Mario Draghi: Introductory statement to the plenary debate of the European Parliament on the European Central Bank's Annual Report 2016

Introductory statement by Mr Mario Draghi, President of the European Central Bank, to the plenary debate of the European Parliament on the European Central Bank's Annual Report 2016, Strasbourg, 5 February 2017.

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Mr President of the European Parliament,

Mr Vice-President of the Commission,

Honourable Members of the European Parliament,

I am very pleased to be here to discuss with you the ECB's activities and your draft resolution on the ECB's Annual Report 2016.

Today's debate represents a good opportunity to take stock of progress made and discuss the way forward.

A decade ago, the global financial crisis was starting. Today, while further efforts are needed to overcome its legacy, the euro area economy is expanding and employment is rising.

Your draft resolution points out that monetary policy has played a key role in this recovery process. The ECB has indeed acted decisively, in line with its mandate. We have addressed financial fragmentation and supported the economy, enabling inflation to gradually converge towards our objective.

The draft resolution also notes that the independence of the ECB has allowed us to take resolute action within our mandate. But independence is just one of the cornerstones of our institutional framework. Accountability is its necessary counterpart. And you, as the representatives of the people of the EU, are the heart of our accountability. Together, independence and accountability underpin our effectiveness and our legitimacy.

In my remarks today, I will focus on two particular issues that have been raised in the draft resolution. First, I will elaborate on economic developments in the euro area and the role of the ECB's monetary policy. Second, I will discuss the state of the financial sector and the measures needed to further strengthen its resilience.

Economic developments and the role of the ECB's monetary policy

The euro area economy is expanding robustly, with stronger growth rates than previously expected and significantly above potential. According to preliminary data, euro area real GDP increased by 2.5% in 2017, compared to the 1.7% that had been foreseen in our December 2016 staff projections for the same year.

The economic expansion is broad-based. The dispersion of growth rates across countries and across sectors is at its lowest level for 20 years. Accordingly, we see positive growth in over 85% of the sectors in the euro area economy, compared with an historical average of 74%. Employment growth has recently strengthened as well in all the main sectors, namely in industry, construction and market services. These developments bode well for economic growth, as expansions tend to be stronger and more resilient when growth is broad-based.

The number of people employed in the euro area has also increased by around 7.5 million since hitting a low in mid-2013. Employment has now reached its highest level since the introduction of the euro. The unemployment rate continues to decline and now stands at close to a nine-year low of 8.7%, down by 3.3 percentage points from its highest level.

As more people find jobs, household incomes rise. This has helped to strengthen private consumption growth, which in turn is boosting business investment. In addition, a number of other factors have supported investment. These factors include higher demand for euro area exports, rising corporate profitability and an increasing use of installed productive capacity.

These positive developments have been fostered and reinforced by the pass-through of the ECB's monetary policy measures, which have eased funding conditions for households and firms. Small and medium-sized enterprises (SMEs) in particular have benefited from our policy measures. The growing inclusiveness of this economic expansion is partly due to the renewed vigour of small businesses, which are a key engine of income creation in our economy.

While our confidence that inflation will converge towards our aim of below, but close to, 2% has strengthened, we cannot yet declare victory on this front.

After increasing to 2% in early 2017 due to a rise in energy prices, headline inflation has fluctuated since May 2017 between 1.3% and 1.5%. Measures of underlying inflation, which exclude the most volatile components, remained subdued and have yet to show convincing signs of a sustained upward trend. Also, new headwinds have arisen from the recent volatility in the exchange rate, whose implications for the medium-term outlook for price stability require close monitoring.

On the back of improved economic conditions, the financial stability situation in the euro area has also continued to evolve positively. As I will explain in more detail, for the time being we have little indication that generalised imbalances are emerging.

Overall, while we can be more confident about the path of inflation, patience and persistence with regard to monetary policy is still warranted for underlying inflation pressures to build up and inflation to converge durably towards our objective. That is why – at our last meeting – we re-affirmed the decisions taken at our October monetary policy meeting last year. Accordingly, our net asset purchase programme, running at a monthly pace of €30 billion, will continue until the end of September 2018, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. In parallel, we will reinvest the principal payments from maturing securities purchased under the expanded asset purchase programme for an extended period of time after the end of those purchases, and in any case for as long as necessary. We expect our key interest rates to remain at their present levels for an extended period of time, and well past the horizon of our net asset purchases.

Looking forward, we remain fully committed to our price stability objective and – in line with our monetary policy strategy – we aim to stabilise inflation around levels that are below, but close to, 2% within a meaningful medium-term horizon. As always, our monetary policy will continue to be guided by our assessment of the progress made towards our objective. Our forward guidance continues to provide a stable framework for our monetary policy stance and its outlook. In line with that guidance, monetary policy will evolve in a fully data-dependent and time-consistent manner.

Strengthening the resilience of the euro area financial sector

Your draft resolution also considers several aspects related to the euro area financial sector and I would like to follow up on some of them.

Let me first of all emphasise that our monetary policy and a healthier financial sector are mutually reinforcing.

