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, before the Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 3 March 2014.

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Madame Chair,

Honourable Members,

This is my last hearing in ECON before the end of this legislature. I would like to first of all thank you, Sharon, for the way you have guided this committee throughout a challenging period.

Let me also thank all of you for the frank and fruitful exchanges we have had in the last two-and-a-half years. It has been an invaluable experience for me. In these difficult crisis times, discharging accountability in front of an assembly with a true European perspective has been helpful for the public acceptance of our actions. Moreover, the hearings have always been a welcome occasion to discuss the state of Economic and Monetary Union between two genuinely European institutions and to debate about what is the right way forward. I am very much looking forward to continuing this approach with the new ECON committee from July onwards.

I would like to take the opportunity of this last hearing to take stock of the monetary policy that the ECB has conducted over the last five years and to review what has been achieved in the euro area over the course of these years. Let me then also offer our assessment of the challenges that lie ahead and that will await the new Parliament and the new Commission.

Before I start to go into detail in these three areas, let me however remind you that the next meeting of the ECB Governing Council takes place on Thursday. In view of the so-called purdah period, you will understand that I will not be able to give detailed answers on our monetary policy stance today.

Five years of monetary policy – the ECB has delivered

In the last five years, the ECB has continued to take the necessary measures with a view to maintaining price stability in the euro area.

Let me turn back to the first hearing of this Parliament's term which took place with my predecessor in September 2009. At the time, the economy was just bottoming out in the aftermath of the great contraction which had ensued after Lehman's failure. We were witnessing negative inflation rates. In this environment, the outlook was seen to be broadly in line with price stability. Inflation was projected to increase toward levels close to 2%. The key ECB interest rates were kept on hold at the very low level to which they had been brought in several stages since the autumn of the preceding year. Some phasing-out of non-standard measures was announced.

However, in May 2010, sovereign debt markets froze in various euro area Member States. Financial fragmentation took a new and unfamiliar form, with financial conditions and the transmission of our monetary policy varying to a great extent across Member States. We responded by introducing the Securities Markets Programme, focused on purchases of government bonds.

Initially, while the economic impact of the sovereign debt crisis was limited and largely confined to vulnerable economies, the rapid global recovery put upside pressure on energy prices. This drove up inflation also in the euro area. We decided to raise interest rates in early 2011 given upside risks to the medium term inflation outlook stemming from energy prices and from ample monetary liquidity.

However, the sovereign debt crisis deepened and the euro area entered a second recession. The inflationary pressures that had emerged before receded. Therefore, we lowered interest rates in a series of steps. Stress in sovereign debt markets quickly undermined the wholesale funding conditions of banks based in those Member States. To forestall a credit crunch, we introduced refinancing operations with maturities of up to three years, in a context of full liquidity allotment at a fixed rate.

As the mutual exposures of banks and their sovereigns fed an adverse, self-reinforcing confidence crisis, investors started to fear that public and private liabilities issued in certain Member States would not be redeemed in our common currency. A significant redenomination risk arose.

As you know, the integrity of the euro area is an absolute precondition for us to be able to deliver on the mandate prescribed by the Treaty and in particular to ensure a smooth transmission of our monetary policy. In order to preserve this integrity, we thus announced our readiness to conduct Outright Monetary Transactions with the specific purpose of removing compensation for that risk from the financial pricing of securities. This announcement reversed the destabilising capital flows that redenomination fears had encouraged in spring 2012.

While financial markets had been on a steady course toward normalisation for some months, in late spring and summer of 2013 the euro area money market – not unlike elsewhere in the global financial system – became subject to external shocks. We noted a sustained increase in expected interest rates. This was unwarranted in view of our underlying macroeconomic conditions, and was not in line with the Governing Council's policy intentions. In July last year we therefore clarified the orientation of monetary policy going forward: we offered forward guidance on the future path of policy conditional on the evolving outlook for price stability.

All our measures, standard and non-standard, have been taken to serve our primary objective of maintaining price stability. And they have delivered: since June 2009 (i.e. the start of this legislature) the average inflation rate in the euro area has been 1.8%. In exceptional circumstances, our measures were exceptional. But our commitment to our primary objective has not changed, and our strategy has remained the guide of our action. Our credible commitment to these core elements is reflected in medium to longer-term inflation expectations remaining firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2% over the medium term.

