Mario Draghi: Hearing of the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Mario Draghi, President of the European Central Bank, at the ECON committee of the European Parliament, Brussels, 9 July 2018.

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Mr Chairman,

Honourable members of the Economic and Monetary Affairs Committee,

Ladies and gentlemen,

It is a pleasure to be back at the European Parliament before your Committee.

Since we last met, the ECB's Governing Council has taken important decisions on the recalibration of our monetary policy stance after September this year. In my remarks today, I will outline these decisions and explain the assessment of the current economic environment on which they were based. Following the recent euro area summit, I will also take this opportunity to discuss the future of our Economic and Monetary Union (EMU), pointing to priorities for the near term from an ECB perspective.

Economic and inflation developments

The euro area economy grew by 0.4% during the first quarter of 2018, marking five years of continued economic expansion. Underlying economic fundamentals remain solid, notwithstanding some moderation in growth at the beginning of the year.

The labour market has improved notably over recent years. Employment has risen by 8.4 million since mid-2013, and is growing in nearly all euro area countries. The unemployment rate stood at 8.4% in May, its lowest level since December 2008, and labour force participation now stands at an all-time high.

Looking ahead, the latest Eurosystem staff macroeconomic projections foresee average annual growth of 2.1% in 2018, 1.9% in 2019 and 1.7% in 2020. While uncertainties related to global factors, including the threat of increased protectionism, have become more prominent, the risks surrounding the euro area growth outlook remain broadly balanced. Of course, we continue to closely monitor developments.

According to the Eurostat flash estimate, headline inflation increased to 2.0% in June from 1.9% in May, reflecting higher rates of energy and food inflation. Excluding these more volatile items, inflation decreased from 1.1% in May to 1.0% in June. As the economy continues to grow and slack is absorbed, supporting rising wages, underlying inflation is expected to pick up. Recent wage agreements in several countries point to a continuation of these favourable dynamics.

I will discuss the inflation outlook in more detail as I explain the monetary policy decisions taken by the Governing Council in June.

The ECB's monetary policy and the phasing-out of non-standard measures

At our last monetary policy meeting, the Governing Council undertook a careful review of the progress made so far towards a sustained adjustment in inflation. Specifically, we assessed inflation developments against the three conditioning criteria for net asset purchases: convergence, confidence and resilience.

As regards convergence, the June 2018 Eurosystem staff projections see headline inflation reaching 1.7% in each of the next three years. These are the latest in a series of projections which foresee inflation converging towards our inflation aim of below, but close to, 2% over the medium term.

Our confidence in the inflation path is also rising. First, the range of uncertainty around the inflation projections has narrowed. Second, underlying inflation has increased from the very low levels that prevailed in 2016 and is foreseen to rise as the economy continues to expand, capacity utilisation strengthens and labour markets further tighten.

Finally, on the third criterion, the projected path of inflation appears to be self-sustained, i.e. resilient to a gradual ending of net asset purchases.

On the basis of this assessment, the Governing Council concluded that progress towards a sustained adjustment has been substantial so far and should continue in the period ahead, although some uncertainties persist. We therefore anticipate that after September we will reduce our monthly net asset purchases from €30 billion to €15 billion and will end our net asset purchases at the end of December. This is subject to incoming data confirming our medium-term inflation outlook.

The expected end of the net asset purchases in December 2018 does not mean that our monetary policy ceases to be expansionary. Monetary policy will have to continue to accompany the economic expansion for some time. We have therefore reaffirmed our reinvestment policy and enhanced our forward guidance on the key interest rates.

We intend to maintain our policy of reinvesting the principal payments from maturing securities purchased under the APP for an extended period of time after the end of our net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. And we expect key ECB interest rates to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained adjustment path.

EMU governance: taking stock of financial union and the euro area architecture

Let me now turn to the governance of Economic and Monetary Union.

In times of heightened global uncertainty, it is more important than ever that Europe stands together. The efforts we have made in recent years to strengthen EMU governance have already made EMU more resilient to shocks. However, our monetary union is still incomplete and remains vulnerable. To support confidence and continue the economic expansion, we need further convergence and integration among euro area Member States.

