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, 25 September 2017.

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Mr Chairman,

Honourable Members of the Economic and Monetary Affairs Committee,

Ladies and gentlemen,

I am very pleased to be back speaking to your committee for the third hearing of this year.

A year ago, we were discussing together the moderate pace of the recovery in the euro area. We were witnessing a slight loss of momentum and assessing the impact of the UK referendum. Over the past 12 months, however, the recovery has accelerated and broadened, supported by the pass-through of our monetary policy.

In my remarks today I will discuss the current economic outlook and the impact of our monetary policy measures. At the request of the committee, I will focus in particular on two topics related to the ECB's monetary policy, namely the corporate sector purchase programme (CSPP) and monetary policy implementation across the euro area.

The economic and inflation outlook

The economic expansion is now firm and broad-based across euro area countries and sectors. Real GDP growth was better than expected in the first half of 2017, coming in at 2.3%, year on year, in the second quarter. The euro area economy has enjoyed 17 consecutive quarters of growth, and the latest information indicates continued momentum in the period ahead.

The ongoing recovery is, crucially, driven by domestic forces, and the labour market has notably improved. The unemployment rate has fallen to its lowest level in eight years. The number of people employed in the euro area has increased by almost 7 million since mid-2013. These employment gains, together with increasing household wealth, are supporting the private consumption outlook. Moreover, investment is improving, buoyed by very favourable financing conditions.

The domestic drivers are making the recovery more robust and resilient to adverse external influences. According to the September ECB staff macroeconomic projections, the economic expansion will continue at growth rates above potential over the projection horizon. Annual real GDP is projected to increase by 2.2% in 2017, by 1.8% in 2018 and by 1.7% in 2019. Risks surrounding the euro area growth outlook are broadly balanced. At the same time, downside risks continue to exist, mainly related to global factors and developments in foreign exchange markets.

The firm economic recovery still needs to translate more convincingly into stronger inflation dynamics. As I reported already in the past, deflation risks have essentially disappeared. Nevertheless, measures of underlying inflation have picked up only moderately over recent months. Headline inflation, which was 1.5% in August, is expected to temporarily decline towards the turn of the year, driven mainly by base effects in the energy component. Afterwards, it is expected to pick up gradually, reaching 1.5% in 2019, according to the ECB staff projections.

Overall, we are becoming more confident that inflation will eventually head to levels in line with our inflation aim, but we also know that a very substantial degree of monetary accommodation is still needed for the upward inflation path to materialise. Moreover, we still see some uncertainties with respect to the medium-term inflation outlook. Most notably, the recent volatility in the exchange rate represents a source of uncertainty which requires monitoring with regard to its possible implications for the medium-term outlook for price stability.

We therefore need to be patient and persistent. An upward adjustment of headline inflation that is durable and self-sustained requires a further absorption of economic slack. This, in turn, still requires a very ample degree of monetary policy accommodation.

With this in mind, we will decide later this year on a re-calibration of our instruments that maintains the degree of monetary support that the euro area economy still needs to complete its transition to a new balanced growth trajectory characterised by sustained conditions of price stability.

The corporate sector purchase programme

The package of monetary policy measures that we have phased in sequentially since June 2014 has led to a significant easing in financing conditions. What is very apparent today, and very difficult to dispute, is that this monetary policy impetus is increasingly leading to stronger economic activity, higher incomes and better employment prospects for people in the euro area.

One key factor has been our ability to activate non-standard instruments that can transmit additional stimulus to the productive sector. In fact, transmission through the banking system has become increasingly effective since we began adopting credit-easing measures. I am referring here specifically to the expanded asset purchase programme (APP), but a similar case can be made for our targeted longer-term refinancing operations.

At the request of the committee, let me focus on one component of the APP, namely the CSPP.

Together with the purchase of asset-backed securities and covered bonds, the CSPP represents an important credit-easing component of the APP. By directly lowering the market-based financing costs of non-financial corporations, it boosts the pass-through of our monetary policy.

Under the CSPP, the Eurosystem has since June 2016 purchased bonds issued by a wide range of non-bank corporations established in the euro area, which include large, as well as some smaller, companies. So far, close to €110 billion of corporate bonds from around 200 issuers, in 20 countries, across all sectors, have been purchased. This information is available on our website and in our publications, and is updated regularly. We continue to analyse possibilities for sharing more information, to the extent that it can enhance transparency without undermining the effectiveness of monetary policy.

Thanks to our corporate bond purchases, firms in the euro area have witnessed significant improvements in their financing conditions when issuing bonds.

