Mario Draghi: Debate about the Annual Report

Speech by Mr Mario Draghi, President of the European Central Bank, at plenary debate of the European Parliament about the ECB's annual report 2017, Strasbourg, 15 January 2019.

* * *

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 2017.

20 years ago, on 1 January 1999, the euro was officially introduced and the Eurosystem started its monetary policy operations. Establishing a single currency area between 11 European countries was a historic step for our continent and a quantum leap in economic integration. Its twentieth anniversary gives us an opportunity to reflect on its successes, but also to consider what still needs to be done for the euro to deliver its full benefits.

In this context, I would like to use my remarks to take a look back at the ECB's monetary policy, to take stock of what we have learned and to highlight the challenges that remain. I will mostly focus on the past seven years, which coincide with my term as ECB President.

The evolution of the ECB's monetary policy

The two decades in which the euro has existed could hardly have been more different. The first decade was the culmination of a thirty-year period of macroeconomic stability – the era known as the "Great Moderation". The second decade then produced the worst economic and financial crisis since the Great Depression. Naturally, these periods required very different monetary policy responses and different tools to implement them.

As the pre-crisis period was characterised by moderate swings in the economic cycle,[1] the ECB was able to ensure price stability mainly by adjusting its policy rates. But the crisis of 2008 fundamentally changed the economic and financial landscape in which the ECB operated. New instruments became essential to safeguard the effectiveness of our monetary policy and stabilise the euro area economy. This in turn required us to refine our approach to central bank communication and accountability.

When I arrived at the ECB in November 2011, the euro area faced a very challenging set of circumstances. The economy had bounced back from the post-Lehman crisis in a similar manner to other jurisdictions. But from 2010 onwards, a loss of confidence in the sustainability of sovereign debt had produced a vicious circle of rising borrowing costs, financial fragmentation, and contracting economic activity. Cuts in key ECB interest rates were not being passed on to firms and households to the same extent in every euro area country. We were witnessing a serious disruption in the monetary policy transmission mechanism which, if left untended, would have posed a profound threat to price stability.

The ECB responded with two sets of policies. First, central bank liquidity was made available to banks for up to three years, and the range of collateral that banks could use to access central bank money was expanded. This helped reduce fragmentation in banks' funding conditions. Second, the ECB announced outright monetary transactions (OMTs) in the summer of 2012, which removed redenomination risk in government bond markets stemming from fears of a possible euro area break-up.

Yet the sovereign debt crisis left a deep scar on the economy. Unemployment rose steeply, firms cut back on investment and loan delinquencies increased. Even though financial fragmentation was diminishing, banks began to shrink their balance sheets and became less willing to lend. This produced a renewed cycle of contracting credit growth and weak demand dynamics. Inflation drifted downwards.

With inflation now well below our objective, the ECB faced a new type of policy challenge. We needed not only to repair the transmission problems created by deleveraging banks. We also needed to expand our policy stance to counteract deflationary pressures.

So in June 2014 we launched our targeted longer-term refinancing operations, which once more provided long-term liquidity to banks – but conditional on extending credit to the private sector. We introduced negative rates on excess reserves to further encourage banks to lend to households and businesses. And soon after, we announced our asset purchase programme (APP), buying asset-backed securities and covered bonds. Faced with a continued decline in inflation and a heightened risk of a de-anchoring of inflation expectations, in January 2015 we expanded the APP to include public sector securities.

Since then, both the size and duration of our asset purchases have been recalibrated in response to changes in the inflation outlook. Our asset purchases have also been complemented by further cuts in policy rates and the use of forward guidance. Communicating our expectations about future policy, along with the conditions that would warrant a change in the policy stance, has successfully contributed to reducing uncertainty around the expected future path of short-term interest rates, thereby helping to preserve accommodative financial conditions.

Supported by these policy measures, the euro area economy has steadily recovered. We have now seen 22 consecutive quarters of economic growth. There are 9.6 million more people in employment in the euro area than there were in the second quarter of 2013 (when the number of people in work fell to its lowest point during the crisis). The unemployment rate has declined to 7.9%, its lowest level since October 2008. And the employment rate of people aged 15-74 has risen from 54% in 1999 to 59% in the second quarter of 2018, the highest rate ever recorded in the euro area.

The main motor of the recovery has been the domestic economy, driven by a strengthening in domestic demand and improving labour markets. That underlying strength of the economy has underpinned our confidence that inflation would converge towards our inflation aim in a sustained manner. As such, since 2017 we have gradually reduced the monthly pace of net asset purchases. We decided to end our net purchases in December last year, confident that the sustained convergence of inflation to our aim would proceed.