It is almost exactly six years since European leaders decided to launch banking union. This was a major step forward and it has significantly contributed to risk reduction and thus a more stable European banking sector. But banking union is not yet complete. The swift adoption of the banking package will help to further strengthen the resilience of the financial sector. We welcome the Committee's adoption of the report on the banking package and call for a swift trilogue process. The agreement on the European Stability Mechanism (ESM) as the backstop for the Single Resolution Fund is equally important. It will provide an additional layer of safety for banks in resolution, ensuring that they can be resolved effectively and without endangering financial stability. All this, in turn, will enhance confidence in the banking sector as a whole and make it more stable. The backstop should be made operational as soon as possible and be given swift and efficient decision-making procedures.

In the period ahead, including the deliberations on a European deposit insurance scheme (EDIS),

we should not be held back by the distinction between risk reduction and risk sharing, for two reasons in particular.

First, substantial risk reduction has already taken place. Common Equity Tier 1 ratios of significant banks – a key indicator of bank health – are now 67% higher than they were ten years ago. Further risk reduction is under way with the reduction of non-performing loans and toxic assets in the portfolios of some large banks.

Second, risk-sharing greatly helps risk reduction. Consider the United States Federal Deposit Insurance Corporation. It successfully resolved 500 banks without causing financial instability, also because it was backstopped by the US government. The corresponding number for the euro area was ten times lower, which is another reason why the euro area banking sector still faces structural challenges. In other words, if risk-sharing were to lead to an orderly management of the financial stability consequences derived from risk reduction, risk reduction would proceed at a much faster pace. Moreover, a European deposit insurance scheme would avoid the risk of destabilising self-fulfilling prophecies in the form of bank runs. It would also reduce the risk of financial fragmentation and thus support the effectiveness of monetary policy throughout EMU, contributing to economic stability. With the right policy framework, risk-sharing and risk reduction are thus mutually reinforcing[1].

A more resilient EMU would also benefit from a bolstered crisis management framework. The commitment to strengthen the ESM made at the recent Euro Summit is therefore very welcome. This should include an increase in its effectiveness and agility in terms of both governance and instruments, while fully respecting the mandates of the Commission and the ECB.

To absorb shocks and reduce the risk of full-blown crises, the euro area would also benefit from a common stabilisation function. Such an instrument could provide macroeconomic support in the event of euro area-wide recessions, thereby preserving convergence, supporting stabilising national policies and allowing monetary policy to operate effectively. At the same time, this instrument should not undermine incentives for Member States to pursue sound fiscal and economic policies. We therefore very much welcome the renewed impulse to this discussion.

An ambitious agenda for the capital markets union (CMU) can further underpin and facilitate the priorities I have outlined. First, CMU would increase private sector risk-sharing, and thus help to cushion local shocks, reducing the need for using public stabilisation tools. Second, a consistent framework is essential for deep and resilient financial integration. For instance, harmonising and improving insolvency frameworks would make it easier for banks to deal with non-performing assets, which would be beneficial to banks' health. A genuine capital markets union would also support deeper, integrated and more stable capital markets, improving access to funding for all.

Let me emphasise that none of the measures I have mentioned are possible without trust between Member States, and that requires national governments to play their part in increasing the resilience of their economies and modernising economic structures.

Conclusion

Our monetary policy measures have been very effective. We estimate that the measures we have taken since mid-2014 will have an overall cumulative impact of around 1.9 percentage points on both euro area real GDP growth and inflation for the period between 2016 and 2020.

Our measures are playing a decisive role in bringing inflation back on track to reach a level that is below, but close to, 2% over the medium term. However, we need to be patient, persistent and prudent in our policy to ensure that inflation remains on a sustained adjustment path.

As I have said before, downside risks to the outlook mainly relate to the threat of increased protectionism. A strong and united European Union can help reap the benefits of economic

openness while protecting its citizens against unchecked globalisation. In leading by example, the EU can lend support to multilateralism and global trade, which have been cornerstones of growing economic prosperity over the past seven decades. But to be successful on the outside, the EU requires strong institutions and sound economic governance at home.

Thank you for your attention.

I am now at your disposal for questions.

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[1] See "Risk-reducing and risk-sharing in our Monetary Union", speech by Mario Draghi, President of the European Central Bank, at the European University Institute, Florence, 11 May 2018.