Real GDP in the euro area expanded in the last two quarters: From July to September, it grew by 0.1% – quarter on quarter – following 0.3% in the second quarter of this year. Developments in survey-based confidence indicators up to November point toward a modest growth rate also in the last quarter of the year. At the same time, unemployment remains high. Necessary balance sheet adjustments in financial and non-financial sectors continue to weigh on economic activity.

Looking further ahead, we expect output to continue to recover at a slow pace. This is in particular due to some improvement in domestic demand supported by our accommodative monetary policy. Euro area activity should, in addition, benefit from a gradual strengthening of demand for exports. Moreover, the improvement in financial market conditions and reduced uncertainty seems to be gradually transmitted to the real economy. Finally, the progress made in fiscal consolidation has strengthened the confidence of markets in the resilience of the euro area. This should also positively affect the recovery.

Nevertheless, the risks to the outlook remain on the downside. They are mainly related to uncertain developments in global money and financial market conditions. Higher commodity prices, weaker than expected domestic demand and export growth, and insufficient structural reforms in euro area countries could also negatively affect economic conditions.

Annual HICP inflation increased in November to 0.9%, according to Eurostat's flash estimate, following an unexpectedly strong decline in October to 0.7%. Underlying price pressures in the euro area are expected to remain subdued over the medium term. We might experience a prolonged period of low inflation to be followed by a gradual upward movement towards inflation rates below, but close to, 2% later on. This reflects the modest pace of the recovery and the fact that medium to long-term inflation expectations continue to be anchored in line with price stability.

Monetary and, in particular, credit dynamics remain subdued. The annual growth rate of loans to the private sector has stabilised at negative levels. Weak loan dynamics continue to reflect primarily the current stage of the business cycle, credit risk and the ongoing adjustment of financial and non-financial sector balance sheets.

Recent monetary policy decisions

Based on this assessment of the current economic outlook, let me now explain in greater detail our more recent monetary policy decisions. In July this year, we introduced forward guidance to clarify the orientation of our monetary policy going forward in an exceptionally uncertain environment: we stated that we expected key interest rates to remain at present or lower levels for an extended period of time. This statement was conditional on an overall subdued outlook for inflation extending into the medium term, which is currently the case, as I have just explained.

In line with our forward guidance, we decided in November to lower the key ECB interest rates further. The interest rate on the main refinancing operations was lowered by 25 basis points to 0.25% and the rate on the marginal lending facility by 25 basis points to 0.75%. The rate on the deposit facility was left unchanged at 0.00%.

Our forward guidance still remains in place: we continue to expect ECB key interest rates to remain at present or lower levels for an extended period of time. Thus, monetary policy will remain accommodative for as long as necessary.

Adjusting interest rates is not always sufficient to maintain price stability. In this crisis, interest rate cuts have been transmitted more slowly and unevenly across euro area countries due to the fragmentation of financial markets. To address this problem, we adopted in recent years a series of non-standard measures. The purpose of these was – and remains – a more effective transmission of the ECB's interest rate cuts, so that our monetary policy can reach companies and households throughout the euro area.

This was also the purpose of our decision in November to continue conducting all our refinancing operations as fixed rate tender procedures with full allotment at least until July 2015. Thus, we have helped to alleviate funding concerns of banks, which are still hesitant to lend to households and firms.

Two years ago, we provided funding support to euro area banks through two Long Term Refinancing Operations with a maturity of three years each. As the funding situation of banks has improved significantly since then, banks have this year opted to repay about 40% of the initially outstanding amount. Accordingly, excess liquidity in overnight money markets has been gradually receding. We are monitoring the potential impact of these developments on our monetary policy stance. We are ready to consider all available instruments.

As usual, it takes time before our policy decisions work their way through financial markets and affect the economy. The November decisions on interest rates, on forward guidance and on prolonging full allotment in all refinancing operations are working their way through.

Financial markets have taken up our conditional commitment to an accommodative monetary policy stance for an extended period of time. Money market term interest rates and yields on bank bonds declined.

