

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

Introductory statement by Mr Mario Draghi, President of the European Central Bank, before the Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 9 July 2012.

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Madam Chair,

Honourable members of the Committee on Economic and Monetary Affairs,

It is a pleasure to be back here in Parliament and in front of your Committee for our regular exchange of views.

Today, I will explain the decisions of the Governing Council of the ECB last week. I will then consider the actions taken by central banks around the world in response to the crisis. I will also discuss the economic adjustment programmes in euro area member countries, and close with some remarks on the longer term vision for EMU.

1. Economic and monetary developments

Last Thursday, the ECB's Governing Council unanimously decided to lower key interest rates by 25 basis points. This has brought the main refinancing rate to 0.75% and the deposit rate to zero. The policy decision took account of further dampening of inflationary pressures, as some of the previously identified downside risks to economic activity materialised.

On non-standard monetary policy measures, the Governing Council decided in June to continue conducting all refinancing operations as fixed-rate tender procedures with full allotment, at least until mid-January 2013. Measures were also taken to improve access of the banking sector to these operations by enhancing collateral availability.

Our measures, both standard and non-standard, support the transmission of monetary policy and the provision of credit to the real economy. They safeguard price stability in the euro area. And they help to reduce financing costs, supporting renewed confidence and sustainable growth.

The ECB remains committed to delivering on its mandate – and retains full capacity to act in a firm and timely manner.

Indicators for the second quarter of 2012 point to a weakening of growth and heightened uncertainty. But looking ahead, we continue to expect the euro area economy to recover gradually, albeit with dampened momentum.

Euro area annual inflation was 2.4% in June 2012, unchanged from May. Inflation should decline in the course of 2012 and be below 2% in 2013. In an environment of modest growth and well-anchored inflation expectations, underlying price pressures should remain moderate. This will restore purchasing power of wages and salaries.

Risks to this outlook are broadly balanced over the medium term: on the downside, they relate to weaker than expected euro area growth; on the upside, risks could stem from further increases in indirect taxes and higher than expected energy prices.

Our monetary analysis gives a picture consistent with price stability over the medium term. In particular, the underlying pace of monetary expansion remains subdued. Weak loan growth largely reflects the current cyclical situation, heightened risk aversion and balance sheet adjustments by households and firms, which weigh on credit demand.

2. Central banks' response to the crisis

Let me now turn to the first topic you asked me to address, the measures taken by central banks around the world in response to the global financial crisis. In a nutshell, I consider those actions to have been bold, forward-looking yet historically informed, drawing appropriate lessons from financial crises of the 20th century.

Central banks have cooperated very closely during the crisis: through an important coordinated interest rate cut in October 2008; provision of swap lines; continuous information exchange; and overall actions that have been mutually consistent. In particular, the overriding objective of medium-term price stability has never been lost from sight.

Both interest rate policy and non-standard measures have taken account of the prevailing specific circumstances: first, the financial and economic structure of each economy; second, the magnitude and specificity of shocks; third, the different operational frameworks of different central banks; and fourth, the different institutional settings in which they operate.

For these four reasons, comparisons across constituencies have their limits. What's more, comparison of the size of central banks' balance sheets may give a distorted picture of the extent of policy action. For example, in the Eurosystem, a significant part of the balance sheet is not related to monetary policy but to gold and foreign exchange reserves.

Therefore, the appropriate way to measure a central bank's actions is to do so in its own institutional and economic setting and against its own objectives.

For the ECB, those actions have been, and will continue to be, geared towards maintaining price stability in the euro area. This is our mandate, and our track record speaks for itself.

3. The ECB's role in adjustment programmes

Effective crisis resolution needs bold actions by central banks but it also needs bold actions by other policy actors, notably governments. This brings me to the other topic that you proposed: economic adjustment programmes and the role of the ECB.

In the aftermath of the crisis, a number of EU and euro area countries have requested financial assistance because of their challenged access to capital markets. At the same time, they have committed to implementing the reforms necessary to secure full market access in the future.

Since financial assistance can only be temporary, the quality of the reforms and their implementation are absolutely essential. It is this quality that ultimately determines the success of a programme.

The design and monitoring of programmes in the euro area is done jointly by the European Commission, the ECB and the IMF. The ECB provides input through its expertise, not least with respect to the financial sector but also with regard to country surveillance. Our experience with this set-up has been very good, and the cooperation with the Commission and the IMF has been excellent.

Today's economic environment obliges all countries to take a very critical look at their past – and it obliges all to take a very objective view of their future.

