Mario Draghi: Significant progress in 2012 and prospects for 2013

Address by Mr Mario Draghi, President of the European Central Bank, at the New Year's Reception of the Frankfurt Chamber of Commerce and Industry, Frankfurt am Main, 22 January 2013.

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Minister-President Bouffier,

Lord Mayor Feldmann,

President Müller,

Ladies and gentlemen,

It is a great pleasure for me to be here with you this evening, and I would like to thank the Chamber of Commerce and Industry very warmly for inviting me.

I am pleased to meet many representatives of the business community and public life of the region Rhein-Main and Frankfurt, the city in which the ECB is so well hosted and where I also feel personally very comfortable.

A New Year's reception is always the occasion to look back on what has happened in the past year and to look forward to what lies ahead.

2012 was a year full of challenges. Yet it was also a year of surprises and new beginnings.

We began the year in an environment of exceptional uncertainty. The euro area was faced with deep, even existential challenges.

This led some experts to make bleak predictions about the future. They doubted the resilience of our economies. They worried about the stability of our single currency. They even questioned its future existence.

To illustrate just how far some doubts went, let me quote the from the Economist's annual publication "The World in 2012", which in the autumn of 2011 said the following:

"If you were sitting down with a blank sheet of paper, you would advise the euro zone to complement its one-size-fits-all monetary policy by pooling sovereignty and creating new institutions. You would set up a European mini-IMF with enough funds to assist troubled countries that adjust their economies. A pan-European banking regulator and a bail-out fund could ensure that large European banks were not at the mercy of their vulnerable sovereign borrowers. […] And, to stop governments from exploiting these mechanisms, euro-zone countries would agree to submit their fiscal policies to the say-so of everyone else. It amounts to a blueprint for the United States of Europe. And it is utterly beyond reach."[1]

If we look back at 2012, on virtually all of these issues, Europe is moving forward or is already there. So the ambition is not "utterly beyond reach". Indeed, it bears out what Walter Hallstein, the first President of the European Commission, once said: that "anyone who does not believe in miracles in European matters is not a realist".[2]

Due to resolute actions by euro area governments and European institutions, the year 2012 turned out quite differently than predicted. The darkest clouds over the euro area subsided. Countries renewed their commitment to reforms. The euro area took strides forward in its common governance.

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[1] The Economist: "The World in 2012", 16/11/2011.

[2] Walter Hallstein: „Wer in europäischen Dingen nicht an Wunder glaubt, ist kein Realist“.

Europe’s policy-makers, including the European Central Bank (ECB) within its mandate, left no doubts about their commitment to our common currency and to its stability.

We can begin 2013 on a more confident note, precisely because significant progress was made during 2012.

Significant progress in 2012

First of all, governments did their part to ensure stability.

During the last year, an important change took place “on the ground” in the economies of Europe. The necessary rebalancing of the euro area economy gathered pace. A comprehensive adjustment in the deficit countries is now taking place.

Many countries are making solid progress in bringing their public finances under control. They are enacting structural reforms to increase competitiveness. This is especially true for the countries under an EU/IMF programme, where adjustment has been extensive.

Reducing the imbalances is certainly a difficult and painful process. But it is essential to restore sustainable public finances and growth. The people in the countries concerned have broadly understood this and backed this course of action. The progress made deserves public recognition and respect.

Governments also came together in 2012 to strengthen the euro area and its ability to prevent and react to crises.

The European Stability Mechanism became active and provides a solid safety net if needed.

The new rules for governing the euro area economy were applied to strengthen oversight of budgets and to monitor emerging imbalances more effectively.

Member States agreed to put debt brakes in their national constitutions.

Most importantly, Europe’s leaders recognised that monetary union needs to be complemented by a financial union, a fiscal union, a genuine economic union and eventually a deeper political union. Discussions are underway with clear timelines in the months ahead.

The most urgent project – financial union – is now taking tangible shape. The ECB is expected to become the single supervisor for the biggest part of the euro area’s banking sector. This is probably the most significant integration step since the Maastricht Treaty. Advances towards a common resolution framework for dealing with non-viable banks are also in the pipeline.

Of course, the ECB also made a contribution in 2012, notably with our special measures. We have shown our commitment to do what is necessary within our mandate to safeguard the stability of the euro. Only a currency whose future existence is not in doubt can be a stable currency.

Is the ECB still focused on price stability? And is it acting in full independence?

I would like to state categorically that the answer to both of these questions is “yes”.

Let me start with price stability. The ECB remains steadfastly committed to its primary mandate of ensuring price stability. All of our measures are designed to achieve this goal. And looking at current and expected inflation rates, there is simply no evidence that could substantiate fears about any deviation from price stability.