But these improvements in financing conditions stemming from the CSPP are not confined to the companies whose bonds are purchased or to the corporate bond market: they are evident across firms and other market segments.

For example, the yield spreads of high-rated corporate bonds that are not eligible for purchase – namely those issued by financial corporations – have fallen by as much as those of eligible bonds issued by non-financial corporations (almost 70 basis points, from 1.25% in March 2016 to 0.57%) since the CSPP announcement. Spreads of non-investment grade corporate bonds, which are not eligible for the CSPP, have also declined by 262 basis points, from 5.59% in March 2016 to 2.97%.[1]

For asset purchases to boost activity and inflation, however, these improvements in financial markets need to be passed through into credit conditions for the real economy.

In this regard, we have seen very favourable spillovers into credit conditions for small and medium-sized enterprises. As more corporations seek market-based financing, given the attractive funding conditions prevailing in the capital markets, banks are left with greater capacity to provide loans to smaller companies, which are more constrained in terms of access to funding sources. Hence, bank lending rates on very small loans to non-financial corporations have declined by around 50 basis points since the CSPP announcement. Looking at our latest Survey on the Access to Finance of Enterprises, smaller companies are indeed reporting improved financing conditions and better access to finance.

The CSPP, therefore, has strengthened the pass-through of our asset purchases to the financing conditions of the real economy and has contributed to the overall monetary stimulus needed to bring inflation rates back in line with our inflation aim.

Conducting monetary policy in the euro area

The supportive impact of our policy measures – including all elements of our asset purchase programme – on financing conditions is therefore evident across firms regardless of their size. It is also evident across sectors and across euro area countries. In other words, we are seeing a smooth transmission of our single monetary policy.

A single currency entails a single monetary policy. Hence, the Governing Council takes decisions to achieve the primary objective of maintaining price stability for the euro area as a whole. It also establishes the necessary guidelines for their implementation.

At the same time, and in accordance with its Statute,[2] the ECB has recourse to the national central banks (NCBs) to the extent deemed possible and appropriate for carrying out the operations which form part of the tasks of the Eurosystem. NCBs in turn have a duty to act in accordance with the guidelines and instructions of the ECB.[3]

This decentralised approach takes into consideration the financial structure of the euro area, i.e. a monetary union made up of segmented national financial markets. In such an environment, the close interaction of NCBs with the banks operating in their jurisdiction brings benefits for the implementation of monetary policy. For example, we are able to collect precise information from a wide range of local counterparties, which can be integrated into the harmonised and rich information set that the Governing Council needs to design policy. Moreover, NCBs, knowing well the specificities of their jurisdictions, are well placed to manage assets to be used as collateral in our operations.

This makes our decentralised system more efficient than a centralised approach under the current circumstances. In the absence of a truly single market for capital, securities markets still depend very much on national specificities and preferences. A successful capital markets union would abolish dividing lines between jurisdictions, with positive effects on the way we implement our monetary policy. In the end, we should not forget that a fundamental reason for monetary union was precisely to foster more integrated capital markets and reap the benefits in the form of improved financing conditions across the euro area.

Conclusion

Since you asked me to elaborate on the issue of decentralisation, let me conclude with a final thought in this respect and in particular on the implications for the functioning of Economic and Monetary Union.

The fact that the ECB's non-standard policy measures have been very effective in supporting the financing conditions of companies and households throughout the euro area should not make us forget the situation we witnessed at the peak of the crisis. For example, institutional weaknesses, structural fragilities and excessive risk-taking contributed to a negative feedback loop between sovereigns and banks in some countries, which significantly impaired monetary policy transmission. The resultant contraction in the euro area economy threatened price stability, our primary objective. Overcoming this vicious circle required considerable effort.

The pattern is now running in reverse, with positive spillovers from all countries. They all have benefited from our measures supporting growth across all of the euro area and thus laying the ground for a sustained return of inflation to levels in line with our aim.

But while a cyclical adjustment has been taking place, there are still structural issues which impede sustainable economic convergence.

In the years to come, a higher degree of sustained convergence and strengthened resilience will be necessary in order to achieve a better-functioning Economic and Monetary Union.

This requires, on the one hand, policy actions by national governments aimed at unlocking the productive potential of our economies. On the other hand, further decisive steps are needed to make Economic and Monetary Union's economic governance truly fit for purpose.

Thank you for your attention. I am now at your disposal for questions.

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[1] Spreads over the corresponding AAA-rated euro area average yield curve.

[2] Article 12.1 of the Statute of the European System of Central Banks and of the European Central Bank.

[3] Article 14.3 of the Statute.