Christine Lagarde: Hearing of the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement (via video conference) by Ms Christine Lagarde, President of the European Central Bank, at the Hearing of the Committee on Economic and Monetary Affairs of the European Parliament, Frankfurt am Main, 7 February 2022.

* * *

Accompanying charts: www.bis.org/review/r220210b_charts.pdf

On this day in 1992, the leaders of twelve European countries decided to transform the European Community into the European Union by signing the Maastricht Treaty. Thirty years on, Europe continues to benefit from many of the accomplishments of that Treaty.

The Treaty established European citizenship, including the right to move and settle freely in the EU. It granted this Parliament extended powers through its right of co-decision and strengthened Europe's voice in the world through a common defence and security policy. And, perhaps most importantly, the Treaty laid the foundation for our economic and monetary union, leading to the introduction of the euro and the establishment of the ECB.

As we are celebrating 20 years of euro banknotes and coins this year, there is no doubt that the single currency has been a success. It has brought stability and made us more resilient in the face of the multiple adverse shocks we have experienced.

Over the past 20 years, the ECB has ensured price stability, with an average inflation rate of 1.7 per cent since early 1999. We are determined to continue doing so.

In my remarks today, I will therefore first update you on the latest assessment of the economic situation in the euro area and present our monetary policy stance. I will do so with a firm determination that clear communication – the topic you have chosen for today's hearing − is crucial for our policy, for our credibility and for the trust people have in us.

Already during my first hearing back in December 2019,[1] I outlined my aspiration to improve our communication practices so that markets, elected representatives like yourselves and the wider public better understand how we reach our decisions, what motivates them, and how they affect people's daily lives.

Following on from our strategy review, we are now using clearer, more narrative-driven language, together with relatable visuals. As at the last hearing, I will thus explain the key macroeconomics developments discussed in this statement with the help of the charts in the accompanying two-page document.

The euro area economy and monetary policy

When we last met in November, I stated that growth momentum was moderating. Indeed, recent data confirm that quarterly growth slowed to 0.3 per cent in the final quarter of 2021, which still allowed gross domestic product (GDP) to recover to its pre-pandemic level. The moderation in growth momentum has resulted mainly from the rapid spread of the Omicron variant. The associated containment measures have dampened activity, particularly in consumer services such as travel, tourism, hospitality and entertainment.

The current pandemic wave and associated restrictions are likely to continue to have a negative impact on growth at the start of this year. Two other factors which we discussed at the previous hearing − namely supply bottlenecks and high energy costs − are also expected to dampen economic activity in the near term.

However, the economic impact of the current pandemic wave appears to be less damaging to activity than previous ones. Moreover, the aforementioned bottlenecks will still persist for some time, but there are signs that they may be starting to ease. This will allow the economy to pick up strongly again later this year.

Inflation has risen sharply in recent months and it further surprised on the upside in January, with the rate increasing to 5.1 per cent from 5.0 per cent in December. Inflation is likely to remain high in the near term. Energy prices continue to be the main reason for the elevated rate of inflation. Their direct impact accounted for over half of headline inflation in January and energy costs are also pushing up prices across many sectors. Food prices have also increased, owing to seasonal factors, elevated transportation costs and the higher price of fertilisers. In addition, price rises have become more widespread, with the prices of a large number of goods and services having increased markedly.

Financing conditions for the economy have remained favourable. While market interest rates have increased since December, bank funding costs have so far remained contained. Bank lending rates to firms and households continue to stand at historically low levels.

Turning to the risk assessment, we continue to see the risks to the economic outlook as broadly balanced over the medium term. Uncertainties related to the pandemic have abated somewhat. At the same time, geopolitical tensions have increased and persistently high costs of energy could exert a stronger than expected drag on consumption and investment. The pace at which supply bottlenecks are resolved is also a further risk to the outlook for growth and inflation. Compared with our expectations in December, risks to the inflation outlook are tilted to the upside, particularly in the near term. If price pressures feed through into higher than anticipated wage rises or the economy returns more quickly to full capacity, inflation could turn out to be higher.

In a few weeks, the March ECB staff projections will provide an updated assessment, taking the most recent data into account. This will help the Governing Council better appraise the implications of the surprisingly high December and January inflation figures for the medium-term outlook.

In particular, we will carefully examine how higher energy prices will transmit through the economy and affect the outlook overall. Two channels could be at play, pulling inflation dynamics in different directions. On the one hand, rising energy costs can drive up prices directly, by increasing the cost of production, as well as indirectly, by having second-round effects on wages. On the other hand, they can have a negative impact on the incomes of households and the earnings of companies, thereby reducing economic activity and dampening the inflation outlook. In the past, the euro area has been particularly vulnerable to the second channel, as surges in energy prices weakened the spending power of households, and reduced inflation over the medium term.

Obviously, in our assessment of the inflation outlook, we have to bear in mind that demand conditions in the euro area do not show the same signs of overheating that can be observed in other major economies. This increases the likelihood that the current price pressures will subside before becoming entrenched, enabling us to deliver on our two per cent target over the medium term.

Indeed, while moving up over recent months, indicators of longer-term inflation expectations are consistent with this expectation. Survey-based measures point to inflation returning to two per cent by 2023 and remaining close to this level thereafter; and market-based indicators stabilise around levels somewhat below two per cent. The solid anchoring of long-term inflation expectations in the euro area is a reassuring development, coming after a long period when they were subdued.

To sum up, the euro area economy has continued to recover, although growth is expected to remain subdued in the first quarter. While the outlook for inflation is uncertain, it is likely to remain elevated for longer than previously expected, but to decline in the course of this year.

In our meeting last week, we confirmed the decisions we took in December. Accordingly, we will continue reducing the pace of our asset purchases step by step over the coming quarters, and will end net purchases under the pandemic emergency purchase programme at the end of March.

In view of the current uncertainty, we need more than ever to maintain flexibility and optionality in the conduct of monetary policy. Our monetary policy is always data-dependent, and this is all the more important in the situation that we are facing at the moment. We will remain attentive to the incoming data and carefully assess the implications for the medium-term inflation outlook.

Those implications are key parameters in our forward guidance. Our forward guidance has several dimensions. There is a defined sequencing between the end of our net asset purchases and the lift-off date. A rate hike will not occur before our net asset purchases finish. Moreover, there are three conditions that will have to be met before the Governing Council feels sufficiently confident that a tilt in our policy rate is appropriate. All the three conditions are meant as safeguards against a premature increase in interest rates. Finally, any adjustment to our policy will be gradual.

Conclusion

Let me conclude.

Former Commission President Jacques Delors described the process leading up to the Maastricht Treaty as one requiring “great determination, rockhard solidarity and a little daring from time to time”.[2]

The leaders of Europe have once again demonstrated these qualities with their policy response to the pandemic crisis. And as we emerge from the pandemic, we need to continue down this path.

The ECB will play its part and show the determination needed to ensure price stability. You may rest assured that our commitment to deliver on this remains absolutely unwavering, as does our resolution to explain, to convince, but also to listen and better understand people’s concerns. Our regular exchanges with you, their elected representatives, are crucial in that regard.

With this in mind, I very much look forward to today’s discussion with you.

---

1 See Introductory statement by Christine Lagarde, President of the ECB, at the ECON committee of the European Parliament, 2 December 2019.

2 See Presentation by President Jacques Delors at the European Parliament, 12 February 1992.