Last year, we saw a situation where fears about the future of the euro area were creating fragmentation in financial markets. This fragmentation had very tangible consequences for the real economy: bank funding costs diverged significantly across countries, and this led to marked differences in bank lending rates to firms and households across the euro area.

In some countries, reductions in ECB interest rates were fully passed on; in others, bank lending rates declined only a little, if at all; and in some they even rose.

Interest rates do not have to be identical across the euro area, but it is unacceptable if major differences arise from fragmented capital markets or unfounded perceptions about the long-term sustainability of the euro. In an economy like the euro area, where around three quarters of firms' financing comes from banks, fragmentation has very severe consequences for the real economy, for investment and employment and ultimately for price stability.

We therefore acted to remove unfounded fears about the euro and to safeguard our ability to ensure price stability for the whole euro area.

Let me explain how we safeguard our independence.

In the summer of last year, passive inaction was no more an option because it would have posed the greatest risks. Therefore, the ECB, learning from previous experience and in compliance with its mandate, had to act - but it would only intervene within a framework that would ensure full fiscal compliance by the governments concerned. It is for this reason that there is a requirement of countries having an adjustment programme to be considered for Outright Monetary Transactions (OMTs). Such a programme must entail conditionality that ensures fiscal discipline.

With fiscal discipline, monetary policy cannot become captured by fiscal dominance. And therefore, the central bank can continue its pursuit of safeguarding price stability in full independence.

And there is one more important lesson from 2012 that we must keep in mind: measures to stabilise the euro area, particularly the OMTs, are not only essential for price stability. They also reduce Target2 balances and, because they foster the cohesion of the euro area, they reduce possible risks for German taxpayers.

To sum up, the facts support an ultimately more confident review of 2012.

Prospects for 2013

As regards the coming year, I would like to suggest three things we need to focus on in 2013:

First of all, we need perseverance.

Despite the good progress so far showing that adjustment is happening, reform efforts need to be sustained. Adjustment is inherently difficult and will remain with us for some time to come. Politicians and their populations will need to persevere, especially on structural reforms that improve competitiveness. Countries need competitiveness to sustain growth. They must move away from debt-financing. There is no possibility of sustained growth based on permanent debt accumulation; and by the way, there is no social fairness based on permanent debt accumulation.

Second, we need continued ambition.

Relative calm in financial markets should not lead to a lowering of our ambitions to fix the structural flaws in the governance framework of the euro area. After the many advances that have been made in creating new rules and institutions, this coming year should focus on implementation.

Third, we need patience.

I am very well aware that for many people in the countries under adjustment, the personal economic situation can be very difficult. But there is simply no alternative to the path of reform.

The crisis has several facets that are of different importance in different countries: there is a debt crisis that needs fiscal consolidation; there is a competitiveness crisis that needs structural reforms; there is a banking crisis that needs a strong financial union; and there is a confidence crisis that needs strong commitment by all policy-makers, including by the central bank expressed through our programme of OMTs.

The social consensus behind the reforms will need to be maintained. These reforms are not undertaken to please Brussels or Frankfurt or Washington but for the deep self-interest of the economies concerned and of the whole euro area. They will make the economies function better, more efficiently and, yes, also more fairly.

Before drawing to a close, let me say a word on the prospective single supervisory mechanism and the role that the ECB shall take on.

Later this year, once the legal texts have been adopted, the ECB will assume a major new responsibility to prepare for becoming the new euro area banking supervisor, as home and heart of the single supervisory mechanism. This will be a major organisational challenge. Internal work is already underway. You can rest assured that we will work hard to ensure that the ECB will deliver on its responsibilities to the highest possible standard.

In the first press conference on this matter, when the single European supervisor had not yet been decided, I said that if it were to be the ECB, the following five principles would need to apply:

- the framework for supervision had to be effective and ensure coherent oversight;
- supervisory decision-making and monetary policy had to be clearly separated;
- national supervisors had to be properly involved through appropriate decentralisation;
- the Single Market had to be preserved for countries that did not join; and finally,
- there had to be full democratic accountability.

Conclusion

Ladies and gentlemen,

The establishment of the supervisory function in Frankfurt is a further tribute to the city as a financial centre. The ECB will also continue to contribute to the cultural life of the city, not least through the ECB Cultural Days that we organise every year and which this year will focus on Latvia. And in the eastern part of the city, we will see the Großmarkthalle emerge in its former glory together with our new tower that is scheduled for completion next year.

Let me conclude. We begin 2013 with more confidence than we had in January one year ago. This confidence is to a large extent built on the progress that all of us – governments, parliaments, the EU and the ECB – have been able to make during 2012. But it is also crucially built on the expectation that progress will persist.

The ECB for its part will be there to continue, as it has done successfully now for 14 years, to safeguard price stability.

Thank you very much for your attention.