Vítor Constâncio: Presentation of the ECB Annual Report 2014 to the Committee on Economic and Monetary Affairs of the European Parliament

Introductory remarks by Mr Vítor Constâncio, Vice-President of the European Central Bank, to the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 20 April 2015.

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Mr Chairman,

Honourable members of the Committee on Economic and Monetary Affairs,

Ladies and gentlemen,

I am honoured and pleased to be back in this Committee to present the ECB's Annual Report 2014 today. This event underlines once again the importance of the dialogue with the European Parliament to ensure the accountability and transparency of the ECB's activities.

And it is precisely because the ECB considers transparency to be such a vital aspect of accountability and effectiveness that we have this year started to publish accounts of our monetary policy meetings.

The publication of the Annual Report complements our efforts towards greater transparency by describing the actions that the ECB undertook in 2014 with a view to fulfilling its mandate in a challenging environment.

Forceful action by the ECB was needed to respond to the impairment of the transmission channels of our monetary policy and to the low inflation environment.

Our monetary policy action was complemented by another major achievement in 2014: the preparations for and start of operations of the Single Supervisory Mechanism. The specific regime foreseen by the Inter-Institutional Agreement between the ECB and your institution takes into account the need for enhanced accountability for this new task for the ECB.

Today, I will first look back at the measures taken by the ECB since the beginning of last year to fulfil its mandate. I would then like to discuss the capital markets union project, which, if pursued with sufficient ambition, could unleash the benefits of more robust financial integration and improve the transmission of our monetary policy.

The ECB's monetary policy

From a monetary policy perspective, the environment we faced in 2014 was very complex and demanding. The muted recovery that had begun in 2013 did not accelerate as initially expected. For the year as a whole, we saw GDP growing by 0.9% in the euro area. Money growth remained subdued and credit continued to contract, albeit at a gradually declining pace. Tight credit standards, combined with elevated and sticky bank lending rates in a large part of the euro area, were viewed as one of the principal causes of the persistent economic slack at the euro area level and, indirectly, as a major source of ongoing disinflation.

In response to these impairments in the monetary policy transmission mechanism, the Governing Council adopted a package of measures between June and October. This package included three main elements: first, two reductions in the key ECB interest rates bringing them to their lower bound; second, the announcement of a series of eight targeted long-term refinancing operations; and third, two purchase programmes for asset-backed securities and covered bonds.

Despite the positive contribution of these measures to an easing of credit conditions across the euro area, inflationary pressures showed no sign of strengthening. On the contrary, the declining trend in headline inflation accelerated towards the end of the year. While the considerable fall in oil prices in the second half of 2014 contributed to this development, it came at the end of a prolonged trend that had already brought inflation to historically low levels, heightening risks of second-round effects.

In order to forestall the setting-in of a self-perpetuating process which could pose serious risks to price stability, the Eurosystem decided on 22 January 2015 to expand its purchase programmes to include public sector securities. The purchases under the expanded asset purchase programme are intended to be carried out until end-September 2016, and in any case until the Governing Council sees a sustained adjustment in the path of inflation which is consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term.

Taken together, the policy measures adopted have contributed to lower interest rates in capital markets and have helped to transmit these favourable developments through the entire financial intermediation chain. They have produced a visible improvement in the transmission of the ECB's accommodative monetary policy stance to the real economy. This has meant a further considerable easing of financing conditions for households and firms, as evident in a significant decline in the levels of lending rates and in a material compression of their dispersion across the euro area. Bank lending rates have declined sharply since summer 2014 (by 40 to 50 basis points), and the nominal cost of external financing for euro area non-financial corporations has declined further, standing at 4.1% in February. This should in turn promote and strengthen a revival in credit and investment. Bank credit to non-financial firms increased in the last three months (to February 2015) at an annualised rate of about 2%, compared with a negative rate last year of less than –2%. A broad-based turnaround in loan dynamics occurred around the second quarter of 2014, in particular for non-financial corporations. The robust growth of narrow money (M1), which is a leading indicator for economic growth, confirms this view. This assessment is further supported by the euro area bank lending survey, which has shown a strengthening in the demand for loans by households and enterprises and an easing of credit standards throughout the year.

Our policies are working and the economic recovery is becoming self-sustained. According with our staff projections the still negative output gap will be closed by 2017. This is helping the evolution of inflation and inflation expectations to levels compatible with our mandate in spite of the effect of the oil price shock implying that the process of normalizing inflation is still at an early stage.

