Mario Draghi: Reception for the opening of the European Cultural Days

Welcome address by Mr Mario Draghi, President of the European Central Bank, at the reception for the opening of the European Cultural Days, Frankfurt am Main, 3 November 2015.

* * *

Ladies and gentlemen,

I am very pleased to welcome you to this reception for the opening of the ECB's Cultural Days. As you know, each year we dedicate this series to one of the 28 EU members as a way to underscore Europe's diversity and richness. This time the focus is on Malta. At the formal opening I will speak more about Maltese culture and the programme of upcoming events. Here, however, I would like to tell you something about your hosts – what the ECB is currently doing, and most importantly, why.

Since last year, when we welcomed the panoply of Bulgarian culture to Frankfurt, the ECB has been through a major transformation. Tomorrow, we will celebrate our first full year as the supervisor of Europe's significant banks – a project which has involved us hiring over 1000 new staff and setting up a new European institution from scratch. We also this year officially inaugurated our new building, which has now become a symbol of the Frankfurt skyline.

What has not changed, however, is the ECB's mandate to deliver price stability for the euro area, which we define as an inflation rate of "below but close to 2 percent" over the medium-term. During the first 17 years of our history, inflation has averaged just over 1.8 percent – so pretty close to our objective.

But note that this definition of price stability is symmetric: inflation should be neither too high *nor* too low. This is a legacy of our colleague Otmar Issing, who appreciated the risks of too low inflation at a time when most people only had the risk of too high inflation in mind. Indeed, history shows that deflation can be just as damaging to the prosperity and stability of our economies as high inflation.

To mention just some of the negative impacts, in a low inflation environment firms' revenues fall but the wages they pay their employees are typically more "sticky", so the *real* wages they have to pay rise. That can lead to higher unemployment. Monetary policy can also become less effective at supporting the economy, as lower inflation leads to higher real interest rates, which cannot be offset by conventional policy when interest rates reach zero. And in a situation of high indebtedness, too low inflation increases the burden of servicing that debt.

In the aftermath of the crisis it has become, at times, more difficult for central banks to achieve the slow increase of price levels that they aim for. This is also true in the euro area where, thanks mainly to falling oil prices, inflation is currently around zero. That would not be a serious problem if we saw low inflation only for one or two months, but it becomes worrisome if there is a risk of too low inflation for too long. In that scenario, it can start to affect people's expectations of future inflation, which then makes low inflation self-fulfilling.

In line with our mandate, the ECB has therefore made full use of its conventional tools – interest rate cuts – to ward off these risks to price stability and keep inflation expectations anchored to our objective. And since rates reached zero, we have switched to unconventional measures – namely large-scale asset purchases – as the main means to expand our stance and ensure that inflation returns gradually back to 2%.

Those asset purchases are proceeding smoothly and continue to have a favourable impact on the cost and availability of credit for firms and households. But even though domestic demand remains resilient, concerns over growth prospects in emerging markets and other external factors are creating downside risks to the outlook for growth and inflation. In this context, the degree of monetary policy accommodation will need to be re-examined at the Governing Council's December meeting. The Governing Council is willing and able to act by using all the instruments available within its mandate if warranted in order to maintain an appropriate degree of monetary accommodation.

Such decisions by the ECB often trigger a lively discussion in the public debate – and often with a quite different flavour depending on the country concerned. While in some countries the main theme is typically that the ECB should "do more", in Germany, as you know, the opposite is the case. The low interest rate environment is often seen as a cause for concern. I would not be surprised if that is the case for many of you here.

One concern is low interest rates unfairly punish savers. I fully understand this – low interest rates of course lead to low nominal returns on certain types of assets. But I think the extent of disquiet with the ECB about this issue also reflects some misunderstandings. There are two points in particular I would like to underline.

First, what matters for savers is not nominal returns on liquid assets such as deposits, but *real* returns – i.e. what those returns actually buy – on the *portfolios* of assets that most households hold, which include for example shares. An interesting piece of research last month by our colleagues at the Bundesbank[1] showed that the real return since 2008 for German households on a typical private portfolio lay at 1.5%. This was lower than the pre-crisis average, to be sure, but better than in several repeated periods since the early 1990s.

Second, we need to keep in mind *why* interest rates are so low today. It is not an arbitrary decision of the central bank; it is because the euro area has been in a long and deep crisis where the economy needed low interest rates to recover. And what would happen if we were to raise rates in that environment? The answer is that it would only push us back into recession, which would mean lower incomes and more job insecurity for everyone. And then, the ECB would have to keep interest rates lower for longer to get the economy back on track. None of this would be in the interests of savers in any country.

Moreover, if one takes a longer-term perspective, it is clear that low interest rates are also being driven by forces outside the ECB's control. It is the productive capacity of the real economy that ultimately produces real returns on savings – and in the euro area, due to our ageing societies and low productivity, that is currently very weak. This is not an issue monetary policy can solve; it depends on reforms that will make our economies more inclusive, flexible and innovative. The long-term interests of savers, in other words, depend on governments implementing the structural reforms that will transform our economies in Europe.

This brings me to another concern about our policies: that the implementation of our monetary policy in fact creates the opposite effect – that it *decreases* the willingness of governments to undertake structural reforms because they pay little interest on their debts.

Again, while I can understand this concern, I think it needs to be looked at in context. First of all, the argument does not fit with the facts we have seen in the euro area. Spain, for example, started its labour market reforms when interest rates had already gone down. Italy undertook labour market reform at the beginning of this year of its own volition. France pursued the Macron Reforms this year as well, and they are not yet finished. So I do not see convincing evidence that structural reforms are impossible without strong market pressure.

Moreover, where very strong market pressure does lead to reforms, are we sure that they are the right ones? Often we have seen in recent years that, when countries face severe sovereign debt tensions, they prioritise raising taxes rather than cutting unproductive

---

1 Monatsbericht Oktober 2015.

expenditure and delay structural reforms. Those reforms that countries really need to boost their long-term growth – such as improving education or judiciary – do not come about in a crisis environment. They have to come about through societies recognising their deep-rooted challenges and collectively fixing them.

But let's imagine for a moment that all this were not the case – that market pressure was essential for structural reforms to happen – should that really be a factor in how the ECB makes its policy?

Remember that we have been given a narrow mandate in the Treaty to deliver euro area price stability, and that narrow mandate is what justifies our independence. Nowhere in the Treaty does it say that the ECB should set interest rates in such a way as to force policy changes on unwilling governments. For us to do that would be undemocratic and a misuse of the independence we have been given. If anybody is to put pressure on governments to enact structural reforms, it has to be other governments within a democratically-agreed framework. Indeed, this is why the ECB has frequently called for stronger European institutions for economic policymaking.

The point here is that one cannot expect the ECB to deliver the objectives that rightfully belong to other policymakers. We will meet our price stability mandate, as we are obliged to do in the Treaty. But it is up to individual countries to build on that foundation and make their economies work better; and it is up to the euro area as a whole to strengthen the institutional architecture of our union.

Only with such a common, comprehensive response can we durably leave this crisis behind, and re-focus on the purpose for which the euro was launched: the unity and prosperity of the peoples of Europe. That is no doubt a challenging task. But the Cultural Days are a reminder what Europe is all about and why it is worth standing up for.