Mario Draghi: Introductory statement to the plenary debate of the European Parliament on the European Central Bank's Annual Report 2015

Introductory statement by Mr Mario Draghi, President of the European Central Bank, to the plenary debate of the European Parliament on the European Central Bank's Annual Report 2015, Strasbourg, 21 November 2016.

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I am happy to be back at the European Parliament to discuss with you the ECB Annual Report for 2015.

This debate is an important pillar of our accountability. We take your comments and suggestions very seriously.

At your request, last year we began publishing the ECB's feedback on your resolution on the ECB Annual Report. On 4 October 2016 the Governing Council also approved principles increasing transparency in developing ECB regulations on European statistics. These principles take into account the transparency practices of the European Parliament, the Council of the European Union and the European Commission.

In my remarks today, I will retrace the economic developments since our last plenary exchange in February. In particular, I will discuss the role of the ECB's monetary policy in supporting the ongoing recovery. I will also review the policy agenda aimed at addressing current vulnerabilities in the euro area.

Economic developments and the role of the ECB's monetary policy in supporting the recovery

The euro area recovery continues to proceed at a moderate, but steady, pace. It has shown remarkable resilience to adverse developments and uncertainties emanating from the global environment.

In fact, euro area unemployment has been steadily declining. More than four million jobs have been created since 2013, when the situation was at its worst. Domestic demand has also strengthened and real GDP growth has recorded positive figures for 14 consecutive quarters. Since the beginning of the year headline inflation has gradually picked up, moving from the negative rate of –0.2 in February to 0.5 in October.

Our monetary policy measures since June 2014 have been a key factor behind these positive developments. Asset purchases, targeted longer-term refinancing operations (TLTROs) and low policy rates have strongly supported the recovery. Let me explain more in detail.

First, the pass-through of our monetary stimulus to bank lending conditions has been remarkable. Interest rates have fallen markedly across a broad spectrum of asset classes and credit markets since June 2014. As a result, euro area firms and households have experienced more favourable borrowing conditions. For example, bank lending rates for companies declined by more than 100 basis points between June 2014 and September 2016. Bank lending conditions for small and medium-sized enterprises (SMEs) – the backbone of our economy – have improved even more: since May 2014 bank lending rates on very small loans to corporations have declined by around 170 basis points. They are now converging towards those of large-scale borrowers.

Evidence from our bank lending survey supports this picture. Banks report that our measures are contributing to more favourable terms and conditions on loans and are supporting credit creation. Moreover, we see that banks are passing on the very attractive funding conditions of the TLTROs to their customers.

Lower borrowing costs for firms and households have stimulated both consumption and investment. For example, household income is benefiting from lower interest rate expenses. Likewise, investment spending benefits from lower financing costs, which are making more investment projects profitable.

Supported by our monetary policy, the recovery is sustaining its momentum. We also expect headline inflation to continue rising over the coming months. At the same time, we are not seeing a consistent strengthening of underlying price dynamics. Much of the expected increase will be driven by statistical factors related to the stabilisation of oil prices.

Moreover, the return of inflation towards our objective still relies on the continuation of the current, unprecedented level of monetary support, in spite of the gradual closing of the output gap.

It is for this reason that we remain committed to preserving the very substantial degree of monetary accommodation necessary to secure a sustained convergence of inflation towards levels below, but close to, 2% over the medium term.

However, as your draft resolution on our Annual Report argues, our monetary policy support has to be accompanied by decisive action from other policy areas.

In fact, we continue to face a number of structural challenges that are holding back a more dynamic expansion of the euro area economy. So the right policies need to be designed to address existing vulnerabilities and challenges and, ultimately, secure higher sustainable growth for the euro area.

The need for policy actions to address current vulnerabilities

As I argued before, the euro area economy has proved resilient despite the uncertainty caused, among other things, by the crisis in emerging market economies, the collapse in oil and commodity prices, and the consequences of the UK referendum.

Beyond the relevance of the ECB’s monetary policy, an important contributing factor has been the more robust financial sector which has emerged from the financial crisis.