On the other hand, we are fully aware of the downward risks that a protracted period of low inflation entails. Consistent with its forward guidance, the Governing Council is ready and able to act if needed, as I mentioned at the most recent press conference .

Furthermore, we currently see no signs of risks of financial imbalances related to the low interest rate environment. What we observe is still a very subdued trend in monetary and credit developments in the euro area.

Nevertheless, if we were to observe the build-up of such imbalances, this would be the field where macro-prudential authorities would have to intervene with market-specific instruments. Local risks have to be addressed by local instruments. This is why supervisory authorities, including the SSM, are now being equipped with the appropriate micro- and macro-prudential policy tools. I am confident that these will be used if necessary.

State of play of SSM preparations

Let me now update you on the latest developments establishing the Single Supervisory Mechanism (SSM), which are well underway.

Our internal preparations aim at ensuring that the ECB will be ready to assume its supervisory responsibilities in November 2014. We will make sure that the ECB's monetary policy mandate focused on price stability will not be affected by considerations and decisions related to banking supervision. Internal rules are therefore being developed for the separation of monetary policy and supervisory functions: The units involved in decision-making will be clearly separated. We are putting in place an organisational set-up whereby the information flow between the two functions will be limited to a "need to know" basis. However, we will avoid unnecessary duplication of structures not involved in the decision-making process. This is cost-efficient, and I am sure you will appreciate this.

As regards recruitment of staff, I can say that the process for senior and middle managerial positions is well underway. Further recruitment initiatives will start in due course.

An important element of our preparations is the comprehensive assessment, which comprises a supervisory risk assessment, an asset quality review and a stress test performed in cooperation with the European Banking Authority (EBA). This exercise will increase transparency by enhancing the quality of information available. It will facilitate the repair of the sector by identifying the necessary corrective actions. And it will build confidence by assuring all stakeholders that banks are fundamentally sound. It will be concluded shortly before the ECB assumes supervisory responsibilities.

The ECB convened a series of meetings in November in Frankfurt with the banks that will undergo the comprehensive assessment. These meetings were positively received and provided the useful opportunity to have a first exchange of views, to receive feedback on our communication, and respond to questions. We also explained that we would welcome prompt action from the banks, beginning now, to strengthen their balance sheets including profit retention and equity issuances.

Other elements of the comprehensive assessment are on-going. The process for the selection of asset portfolios to be reviewed for the asset quality review was initiated in November, based on specific data collections. Furthermore, we expect to announce the key parameters of the stress test exercise together with the European Banking Authority (EBA) towards the beginning of next year.

In this context, let me explain again the treatment of sovereign bonds: The Asset Quality Review is a valuation exercise where we will apply the current regulatory framework. It is not for us to change this framework – this is a global discussion, and the Basel Committee is the right forum for it. That said, we will of course "stress" a wide range of assets as part of the stress tests: Sovereign bonds will be among them.

To ensure the credibility and rigour of the comprehensive assessment, backstops should be well specified and in place as soon as possible. The pecking order should be first private sources, then national public backstops and, as a last resort, European instruments.

Turning now from supervision to resolution, I understand you have reached agreement with the Council on the Bank Recovery and Resolution Directive. Let me again strongly welcome this agreement, as it is an important step towards to the completion of the Banking Union.

However, for the credibility of the Banking Union, another step must be taken too: The SSM needs a strong and credible Single Resolution Mechanism as its counterpart. Responsibilities for supervision and resolution need to be aligned at the European level. Thus, I urge you and the Council to swiftly set-up a robust Single Resolution Mechanism, for which three elements are essential in practice: a single system, a single authority, and a single fund. We should not create a Single Resolution Mechanism that is single in name only. In this respect, I am concerned that decision-making may become overly complex and financing arrangements may not be adequate. I trust that the European Parliament, together with the Council, will succeed in creating a true Banking Union.

Thank you for your attention. I am now looking forward to your questions.