Mario Draghi: Introductory statement at the Congreso de los Diputados de España

Introductory statement by Mr Mario Draghi, at the Congreco de los Diputados de España (Meeting with Members of Parliament), Madrid, 12 February 2013.

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Dear President Posada,

Honourable Members of Parliament,

I would like to thank you most warmly for your kind invitation to appear before this chamber of Parliament.

As President of the European Central Bank (ECB), it is an honour to have this opportunity to discuss the big challenges facing the euro area economy and to explain the major policy actions that we are taking in response to those challenges.

After outlining what we have done, I will be very keen to hear your views – on Europe's economy, on ECB policies and on the future design of our economic and monetary union. By the end of this session, I hope that we will have reached a good mutual understanding – one that will allow us, within our respective institutional mandates, to make further progress on the twin challenges of strengthening our union and returning to sound and stable growth.

Over the past few years, we have seen how deeply the economies of the euro area countries are interconnected. It is an emphatic reminder of how economic policies in one country have significant effects on other countries.

As the democratically elected representatives of the Spanish people, you are responsible for domestic economic policy. Yet in the exercise of those duties, just like all national parliaments in the euro area, you influence the functioning of our economic and monetary union as a whole. As the President of the European Council Herman van Rompuy has said, national parliaments have become European institutions. It is important that we all recognise these mutual interests.

In my introductory remarks today, I would like to focus on three topics: the state of the economy, the ECB's monetary policy and the longer-term vision for our economic and monetary union. I will then be happy to hear your views and take your questions.

Adjustment in the euro area economy

Let me begin with the overall situation. As you know, the euro area economy is undergoing an important adjustment. This process is necessary, but it is particularly painful and protracted in those areas where past misalignments of policies created vulnerabilities. Particular difficulties stem from the large imbalances of highly indebted sectors and unsound public finances in some euro area countries.

But we are seeing the first positive results of the adjustment. For example, euro area countries have almost halved their fiscal deficits from 6.2% of GDP in 2010 to an estimated 3.3% in 2012. Excluding interest payments, the primary deficit of the euro area as a whole is virtually zero. This contrasts with the United States and Japan, which recorded primary deficits of around 6% of GDP in 2012.

Several euro area countries are addressing their external imbalances, among them Spain, whose current account deficit fell substantially – from almost 10% in 2008 to about 1% in 2012. According to the latest data, your country's exports have increased notably – by about 20% in volume between 2009 and last year. There has been a similar increase in Portugal and, to a somewhat lesser extent, in Ireland.

Over the same period, the share of exports in GDP increased by around 10 percentage points in Spain, Ireland and Portugal. Exports are providing a strong positive contribution to real economic growth. These economies are also seeing a fall in unit labour costs, which will improve their competitiveness and provide a platform for sustainable growth.

Notwithstanding these signs of improvement, the adjustment has not yet had a visible impact on people's daily lives. Frustration in some parts of the population is thus understandable. Reform efforts take time to reveal their full beneficial effects – and they must reach a critical mass before they lead to a fundamental turnaround in economic prospects.

The top priorities on the reform agenda remain correcting misalignments and restoring the capacity of the economy to create value, incomes and jobs. Governments must persevere on the path towards sound and stable growth. National parliaments are key contributors to this process, notably in effective communication to the public of the ultimate goals.

In saying all this, I am acutely aware of the significant social costs that the adjustment entails, especially for those who have lost their jobs. I am very conscious of this human dimension of the recession, particularly the difficulties facing many of your constituents. But the reforms should not be seen in isolation: they aim to create stronger, better functioning and, yes, also fairer economies, for the benefit of all citizens.

Countries undertaking painful but necessary reforms should not feel that they have been left to fend for themselves. Creating a more stable and prosperous future for Europe is the goal that unites all euro area countries. To make progress, we need a shared sense of direction, a sense of cohesion across countries and a sense of solidarity within societies.

The shared sense of direction is expressed in laying the foundations for sustainable growth. In some countries, this implies re-orienting the main engines of growth towards productive sectors. It also implies regaining competitiveness by containing or reducing costs via a combination of accelerated productivity and wage restraint.

The sense of cohesion is expressed in the single market, the single currency and common European institutions to ensure good governance and, when needed, mutual assistance and support.

The sense of solidarity within societies should be expressed by ensuring that the burden is not borne disproportionately by certain sectors or groups of people.

The ECB's monetary policy

Let me now turn to the specific policy actions that the ECB has taken in response to the challenges to the euro area economy.

There are two key elements. The first has been to reduce our key interest rate to 0.75%, a level previously unseen in virtually all euro area countries. The interest rate in the overnight interbank market is now even lower, close to zero.

The second element has been to give banks unrestricted access to central bank funding through both our short- and long-term operations. This policy meant that banks did not have to shrink their balance sheets unnecessarily at a time when market funding became unavailable or excessively costly. It prevented a potential deflationary scenario, thus ensuring delivery on the ECB's primary objective of maintaining price stability in the euro area.

At the same time, the policy has alleviated funding constraints for banks that decide to renew or extend their loans to firms and households. This removes one obstacle to growth. Since three quarters of firms' external finance in the euro area comes from banks, we need them to be delivering a sound supply of credit to support investment and job creation.

We have provided banks with assurance that, with adequate collateral, they can draw unlimited volumes of central bank liquidity at our key interest rate. We effectively stood in for the interbank market: when that market stopped functioning, our actions allowed banks to continue lending. The overall size of our refinancing operations increased from less than €450 billion before the crisis to more than €1.2 trillion at its peak.