The decision to address the mistakes of the pre-crisis era through ambitious regulatory reforms is thus paying off. It has resulted in a European financial sector that is now stronger in terms of capital, leverage, funding and risk-taking. For example, Common Equity Tier 1 ratios in the euro area have improved substantially, rising from less than 7% for significant banking groups in 2008 to more than 14% today.

The welcome improvements in bank solvency – and the related improvement in asset quality – are a tangible result of our common work to create the Banking Union.

The comprehensive assessment we conducted in 2014 – together with a deep asset quality review – encouraged banks to strengthen their balance sheets without delay. As a result, while the level of non-performing loans (NPLs) remains high in some countries, today this problem is not primarily related to the robustness of balance sheets. Coverage ratios are close to 50% and much of the remainder is collateralised.

A more resilient euro area banking system has been able to respond to the impetus originated by our monetary policy and facilitate the recovery in credit we have witnessed so far.

However, a number of structural factors are still weighing on the ability of the financial sector to fully support the euro area recovery. Notably, the profitability of euro area banks remains a challenge to be addressed.

While bank profitability and the level of bank equity prices is not *per se* a matter for policymakers, insofar as it raises financing costs for banks, it could ultimately curtail lending to the real economy and hold back the recovery. We should therefore consider what factors are behind this and what we can do to address them.

One factor is certainly the low growth and low inflation environment, which translates into low interest rates. By supporting the recovery, our monetary policy measures are supporting a return towards higher rates of return. In other words, low interest rates today are necessary for a return to higher interest rates in the future.

But legacy and structural challenges are also important factors behind banks' low profitability.

Where profitability is being affected by structural issues, such as overcapacity and inefficient cost structures, rationalisation and consolidation must form part of the answer.

Where NPLs are at a high level, creating the conditions for a faster resolution of bad loans is an essential part of the solution. ECB Banking Supervision has presented its draft guidance on NPLs for public consultation. We have also conducted a stocktake of national supervisory practices and legal frameworks related to NPLs. With a view to creating liquid markets of distressed debt, efforts will be required to foster the development of an NPL servicing industry, to improve data quality and access, and to remove tax and legal impediments to debt restructuring.

The European Parliament also has an important role to play in a number of key legislative dossiers.

Some relate to the Banking Union, with the proposed European Deposit Insurance Scheme and the introduction of "risk-reduction" measures in the context of the upcoming revision of the legislative pillars of the Single Rulebook for banks – namely the Bank Recovery and Resolution Directive (BRRD), the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD).

Others relate to the Capital Markets Union (CMU). In particular, the negotiations concerning the securitisation regulation need to be finalised soon. Securitisation can play a very important role in increasing bank funding to the economy but regulatory uncertainty is detrimental to European securitisation markets. We consider that the Commission has put forward a strong package that balances a revival of the European securitisation markets with the preservation of a prudent regulatory framework.

Progress needs to be made in other areas too, in particular insolvency law and taxation, as announced in the Commission's Communication. It will also be necessary to address the financial stability aspects of CMU as part of the macroprudential review.

A stable, profitable and competitive financial sector is essential for sustainable economic growth. But the reverse is also true. This is why we need more decisive action to raise the potential growth rate of the economy.

First, let me echo your draft resolution. The implementation of structural reforms needs to be substantially stepped up. This concerns, in particular, policy actions to raise productivity and improve the business environment. We will soon discuss the Annual Growth Survey 2017, which touches upon these exact issues. We should make the best use of the annual cycle of economic governance by ensuring that recommendations – including euro area recommendations – are really taken into account and effectively implemented.

Second, fiscal policies should also support the economic recovery, while remaining in compliance with the fiscal rules of the European Union. For instance, a more growth-friendly composition of fiscal policies could boost growth.

This leads me to my final and concluding point.

Conclusions

During our last plenary exchange in February I said that the cohesion of Europe was being tested. Since then, the challenges have increased.

It is now more than ever important and necessary that Europe responds cohesively and decisively to the challenges it is facing.

I believe we should remember the words of a great European, Carlo Azeglio Ciampi, spoken in this room more than ten years ago:

"If we act alone we will be at the mercy of events bigger than us, events that threaten peace and European security."

I am confident that the foundations on which the EU project is built are strong enough to achieve the objectives that have been entrusted to us by the people of Europe.

I am now looking forward to the debate.

Thank you for your attention.