Mario Draghi: IMFC Statement

Statement by Mr Mario Draghi, President of the European Central Bank, at the thirty-seventh meeting of the International Monetary and Financial Committee, Washington DC, 20 April 2018.

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The euro area economy has been expanding robustly, with growth broad-based across countries and sectors. The economy grew by 2.8% in year-on-year terms in the fourth quarter of last year, according to the latest estimate. This strong performance has translated into notable improvements in the labour market. The unemployment rate in the euro area has dropped to its lowest level since 2008, while the number of people employed has increased by almost eight million since mid-2013. Notwithstanding the latest economic indicators, which suggest that the growth cycle may have peaked, the growth momentum is expected to continue.

Domestic demand remains the mainstay of the ongoing recovery, underpinned by the ECB's monetary policy measures. Private consumption is supported by employment gains and increasing household wealth. Business investment has strengthened amid improvements in corporate profitability, very favourable financing conditions and solid demand. In addition, euro area exports are benefiting from the broad-based global expansion.

The latest ECB staff projections put annual real GDP growth at 2.4% in 2018, 1.9% in 2019 and 1.7% in 2020. While recent data releases have overall been weaker than expected, risks to growth remain broadly balanced. Downside risks continue to be related primarily to global factors, including rising protectionism. The latter may have already had some negative impact on global sentiment indicators. In this context, preserving free and open trade that is underpinned by multilateral cooperation is crucial to foster a favourable global economic environment.

While headline inflation in the euro area has been somewhat volatile in recent months, this largely reflects the impact of base effects in energy and food inflation. Measures of underlying inflation remain subdued overall, but are expected to rise gradually over the medium term, supported by the ECB's monetary policy measures and in line with the ongoing re-absorption of economic slack and rising wage growth. The latest ECB staff projections point to annual euro area headline inflation of 1.4% in 2018, 1.4% in 2019 and 1.7% in 2020. Exchange rate volatility and financial conditions represent sources of uncertainty which require monitoring with regard to their possible implications for the medium-term outlook for price stability in the euro area.

Looking ahead, while our confidence in the inflation outlook has increased, remaining uncertainties still warrant patience, persistence and prudence with regard to monetary policy. An ample degree of monetary stimulus remains necessary for underlying inflation pressures to continue to build up and support headline inflation developments over the medium term. Accordingly, our net asset purchases are intended to run at the current monthly pace of €30 billion 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. Furthermore, the ECB will continue to reinvest the principal payments from maturing securities for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary. Finally, the Governing Council continues to expect the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the ECB's net asset purchases.

The condition and resilience of the euro area banking sector has continued to improve. The aggregate Common Equity Tier 1 ratio of significant institutions in the euro area stood at 14.3% at the end of the third quarter of 2017, up from 13.7% a year earlier. Euro area banks also saw their profitability improve in 2017, in part supported by the robust economic expansion and the limited cost of risk. Continued efforts to address non-performing loans (NPLs) resulted in an overall decrease in the NPL ratio for banks under ECB supervision from 6.5% to 5.2% in the third quarter of 2017. Notwithstanding these positive developments, a number of structural challenges continue to dampen banks' profitability prospects. These include, to varying degrees across countries and banks, cost inefficiencies, excess capacity and a lack of income diversification, while NPLs still remain high in some countries. In this context, a comprehensive action plan for dealing with legacy asset quality issues has been adopted by the Council of the European Union and is now being followed up by EU and national authorities. The ECB has published guidance to banks on NPLs, including its supervisory expectations for the prudential provisioning of new NPLs. Furthermore, in cases where Level 3 assets are material for specific banks, we continue to devote significant attention to potential valuation issues through both our off-site and on-site supervisory processes.

With respect to financial stability more broadly, the economic recovery has improved the resilience not only of banks but also of the non-financial sector in the euro area. Private sector debt ratios have declined in recent years. There are so far no indications of excessive credit growth or broad-based asset price misalignments in the euro area. However, developments in asset prices require close monitoring as risk-taking continues to gain momentum in financial markets and valuations are becoming stretched in some market segments. The ECB expects the national macroprudential authorities in the euro area to remain vigilant and continue to use the macroprudential policy instruments at their disposal to counteract any emerging risks when necessary. On its part, the ECB will contribute within its macroprudential mandate.

The positive developments in the euro area are not independent of the global growth momentum. Open trade, investment and sustainable financial flows play a key role in the cross-border diffusion of new technologies that drive forward efficiency improvements. They need to be underpinned by effective multilateral cooperation, both in the field of trade and in financial regulation and supervision, to help avoid major disruptions in global financial stability. Preserving openness is crucial if the global economy is to thrive and to secure its growth potential.

In the euro area, decisive contributions from areas beyond monetary policy remain necessary to raise the longer-term growth potential and reduce vulnerabilities. The current favourable economic conditions, in a politically stable environment, should help euro area countries to step up the implementation of reforms and thereby spur innovation and investment, further creating new jobs and reducing unemployment. A full and consistent application of the EU's economic governance framework, including the European Semester and the macroeconomic imbalance procedure, remains crucial to effectively incentivise national ownership of structural reforms. The current solid economic expansion also calls for fiscal buffers to be rebuilt in line with the requirements of the Stability and Growth Pact. The full and consistent implementation of the Pact is essential to ensure credibility and confidence in the EU fiscal framework, to rebuild fiscal buffers in national budgets for potential challenges ahead and to safeguard public debt sustainability. This is particularly important in countries where government debt remains high. In addition, all euro area countries would benefit from intensifying efforts towards achieving a more growth-friendly composition of public finances.

The Economic and Monetary Union (EMU) should be strengthened, first by implementing what has already been agreed and finishing the common projects we have started: completing the banking union, strengthening the governance and the operational capacity of the European Stability Mechanism and building a capital markets union. At the same time work needs to continue on designing and establishing a time frame for an effective and incentive-compatible euro area stabilisation function. A more complete EMU will be the foundation for a stable and resilient euro area economy contributing to global economic growth and financial stability.