We have also provided banks with assurance that they can rely on our refinancing operations for extended periods. The maximum maturity of these operations increased from three months to three years. Without the two three-year refinancing operations launched in late 2011 and early 2012, there could have been a major credit crunch.

Through these measures, the ECB has decisively addressed the liquidity pressures faced by euro area banks. Here in Spain, for example, the liquidity support extended to the banking system currently corresponds to a quarter of the country's GDP, about eight times what it was before the crisis.

To ensure delivery on the ECB's primary objective of safeguarding price stability, it was essential to create an environment in which liquidity is not an obstacle to credit creation. But liquidity is not the only factor determining banks' capacity and willingness to lend to firms and households. There are two additional factors: banks' availability of capital; and the general perception of risk in the economy.

Provision of capital is not among the tasks of a central bank. It is the task of shareholders to ensure that banks are solvent and able to sustain their core business. When the private sector is unable or unwilling to provide capital, it is for the fiscal authorities – governments and parliaments – to decide whether and how to act.

Here in Spain, the authorities have been proactive, even in strained conditions, embarking on an ambitious financial adjustment programme with the assistance of their European partners. The programme – which is proceeding on schedule – has removed from the balance sheets of the weakest banking institutions the troubled assets that had been a drag on their business. The programme has recapitalised these institutions with fresh funds and laid the foundations for their return to health and active lending.

The general perception of risk is the third determinant of credit. Just like any other central bank, the ECB cannot control *microeconomic* risk – how banks assess whether a potential borrower will fail to repay a loan.

Microeconomic risk is related to the conditions prevailing in the specific sector in which a firm operates or to the firm's cost structure and capacity to innovate and create value. It is the role of structural, sectoral and fiscal policies to facilitate the reallocation of resources to activities that have real economic value.

For its part, the ECB is actively contributing to a reduction in *macroeconomic* risk: by firmly stabilising inflation expectations, it provides a nominal anchor for the economy as a whole. This is important for all lending and borrowing decisions, particularly the financing of longer-term investment projects.

Our decision last summer to prepare for Outright Monetary Transactions (OMTs) in government bond markets can be seen in this light. OMTs are designed to focus on bonds with a remaining maturity of up to three years, aiming to keep medium-term inflation expectations stable by avoiding a highly damaging breakdown in the transmission of monetary policy.

The ECB can only consider OMTs if there are major problems in the transmission of monetary policy and if there is strict and effective conditionality attached to an appropriate European Stability Mechanism (ESM) programme.

There are two reasons for this conditionality framework. First, OMTs are a backstop against destructive speculation. They are not a subsidy for government financing. OMTs should remove only the part of the interest rate at which governments borrow that is due to unfounded expectations of destructive scenarios for the euro area.

But our interventions are conceivable only if the risk of fiscal dominance is firmly excluded. This requires certainty that governments will maintain fiscal discipline and that continuous reforms will correct underlying weaknesses. Only strict and effective conditionality can generate that kind of assurance.

The second reason for conditionality is that an ESM programme is a catalyst for reform. It can change the economic prospects of a country towards a higher growth potential, complementing monetary policy in its efforts to support the economy.

In the past few months, we have seen a gradual easing of financial conditions. Credit spreads on sovereign and corporate bonds have fallen. Equity prices have recovered. Banks have regained market access. And money has flowed back into European debt markets.

ECB policies have played a pivotal role in this improvement, as has resolute action by governments, parliaments and the private sector. All should persevere in these efforts with confidence. The ECB, for its part, will continue to safeguard price stability, as it has done over the past 13 years.

The longer-term vision

Let me turn briefly to the longer-term vision for Europe. As you know, it is widely understood that our monetary union needs to be complemented by a financial union, a fiscal union, a genuine economic union and eventually a deeper political union.

The most urgent project – financial union – is taking tangible shape. The ECB is expected to become the single supervisor for a large part of the euro area's banking sector. We stand ready to launch our internal preparations as soon as the European Parliament and the European Council reach an agreement on the legislation.

The proposal for a single resolution framework is also in the pipeline. Taken together, these two reforms will re-establish confidence in the euro area's banking sector.

It is also essential that we complete economic union by creating the conditions for each country to find its place in the open market economy that is the euro area, and to exploit its comparative advantages to generate jobs and growth.

This is the meaning of a well-functioning economic union. And it will only happen if we restore competitiveness across the euro area, if we improve the functioning of product and labour markets, and if we invest in skills and innovation.

The idea of "mutually agreed contracts for competitiveness and growth" or "reform contracts" could be very helpful here by targeting policy actions in areas that are key to restoring competitiveness. We would also benefit from a thorough review of product and labour markets to ensure that they are compatible with the functioning of monetary union.

Conclusion

Let me conclude. We have begun this year with a more stable financial environment. This has been achieved through concerted reform efforts by governments and parliaments and decisive actions by European institutions.

As I said at the beginning of my remarks, all national parliaments in the euro area influence the functioning of our economic and monetary union. Spain plays a prominent role in this process.

Throughout the current phase of economic adjustment, communication between European and national policy-makers and consensus-building efforts within domestic constituencies are of critical importance. This is the best way to safeguard our future collective prosperity.

Thank you for your attention. I will now be pleased to hear your views and take your questions.