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, Strasbourg, 14 July 2014.

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Mr Chairman,

Honourable Members,

Allow me to start by congratulating all of you on your election to this House, and you, Mr Chairman, on your appointment as Chair of the committee in the new legislative period.

The architects of Monetary Union conceived the ECB as a central bank with a clear mandate and with strong provisions for its independence. But for a public institution in a democratic society, independence can never come without being commensurately transparent and accountable to the elected representatives of the people. Our regular exchanges of views are a key channel for the ECB to discharge its duty of central bank accountability; hence, they plays an essential role in providing the ECB with the necessary legitimacy to fulfil the tasks assigned to it by the Treaties. To underscore our commitment to transparency, the ECB has recently decided to go a step further by publishing regular accounts of the monetary policy meetings of the Governing Council, which is intended to start in January next year.

It is in this spirit that I am looking forward to our exchange of views over the next five years. And, therefore, without further ado, let me go into the substance for today: first, I will share with you our assessment of the economic outlook for the euro area. Second, I will explain the package of policy measures we adopted at the beginning of June. Finally, I will briefly touch upon the challenges that await us in the next five years.

Economic outlook

Let me start with the economic outlook: in the first quarter of 2014, euro area GDP grew by 0.2%. Growth was thus positive for the fourth quarter in a row. In line with earlier expectations, domestic demand has increasingly become the main source of growth. For the second quarter, monthly indicators have been more mixed, however partly reflecting technical factors. Overall, looking through the usual volatility in monthly indicators, the on-going moderate recovery is expected to continue.

Looking further ahead, domestic demand can be expected to continue to support growth – together with both the further monetary policy accommodation that was introduced in June and the on-going improvement in financing conditions. The progress made in fiscal consolidation and structural reforms, as well as gains in real disposable income, is expected to provide positive impetus to growth over the next two years. Furthermore, demand for exports should benefit from the on-going global recovery, and should thereby reinforce the growth momentum in the euro area.

Although labour markets have shown some signs of improvement, unemployment remains high in the euro area. Unutilised capacity continues to be sizeable. Moreover, credit growth to the private sector remains subdued, and the necessary adjustment of balance sheets in the public and private sectors will probably continue to dampen the pace of recovery.

The risks surrounding the economic outlook remain on the downside. Geopolitical risks, as well as developments in both emerging market economies and global financial markets, may have a negative effect on economic conditions in the euro area, through their impact on energy prices and global demand for euro area products. Further downside risks include an inadequate implementation of structural reforms in the Member States and weaker than expected domestic demand.

Looking at price developments, we see that euro area HICP inflation declined sharply from late 2011 to October last year, and has since been fluctuating around very low levels below 1%. According to the latest data (Eurostat's flash estimate), euro area annual HICP inflation stood at 0.5% in June 2014, unchanged from May.

Annual HICP inflation is expected to remain at low levels over coming months, before increasing gradually in 2015 and 2016. At the same time, medium to long-term inflation expectations remain firmly anchored in line with price stability.

Upside and downside risks to the outlook for price developments are both seen as limited and broadly balanced over the medium term. We will monitor the possible repercussions of geopolitical risks and exchange rate developments closely in this context. The exchange rate is not a policy target for the ECB. Nevertheless, the exchange rate remains an important driver of future inflation in the euro area. Certainly, the appreciation that took place since mid-2012 had an impact on price stability. In the present context, an appreciated exchange rate is a risk to the sustainability of the recovery.

Recent monetary policy measures

Let me now move to explaining our monetary policy stance.

We decided on a number of monetary policy measures in early June. These measures are aimed at providing additional monetary policy accommodation by supporting lending to the real economy. In line with our price stability mandate, these decisions are an essential contribution to bringing inflation rates closer to 2%. They will also contribute to a further strengthening of the recovery.

- Specifically, we lowered all key interest rates further. Our main refinancing rate now stands at 0.15%. Accordingly, our deposit facility rate has been cut to a negative level and now stands at –0.10%.
- We will conduct targeted longer-term refinancing operations (TLTROs) as of September 2014. In these operations, banks will be entitled to borrow from the Eurosystem, conditional on their lending to the private non-financial sector, with loans to households for house purchase being excluded.
- In addition, we are intensifying our work in preparation of possible outright purchases in the market for asset-backed securities (ABSs).
- Furthermore, we also decided that at least until the end of 2016, we will continue to fully meet the demand of banks for liquidity in our refinancing operations – of course, against adequate collateral.
- Finally, we have suspended the weekly operations to absorb the liquidity injected under the Securities Markets Programme.

