Mario Draghi: IMFC Statement

Statement by Mr Mario Draghi, President of the European Central Bank, at the thirty-eighth meeting of the International Monetary and Financial Committee, Bali, Indonesia, 12 October 2018.

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The euro area economy continues to expand in a broad-based manner, across countries and sectors, despite some moderation following its strong growth in 2017. The economy grew by 2.1% year-on-year in the second quarter of this year. It continues to exhibit a high level of capacity utilisation, and labour markets are tightening in several countries and sectors. The unemployment rate in the euro area has dropped to its lowest level since 2008, and the number of people in employment has increased by more than nine million since mid-2013. The latest economic indicators suggest that, overall, this broad-based growth in the euro area will continue.

Our monetary policy measures continue to underpin domestic demand, which remains the mainstay of the ongoing expansion. Private consumption is being supported by employment gains and rising wages. Business investment has strengthened amid improvements in corporate profitability, favourable financing conditions and solid demand. In addition, the expansion in global activity is expected to continue, benefiting euro area exports.

The latest ECB staff projections put annual real GDP growth at 2.0% in 2018, 1.8% in 2019 and 1.7% in 2020. At the same time, uncertainties relating to rising protectionism, vulnerabilities in emerging markets and financial market volatility have gained more prominence recently.

Headline inflation in the euro area has lately been hovering around 2.0%, somewhat higher than the levels observed in the first months of this year, mainly reflecting a higher annual rate of change in energy prices. While measures of underlying inflation remain generally muted, they have been increasing from earlier lows. Uncertainty around the inflation outlook is receding. Looking ahead, underlying inflation is expected to pick up towards the end of the year and then increase gradually over the medium term, supported by our monetary policy measures, the continuing economic expansion and rising wage growth. The latest ECB staff projections foresee annual euro area headline inflation at 1.7% in 2018, 2019 and 2020.

Overall, recent developments vindicate the Governing Council's earlier assessments of the medium-term inflation outlook. Incoming information continues to support our confidence that the sustained convergence of inflation to levels below, but close to, 2% will proceed, and will be maintained even after a gradual winding-down of our net asset purchases. Accordingly, at its last monetary policy meeting the Governing Council confirmed that it continues to expect the 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 the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term. The Governing Council also decided to reduce the monthly pace of the net purchases under the asset purchase programme (APP) to €15 billion from October until the end of December 2018 and anticipated that, subject to incoming data confirming our medium-term inflation outlook, net purchases will then end. Finally, the Governing Council also confirmed its intention to reinvest 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.

Significant monetary policy stimulus is still needed to support the further build-up of domestic price pressures and headline inflation developments over the medium term. This support will continue to be provided by the net asset purchases until the end of the year, by the sizeable stock of acquired assets and the associated reinvestments, and by our enhanced forward guidance on the key ECB interest rates. In any event, the Governing Council stands ready to adjust all of its instruments as appropriate to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner.

The financial health of the euro area banking sector has continued to improve. Although showing a slight decrease from 14.6% at the end of 2017, the aggregate Common Equity Tier 1 ratio of euro area significant institutions stood at 14.1% at the end of the first quarter of 2018. Banks have made progress in reducing their stocks of non-performing loans (NPLs). In the first quarter of 2018, the NPL ratio for euro area significant institutions dropped further, to 4.8%, compared with 5.9% a year earlier. However, euro area banks' profitability remains subdued. The average return on equity of euro area significant institutions declined to 6.6% in the first quarter of 2018, from 7.1% a year earlier. In this context, EU and national authorities are still following up on a comprehensive action plan for dealing with legacy asset quality issues, adopted by the Council of the European Union. We have published guidance to banks on NPLs, including our supervisory expectations for their prudential provisioning. Furthermore, we continue to devote significant attention to potential valuation issues, with a focus on banks that have material exposures to complex financial assets – including but not limited to level 3 assets – through both our off-site and on-site supervisory processes.

With respect to financial stability more broadly, recent episodes of heightened financial market volatility have led to only limited contagion across countries and markets. Currently, there is no indication of excessive credit growth or broad-based asset price misalignments. However, some sectors of the real estate markets warrant close monitoring in some euro area countries, in particular following up on warnings issued by the European Systemic Risk Board. Furthermore, developments in the non-bank financial sector require monitoring as well. We expect the national authorities to remain vigilant and continue to use the macroprudential policy instruments at their disposal to counteract any emerging risks when necessary. And on our side, we will contribute within our macroprudential mandate.

An orderly withdrawal of the United Kingdom from the European Union poses a limited overall risk to the euro area's financial stability. However, the uncertainty triggered by a cliff-edge Brexit could have the potential to pose a more significant downside risk to financial stability. We will continue to monitor developments ahead of UK's exit on 29 March 2019. In view of the prevailing uncertainty about the outcome of the negotiations and the ensuing legislative and regulatory decisions, the private sector is primarily responsible for making adequate arrangements to prepare itself for any scenario.

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 enhancing productivity, for example through the cross-border diffusion of new technologies that drive efficiency improvements. These factors need to be underpinned by effective multilateral cooperation, both in trade and in financial regulation and supervision, to help avoid major disruptions to global financial stability. Preserving openness is crucial if the global economy is to thrive and secure its growth potential.

Encouraging multilateral cooperation is a central theme of the G20 Eminent Persons Group report. It emphasises the need to firm up global financial resilience and reduce the incidence and severity of crises in order that countries do not fear openness. We support discussing the proposals of the G20 Eminent Persons Group with an open mind in the coming months.

The ECB supports further strengthening of the Global Financial Safety Net (GFSN) with a strong, quota-based, and adequately resourced IMF at its centre. While the first line of defence for national and international stability is to have sound domestic policies in place, the IMF's role at the centre of the GFSN strongly supports global financial stability.

The launch of the "Bali Fintech Agenda" developed by the IMF and the World Bank brings together key considerations posed by member countries with regard to reaping the benefits from the fintech phenomenon and addressing its associated risks. Given the cross-border nature of fintech developments, we support international cooperation, coordination and information sharing also among standard-setting bodies and authorities while avoiding potential duplicative and overlapping efforts.

In the euro area, in order to reap the full benefits of our monetary policy measures, other policy areas must contribute more decisively to raising the longer-term growth potential and reducing vulnerabilities. The implementation of structural reforms needs to be substantially stepped up. The ongoing broad-based expansion also calls for fiscal buffers to be rebuilt. This is particularly important in countries where government debt is high and for which full adherence to the Stability and Growth Pact is critical for safeguarding sound fiscal positions. The transparent and consistent implementation of the EU's fiscal and economic governance framework, over time and across countries, remains essential.

In addition, Economic and Monetary Union (EMU) needs to be strengthened, first and foremost by implementing what has already been agreed and finishing the common projects we have started: completing the banking union, strengthening the operational capacity and the role of the European Stability Mechanism, and deepening the capital markets union. Work needs to continue on designing a fiscal capacity that provides adequate macroeconomic stabilisation while containing moral hazard. Fiscal rules need to be made more effective. A more complete EMU will be a better foundation for a stable and resilient euro area economy that contributes to global economic growth and financial stability.