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

Introductory statement by Mr Mario Draghi, President of the European Central Bank, at the ECON committee of the European Parliament, Brussels, 28 November 2016.

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I am glad to be back at the European Parliament just a week after the plenary debate on the ECB's activities in 2015. This will be my last visit this year, so it is a good opportunity to reflect on upcoming challenges.

In 2016 the euro area economy proved to be resilient, in spite of uncertainty stemming from the economic and political environment. Inflation has gradually edged up, and the ECB's monetary stimulus has been a key ingredient of the ongoing recovery.

In my remarks today I will first focus on the upcoming challenges at global and euro area levels. Then, at the request of this committee, I will discuss the still uncertain impact of Brexit and its implications from a Single Market perspective.

Strengthening the recovery: responding to current challenges at global and euro area levels

The global economy is expected to continue its recovery, although growth will remain slower than before the crisis. While showing signs of resilience, the global economy is facing significant political and economic uncertainties.

In this context, one of the key takeaways from the 2016 World Bank-IMF Annual Meetings was that monetary policy cannot be the only game in town. It cannot generate sustainable and balanced growth on its own. To increase the effectiveness of monetary policy, fiscal and structural policies are needed that reinforce growth and make it more inclusive.

The euro area economy continues to expand at a moderate but steady pace, despite the adverse effects of global economic and political uncertainty. This gradual upward trend is expected to continue, not least owing to our monetary policy measures.

In particular, our very low policy interest rates, the favourable lending conditions in our targeted longer-term refinancing operations and our ongoing asset purchases have resulted in lower borrowing costs. Firms are benefiting from improved conditions when seeking loans from banks and when issuing equity or new bonds. Smaller firms are also benefiting, both via lower borrowing costs from banks and from the increased capacity of banks to grant loans, while larger firms are increasingly seeking funding from the financial markets.

These conditions support higher consumption and investment. This is reflected by the gradually improving supply of loans to households and firms.

Still – if supported by decisive action taken by other policymakers – monetary policy measures in the euro area could be even more effective. Low productivity growth, legacy problems in the banking sector and limited progress with structural reforms are all issues that need to be tackled swiftly. This would help close the output gap faster and increase growth potential, resulting in higher employment.

I am aware that the attention of our policymakers has shifted. In the direct aftermath of the financial crisis the need to complete Economic and Monetary Union came to the forefront of the European debate. Since then circumstances have changed. Today Europe's focus is more on security. Both projects require Europe to be united – to act together. However, let us not forget that Europe will be better able to protect itself if it has a strong and resilient economy. And for that purpose, Economic and Monetary Union will have to overcome the vulnerabilities stemming from its incompleteness. One important lesson from the crisis is that a half-built house is not stable, it is fragile. Progress is thus needed in all the unions identified in the Five Presidents' Report.

This committee plays an important role in ensuring greater financial sector resilience in the European Union and in completing the banking union. To this end, solid progress is needed on the current legislative dossiers. The European Parliament will also play a leading role in the context of the proposed revision of the Single Rulebook's legislative pillars: the Bank Recovery and Resolution Directive (BRRD), the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV).

The Single Market and Brexit

Let me now turn to the repercussions of Brexit, which you have asked me to address in more detail.

For both the euro area and the United Kingdom, the Single Market has been a fundamental asset and a positive sum game. Bringing together European economies has allowed the European Union to reap efficiency gains and better satisfy demand. For sectors such as financial services, the ability to serve an EU-wide, interconnected market is a key factor of success. The Single Market also makes it possible for firms to benefit from the complementarities of various locations across the EU as part of European value chains. Moreover, the free movement of people ensures that anyone can seek work where economic activity is concentrated as a result of agglomeration effects. Economic clusters in turn benefit from being able to recruit workers from across the EU.

The United Kingdom has benefited from the strong economic and financial links within the Single Market. In fact, more than 40% of the foreign value-added contained in UK exports comes from the rest of the EU. Within the Single Market, the United Kingdom has also been a major hub for wholesale banking activities. More specifically, the single passport means that UK-based banks can currently serve the rest of the EU without needing to set up subsidiaries in other Member States, and vice versa. That implies sizeable savings in terms of capital and liquidity.

If, in the long run, the risk of a less open UK economy in terms of trade, migration and foreign direct investment were to materialise, there would be a negative impact on innovation and competition and, thus, productivity and potential output. Such developments would first and foremost weigh on the UK economy. They would to a likely lesser extent also have some limited adverse spillover effects on the euro area. The overall impact would, however, vary across countries depending on their trade links with the United Kingdom.

So far the euro area has weathered the fallout from the referendum outcome with encouraging resilience, also thanks to the preparations of central banks and supervisors on both sides of the Channel. The outcome of the vote led to a pronounced bout of heightened risk aversion, but the market reaction was short-lived and asset prices largely recovered in the weeks thereafter. Also, the euro area Economic Sentiment Indicator and the Purchasing Managers' Index, which declined in August, recovered in September and October.

In the United Kingdom, economic activity has also remained fairly resilient on the back of robust consumption growth. At the same time, uncertainty appears to have weighed on investment and the pound sterling. Economic activity in the United Kingdom is generally expected to slow down.

It is difficult to predict the precise economic implications of the United Kingdom withdrawing from the EU. They will notably depend on the timing, progress and final outcome of the upcoming negotiations. Thus, it is important to have clarity on the negotiation process as soon as possible in order to reduce uncertainty.

However, let me be clear. While the UK referendum did create uncertainty as far as the country's participation in the Single Market is concerned, the Single Market cannot go backwards. It is imperative that its integrity and the homogeneity of rules and their enforcement will be preserved. This also means we cannot take backward steps concerning the regulatory, supervisory and oversight framework for banks and financial market infrastructures, which has been enhanced considerably since 2008.

It is, in fact, essential to further strengthen and develop the Single Market. In the area of financial services we have made significant progress. The Single Market for financial services is now supported by the Single Rulebook for banks and by common supervisory institutions. Within the euro area we went further with the banking union. As I have said, we are not at the end of this process. For instance, financial integration through a fully fledged Capital Markets Union could diversify financing sources for European companies. By fostering private risk-sharing, it can also contribute to a more resilient European economy.

Conclusion

Let me conclude.

It is encouraging to see that recent opinion surveys show support for European integration increasing since the UK referendum, contrary to the expectations of many. At the same time, there are lessons to be learnt. The key lesson is that the European Union has to deliver on key objectives from the citizens' perspective if it is to rekindle trust in the European project. And to address the widespread feelings of insecurity, including economic insecurity, the European project needs strong economic foundations. For the euro area economy, this means strengthening the recovery, preserving financial stability and addressing the remaining vulnerabilities of Economic and Monetary Union.

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