We took these decisions to enable our accommodative monetary policy stance to better feed through to the wider economy. Weak credit growth in the euro area, particularly to small businesses, has been a major headwind for the recovery. Indirectly, it has been a continuous drag on inflation over the recent past. In fact, despite significant reductions in policy interest rates and, overall, more contained macroeconomic risks, bank-intermediated credit growth remains subdued and lending rates for small businesses are well above the levels usually observed in similar phases of the business cycle.

To address this challenge, our TLTROs are tailored to incentivise bank lending to the real economy in the euro area. The TLTROs will provide long-term funding to participating banks. This should ease their financing costs, allowing banks to pass on such attractive conditions to their customers. This will ease credit conditions and stimulate credit creation. Moreover, the growth of our balance sheet as a result of a significant take-up in our TLTROs will put downward pressure on interest rates in the money markets. This will contribute further to lowering the banking sector's funding costs.

However, the TLTROs will not merely provide long-term funding. The TLTROs are targeted operations: the stronger the flows of new net lending to non-financial corporations and consumers (relative to a specified benchmark), the higher the amount that banks will be permitted to borrow from the Eurosystem at very attractive terms and conditions over a period of up to four years. Hence, we have built in strong incentives for banks to expand their lending beyond original plans – both banks with a recent record of positive lending and those that have been deleveraging.

Overall, the measures adopted last month have already provided additional monetary policy accommodation. Even though substantial easing measures had already been priced in by markets before the Governing Council's June meeting, money market rates and bond yields declined further after the announcement of our decisions. Expectations with respect to short-term money market rates have come down some basis points from their already very low levels.

Looking forward, we will maintain a high degree of monetary policy accommodation. In view of the outlook for inflation, we will keep the key ECB interest rates at current levels for an extended period of time. Moreover, the ECB continues to stand ready to take action, if necessary, to further address risks of too prolonged a period of low inflation. This could also include the use of other unconventional instruments in line with our price stability mandate.

Challenges ahead

Let me now turn to the challenges that the euro area will face in the years to come. In the last legislative period, a great deal has been done to restore stability as a key prerequisite for economic dynamism. This has resulted in a return of confidence to the euro area. But high public and private debt, low growth and unacceptably high levels of unemployment are reminding us that the most pressing matter now is to bring the euro area back onto a path of shared prosperity.

To achieve this, the focus in the next five years should lie on thoroughly implementing the reinforced policy framework that was agreed in the last term, and on further increasing the resilience of euro area countries' economies. For us at the ECB, this means assuming a new role in the banking union by supervising the euro area banks as from November. With the comprehensive assessment exercise that we are currently conducting, we will contribute to putting euro area banks on a healthy footing, so as to enable them to provide financing to the real economy. For euro area Member States, this means undertaking the necessary structural reforms to foster growth, and to avoid any new build-up of macroeconomic imbalances. It also means continuing fiscal consolidation to rebalance public finances in line with the rules underpinning the Stability and Growth Pact. The euro area policy framework was strengthened considerably by the agreement between this House and the Council on the six-pack and the two-pack. We should take great care not to roll back this important achievement, or to water down its implementation to an extent that it would no longer be seen as a credible framework.

Notwithstanding the significance of the reinforcements put in place for the policy framework, I believe that there is still room for further legislative action where the financial sector is concerned. In addition to a better performing banking sector, an increased role of capital markets could help to support both growth in Europe and the financing of the real economy. To fully reap the benefits of capital market integration, the regulatory environment needs to be harmonised further and, potentially, to be adapted. The joint paper of the ECB and the Bank of England on a better functioning securitisation market in the EU has set out a number of proposals in this regard. Furthermore, a better regulation of financial benchmarks is necessary to restore the confidence and trust of citizens and market participants in the financial system. A swift adoption of the relevant Commission's proposal is of utmost importance. Discussions will also continue on the shape and structure of our banking sector and the regulation of the shadow banking sector.

Finally, over and beyond this focus on concrete short and medium-term measures, we should bear in mind that Economic and Monetary Union still remains an incomplete structure. Let us seize the opportunity of a new Parliament and a new Executive to reflect further on how to develop the architecture of our EMU in order to enhance its functioning. In particular, I think there is a case for some form of common governance over structural reforms. This is because the outcome of structural reforms – a continuously high level of productivity and competitiveness – is not merely in a country's own interest. It is in the interest of the Union as a whole. For example, one could consider embedding the process of undertaking necessary structural reforms in a common framework of convergence towards policies and institutions aligned to best practices.

Honourable Members, as EU institutions, the central bank and the Parliament of the European Union are duty bound to maintain a close and fruitful relationship of cooperation. I sincerely hope that in this respect, we can continue in the same spirit as we left off three months ago.

I am now looking forward to answering your questions.