It is only against the background of the past that the adjustment programmes currently underway in several euro area countries can be understood. It was past economic developments and policies that led to excessive imbalances in a number of countries. And it was those imbalances – fiscal, macroeconomic and external – that were neither healthy nor sustainable.

Unsustainable imbalances provide the objective need for adjustment programmes – and the degree of the adjustment is directly related to the extent to which past policies were misguided.

Policy adjustment in the euro area takes place under market pressures, but less so than for countries outside the euro area because being part of monetary union shelters countries against some pressures, notably on the exchange rate.

But this does not mean that the degree of policy adjustment can be lower. The schedule of regaining full market access within a few years applies here too. Therefore, perseverance in bold and necessary reforms is crucial.

A critical success factor is ownership of the programmes by governments, parliaments and ultimately the citizens of the countries concerned. An essential precondition for ownership is that policy-makers communicate clearly about the economic rationale for adjustment. As I have suggested, this means taking a critical view of the past and an objective view of the future.

This process has started. Increasingly, national policy-makers make the case for reform strongly. They point to past developments in explaining the background of adjustment and now highlight the many beneficial elements of reforms. Some of these reforms improve fairness by combating tax evasion or rent-seeking by vested interests, and they improve the efficiency of the public sector.

National policy-makers are now increasingly making a central part of their objective the overall aim of EMU: to sustain economic well-being in the absence of major imbalances, and to generate sustainable growth in a competitive environment.

In my view, a great deal of progress is underway in this respect.

For example, the Irish authorities have maintained a strong track record for maintaining reform momentum throughout their programme. They have also taken important steps towards restoring the stability of the financial system.

In Portugal, programme implementation remains good and important progress has been made in such areas as the labour market, the housing market, the general competition framework, the judicial system and the transport sector. The Portuguese authorities remain fully committed to achieving this year's fiscal target.

The Spanish authorities too have shown that they remain fully committed to accelerating the structural reform agenda and putting the financial sector on a sound footing. They are also committed to improving external competitiveness to lay the foundations for more sustainable prosperity.

Even without programmes, many policy-makers are bold in reform. In Italy, for example, reforms to increase competition, reduce the administrative burden and increase labour market flexibility have been important measures. The country's spending review will help to achieve the fiscal targets.

Virtually all other countries are undertaking measures to improve fiscal solidity and the basis for sustainable growth without excessive imbalances. So despite the current challenges, countries' progress is strong and the fundamentals of the euro area as a whole are sound.

The euro area's fiscal deficit is declining towards 3% of GDP; price stability is ensured; and the external accounts have remained close to balance. All these are reasons to pursue reforms with a strong degree of confidence.

4. A longer-term vision for EMU

Why then do we still have tensions in a number of market segments? Let me first stress that a lot has been done at country as well as euro area level in terms of economic reforms and governance. But we need full implementation. We have to make clear that EMU is a union based on stability at national and aggregate levels.

Stability at national level means completing reforms to ensure sustainable growth without major imbalances. Stability at aggregate level means implementing the vision recently presented at the summit.

The central message of that vision is this: the euro is here to stay – and the euro area will take the necessary steps to ensure that.

In my view, the core of the report submitted by President Van Rompuy is the identification of four building blocks:

First, a *financial market union* that elevates responsibility for supervision of banks to the euro area level.

Second, a *fiscal union* that reinforces oversight of budgetary policies at the euro area level and also provides some fiscal capacity to support the functioning of the currency area.

Third, an *economic union* with sufficient mechanisms to ensure that countries can achieve sustained prosperity without excessive imbalances.

And finally a *political union* that strengthens the legitimacy of EMU among euro area citizens and deepens its political foundations.

These four building blocks are mutually consistent and coherent, and should be pursued in parallel. I am looking forward to the work on a roadmap that has started. In my view, three issues deserve particular attention:

First, we need to move towards a further sharing of sovereignty in the fiscal, financial and economic domains. There can be no shortcuts in establishing a sound and stable EMU.

Second, EMU is an integral part of the Treaty. This calls on all relevant bodies and actors to engage constructively on improving its functioning, not only at Union but also at national level. To call for an impeccable application of the Treaty and at the same time refuse closer union mentioned in Article 1 of the Treaty is inconsistent, to say the least.

Third, we need to accompany deeper euro area integration with significant progress on democratic legitimacy and accountability. There is no doubt that you and your colleagues – the members of the European Parliament, the directly elected representatives of the citizens of Europe – will continue to play a central role in the steps towards political union.

Thank you for your attention.