At the same time, recent economic developments have been weaker than expected and uncertainties, notably related to global factors, remain prominent. So there is no room for complacency. A significant amount of monetary policy stimulus is still needed to support the further build-up of domestic price pressures and headline inflation developments over the medium term. Our forward guidance on the key ECB interest rates, reinforced by the reinvestments of the sizeable stock of assets we have acquired, continues to provide the necessary degree of monetary accommodation for the sustained convergence of inflation to our aim.

Lessons for monetary policy and the monetary union

So what have we learned from this experience? The ECB's monetary framework rests on three elements: a clear mandate to achieve price stability; independence over the instruments we can use to achieve our mandate; and a strong accountability framework. The importance of each of these elements has been reinforced by the crisis.

First, we have seen that a well-defined mandate is vital for our credibility with the public, because it guarantees that the ECB will always act in the interest of the whole euro area, and will not be swayed by interest groups.

Second, we have seen that instrument independence is key to an effective monetary policy, since it allows the central bank to act quickly and flexibly to shocks, especially in exceptional times. Indeed, a well-equipped toolbox, comprising both standard and non-standard instruments, has proven indispensable in conditions where monetary policy transmission is impaired or where space for interest rate cuts is limited.

Third, we have seen the importance of a strong accountability framework, particularly when central banks have to use new tools that are not well-understood by the public. Central banks are powerful and independent, but they are unelected. This combination can only be squared if they are held accountable by elected authorities.

In light of this, we have stepped up our efforts to improve our communication and strengthen our accountability in recent years. The Governing Council has started to publish the accounts of its monetary policy meetings. The ECB and the European Parliament have increased the intensity and focus of their exchanges.[2] All this has provided us with more opportunities to explain our decisions and demonstrate how the ECB is acting in accordance with its mandate, which is a fundamental pillar of its legitimacy.

The crisis has offered many lessons beyond monetary policy, too. The euro area entered the crisis with an incomplete institutional and regulatory framework, not only for the banking sector but also in other areas of economic policy.

The creation of the banking union and the European Stability Mechanism has strengthened the ability of EU authorities to intervene decisively in future crises. Reforms at national level, and the strong political commitment to the euro shown by European policymakers, were equally instrumental in strengthening the foundations of our common project. But the necessary changes took time, and it was time that the euro area lost in its recovery. Our monetary union is now in better shape, but further progress can and should be made.

As I had the opportunity to discuss during my regular hearing before the Committee on Economic and Monetary Affairs, and as your draft resolution points out, the priority now is to increase the resilience of the euro area. This would also strengthen the transmission of monetary policy in future downturns.[3] Resilience depends on the euro area being able to use a broad policy mix involving monetary, fiscal, prudential and structural instruments.[4]

Conclusion

Let me conclude.

The first two decades of the euro area have seen an evolution in the way the ECB conducts its monetary policy. Faced with unprecedented threats to price stability, the ECB adapted its policy instruments to continue delivering on its mandate. We will continue to do so if and when needed, in compliance with our mandate as defined by the EU Treaties, and with all the independence over our tools as defined by our legal framework.

Today, we can say that the euro area has emerged from a crisis so severe as to threaten at times its existence. We are out of it, primarily because of the resilience, the energy, and the entrepreneurial capacity of European citizens, as well as their trust in their leaders' commitment to the euro. Our policy response and the important changes to the architecture of the EMU in the meantime also helped the euro area out of the crisis. In many ways we have a stronger monetary union today than we had in 2008. This is also reflected in the euro's popularity among euro area citizens, which is currently at its highest level since it was introduced. But more work is still necessary to complete the EMU, so as to make it more resilient in the face of future crises.

To deliver its full benefits, the European Union requires permanent political commitment, at both national and European levels, and across policy areas.

In this respect I can testify to the essential role the European Parliament has played during the challenging years of the crisis. And I am certain that it will also be fundamental in carrying out the remaining work until the completion of the EMU.

The credibility of the ECB rests on its independence and this is based on its accountability with respect to its mandate, as enshrined in the EU Treaties. The European Parliament in holding the ECB to account gives legitimacy to its independence. And since this is my last hearing before this plenary as ECB President, let me thank all of you for how this process has been carried out during my mandate, for the valued interactions with you, and the opportunity you have given me to explain the ECB's policies.

Thank you.

---

[1] See Hartmann, P. and Smets, F., "The first 20 years of the European Central Bank: Monetary Policy", *ECB Working Paper Series No 2219*, December 2018.

[2] See "The evolution of the ECB's accountability practices during the crisis", Economic Bulletin, Issue 5, ECB, 2018.

[3] Introductory statement by Mario Draghi, President of the ECB, at the ECON committee of the European Parliament, Brussels, 26 November 2018.

[4] "Unemployment in the euro area", speech by Mario Draghi, President of the ECB, at the Annual central bank symposium in Jackson Hole, 22 August 2014.