By supporting the economic recovery, our monetary policy measures have had a positive impact on the credit quality of banks' loans to businesses and households, and helped banks to further reduce their provisioning costs. Moreover, a stronger economy generates greater volumes of sustainable bank lending. Both factors have therefore strengthened the solidity of the European banking sector.

A better integrated and sounder financial sector has also been able to transmit our policy impulses more evenly across the euro area. The improved health of the banking sector, coupled with our credit easing measures, has brought about a marked improvement in the transmission process, as shown by the reduced heterogeneity of bank lending rates across countries and improved borrowing conditions for SMEs.[1]

The difference between interest rates for loans to non-financial corporations of above and below €1 million also continued to decline, indicating easier access to finance for SMEs, in particular in the countries that were most affected by the financial crisis.

A more robust financial sector has also allowed us to pursue an accommodative policy for as long as necessary, without any build-up of significant financial stability risks.

The draft resolution points in particular to the risks stemming from possible asset bubbles. We are closely monitoring developments in some market segments, such as prime commercial real estate and housing markets in some countries, and corporate bond markets for lower-rated issuers. As we explain in our Financial Stability Review,[2]

The publication is accessible on the ECB's website at: www.ecb.europa.eu/pub/fsr/html/index.en.html

asset price increases in euro area markets have so far not been accompanied by excessive credit growth. Although credit flows have been recovering, growth rates are still far below anything we saw before the crisis and on the low side of the range of growth rates historically seen during recoveries. So there is no evidence of systemic credit-fuelled bubbles.

The efforts we have made in recent years to strengthen prudential regulation and supervision, above all with the establishment of the banking union, have certainly played a role in protecting financial stability.

In particular, the ECB Banking Supervision plays a key role in ensuring the safety and soundness of banks. It enhances the banks' resilience through strengthened prudential regulation. It also fosters cross-border financial integration and provides a level playing field by harmonising supervision across the euro area.

Also on the macroprudential side, we see national authorities in close cooperation with the ECB being very active in further mitigating the emergence of possible systemic risks, especially with respect to residential real estate developments.

Despite the improved cyclical environment, improved market sentiment and the substantial strengthening of its shock absorption capacity, the European banking sector continues to face structural challenges, as you also state in your resolution.

Indeed, overcapacity and cost inefficiencies continue to weigh on bank profitability in certain banking markets.

Moreover, the high stock of non-performing loans (NPLs) needs to be further reduced and any future build-up needs to be avoided. NPL levels have been declining for more than three years and good progress has been made on the EU Council Action Plan, although there is still a considerable way to go. Additional efforts by banks, supervisors, regulators and legislators are needed to create an environment in which NPLs can be effectively managed and efficiently disposed of.

Strengthening the resilience of the euro area financial sector also means adapting to a changing operating environment.

The resolution mentions, for instance, the growing role of fintech companies. This means more competition for banks, including in the field of lending and payment services. At the same time, new technology presents an opportunity for banks to increase the value added and the cost-efficiency of their services.

Another factor shaping the euro area financial sector is the United Kingdom’s decision to leave the EU. At this stage, we do not have clarity regarding the shape of the UK’s future relationship with the EU. Well-managed preparations are thus essential for dealing with frictions in the transition from the current situation to the eventual new equilibrium especially in the event that no transitional agreement is reached between the EU and the UK.

Banks and financial institutions are not the only ones that have to prepare for an operating environment in a state of flux. Policymakers too, at national and European level, have to make sure that the regulatory framework is fit and ready to safeguard the resilience of the financial sector in the face of the new challenges.

Let me mention two examples.

First, finalising the banking reform package is crucial. The package will strengthen the regulatory architecture, reduce risks in the banking sector and increase financial stability. It will introduce into Union law new internationally agreed standards, such as the leverage ratio requirement, which will restrict the build-up of excessive leverage in the banking system, and the standard on total loss-absorbing capacity (TLAC), which will strengthen the resolution framework. As co-legislators, you play a vital role in this process. I would encourage you to aim for a consistent implementation of the internationally agreed standards, so as to ensure a level playing field worldwide and to reduce options and national discretions as far as possible.

Second, it is important to complete the architecture of the banking union by putting in place the agreed common backstop to the Single Resolution Fund and by establishing a European deposit insurance scheme (EDIS). These are two fundamental pieces of the banking union project and their implementation should not be postponed further. The backstop should ensure that sufficient funding is available at all times to guarantee orderly resolutions. A fully fledged EDIS is an indispensable counterpart to the single currency as everyone in the euro area should be able to have confidence that the money in their bank account enjoys the same level of protection, regardless of where the account is held within the euro area.

Conclusion

Let me conclude. We pay close attention to the European Parliament’s resolution on our Annual Report. And we will respond in detail to the issues you raise there when we publish our ECB Annual Report for 2017.

The strong relationship between the ECB and the Parliament not only demonstrates the importance of accountability, but it also bears possible lessons for the reflection on the future of EMU whose strengthening should remain a priority.

A well-designed and effective policy framework requires a clear institutional architecture, measurable objectives and the tools to achieve them. And it needs to be accompanied by strong accountability. This is essential not only to ensure that policies are effective. It is also crucial if the public is to understand those policies and play an active role, in particular via their representatives in Parliament.

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

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