Five years of economic and governance reforms – the euro area is more stable and resilient

The last five years have not only seen effective *monetary* policy-making in the euro area – we should also remind ourselves that much has been achieved in the field of *economic* policy-making.

Four years after the first Member States requested financial assistance, today we can safely say that the worst has been averted. The political will of all actors involved has been strong enough to defend the integrity of the euro area. Many had underestimated this will.

And more than that: Contrary to the bleak picture that some are trying to paint these days, the euro area is – in terms of economic fundamentals and institutional set-up – on a better footing than it was at the beginning of this Parliament's mandate. It is clearly moving in the right direction – the glass is at least half-full.

To a large extent, this can be attributed to the correction of economic policies at the national level. Imbalances are receding and foundations are being laid for improved competitiveness and stronger growth. This is especially true for programme countries, which have undertaken a remarkable effort to consolidate public balance sheets, repair their financial sectors and reform the structure of their economies.

Beyond national policies, the euro area as a whole has become more resilient. In these turbulent years, when the return to national remedies often looked tempting, the European Parliament with its true European perspective played a crucial role in ensuring truly European solutions. I am aware that the institutional approach that had to be taken at some instances has created some discomfort especially within your house. But overall, let us recognise what has been achieved:

First, the six-pack, the two-pack and the Fiscal Compact have made the governance framework more commensurate to the challenges of a monetary union. This was an important step towards sound public finances in the euro area.

Second, improved financial regulation (as exemplified by CRD IV and by the compromise reached on the BRRD) and the gradual steps towards a true banking union (with a single supervisor, a single resolution mechanism and a harmonised framework for national deposit guarantee schemes) will importantly reduce the risk that a crisis of the magnitude that we have just experienced will materialise again.

Third, in 2010, there had been no arrangements in place to deal with Member States losing market access. This absence had created major uncertainty in markets about the way forward. With the ESM and the two-pack, both a permanent funding instrument and a governance framework have been created. This has been a major step forward and will ensure that in the future, the euro area will be better prepared to respond to such crises.

In historic perspective, five years are a blink of an eye. In less than five years, the euro area has taken a remarkable leap forward that has kept us together. This cannot be highlighted enough in the weeks to come.

The next five years ahead – towards completing the Union

I have no doubt that from July on the next parliament will continue to assume the important role this house has played in the last legislature. The challenges that still lie ahead of us are too important and too complex to indulge in complacency. It is too early to claim "mission accomplished".

People in the euro area are still suffering from the inevitable adjustment process following years of accumulated imbalances. Unemployment remains unacceptably high. Citizens are judging Europe on its capacity to deliver jobs and sustainable growth. The years to come are about creating a more perfect union that caters to these objectives.

Foremost, this means delivering on commitments made in the past. Member States need to keep their promises to correct imbalances and to reform the structure of their economies. Fiscal policies have to be brought in line with the provisions of the Stability and Growth Pact and of the Fiscal Compact. Fiscal consolidation should be designed in a growth friendly manner while structural reforms will boost potential growth.

This concerns all Member States, not just those who looked at some point into the abyss of losing market access. This concerns also the European institutions. They have to ensure that common rules are thoroughly and evenly applied.

Delivering on past commitments also means keeping the promise made by Heads of States or Governments in June 2012 to complete banking union. It means swift transposition of agreed directives into national law and a stringent application of the adopted regulatory framework. It also means that a strong second pillar of banking union, a Single Resolution Mechanism, needs to be agreed before the end of this legislature.

Creating a more perfect union also requires filling the remaining gaps in the architecture of Economic and Monetary Union. A genuine and comprehensive Economic and Monetary Union as outlined in the Four Presidents Report should still remain our long-term objective.

This does not mean pushing integration as far as we can. This is neither economically necessary nor politically realistic. It means aligning economic governance and policies of Member States where appropriate to ensure that positive spillovers are enforced while negative externalities are minimised. Sharing sovereignty in crucial policy areas is certainly one way to accomplish this.

It is not for a central bank to prescribe solutions. This is a political prerogative. But it is my hope both as a central banker and as a European citizen that the upcoming electoral campaign will serve as an opportunity to engage in a debate on solutions for Europe's common way forward.

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