However, monetary policy does not operate in isolation, and other policy initiatives are equally important.

For this reason, the start of the activities of the Single Supervisory Mechanism and the completion of the comprehensive assessment were critical steps in helping to achieve a healthier monetary policy transmission process. In general, the SSM within the banking union – and in combination with the actions of the Single Resolution Mechanism and the Single Resolution Fund – will further contribute to breaking the nexus between sovereigns and banks.

Moreover, the euro area needs a coherent and comprehensive strategy to create the conditions for a sustained recovery, based on investment, job creation and productivity growth. Fiscal policies should support economic growth, while ensuring debt sustainability. At the same time, structural reforms should be implemented promptly and with determination, as firms and households must be not only able but also willing to invest. We keep repeating this call because the combination of sound fiscal policies and improved economic structures has the potential to make monetary policy more effective by encouraging economic actors to take advantage of improved financing conditions and increase investment. Monetary policy can and will smooth and accelerate the transition to a sustainable growth trajectory, but it cannot lift that trajectory. For this to happen, it is essential that available financial resources are well allocated and used productively. In this regard, the capital markets union agenda can also make an important contribution.

A capital markets union has great potential – but only if pursued with ambition

The Commission intends to establish the main building blocks of a capital markets union (CMU) in the current legislative period. From our perspective, such a project, if comprehensive and well designed, could indeed bring significant benefits to the EU.

CMU is a means of enhancing the integration of capital markets and making that integration more robust. Integrated capital markets can strengthen financial stability by increasing private risk sharing, thereby facilitating the absorption of shocks throughout the EU. At the same time, well-functioning capital markets facilitate the transmission of our monetary policy. Financial integration therefore features prominently in the Eurosystem's mission statement.

CMU is also an agenda for an increase in the diversity and size of capital markets through the further development of certain market segments. Deeper and more diverse capital markets provide alternative sources of funding. For example, financing tools could be developed to better account for the specific needs of small and medium-sized enterprises, infrastructure projects or long-term financing. Moreover, the reduction of the economy's dependence on bank financing would widen the set of tools available for the conduct of monetary policy.

However, there is a real danger of failing to explicitly identify the necessary conditions for the CMU to achieve its objectives.

Let's be clear: a genuine CMU means achieving a high level of financial integration in completing the Single Market in this area. In a genuine CMU, all market participants with the same relevant characteristics should face a single set of rules, have equal access to a set of financial instruments or services, and be treated equally when they are active in the market. The EU's capital markets union therefore needs to be underpinned by a single legal and regulatory framework that provides a level playing field and allows markets to integrate and develop.

This has a number of implications.

First, the goal of having such a capital markets union is in itself very ambitious. Hoping that CMU will bring the expected benefits without accepting the prospect of full regulatory harmonisation is wishful thinking. Getting halfway there will not be enough. In fact, half a capital markets union is still no capital markets union. This was one of the lessons of the crisis, in particular regarding the interplay between the Single Market and an incomplete regulatory and supervisory framework for banks. There is no reason to doubt that what holds for banking also applies to capital markets.

Second, developing a genuine single rulebook for capital markets would also mean addressing barriers in policy areas that are relevant beyond capital. These include politically sensitive areas such as insolvency and corporate laws as well as taxation of financial products. Where legislative progress is for the moment not possible at the EU level, we need determined and concerted action at the national level to lower cross-border barriers.

Third, the single rulebook would also need to be complemented over time by the common implementation and enforcement of rules as the deeper interconnectedness generated by CMU increases risks of contagion and consequently requires enhanced oversight and supervision of markets and institutions.

The European Parliament as co-legislator has a pivotal role to play in this process, and I trust that it will be a key contributor to the creation of a genuine CMU.

Conclusion

Let me conclude.

The major efforts undertaken since the beginning of 2014 as regards both monetary policy and the banking union demonstrate that Europe can deliver when determined action is needed.

Nevertheless, we need to go further. Sound fiscal and structural policies at the national level and further steps to reinforce the institutional underpinning of Economic and Monetary Union would allow the euro area economy to become more resilient. Moreover, decisive actions and reforms are needed to support the creation of a genuine capital markets union with a view to unleashing the full benefits of more robust financial integration. These developments will play a key role in paving the way to a sustained recovery and a stronger monetary union, resilient to shocks and a guarantee of stability and prosperity.