Mario Draghi: Hearing before the Plenary of the European Parliament on the occasion of the adoption of the Resolution on the ECB Annual Report 2011

Introductory statement by Mr Mario Draghi, President of the European Central Bank, at a hearing before the Plenary of the European Parliament on the occasion of the adoption of the Resolution on the ECB Annual Report 2011, Strasbourg, 16 April 2013.

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President,

Honourable members of the European Parliament,

I am very pleased to take part in this debate today. It forms a central part of the ECB's accountability towards the European Parliament to which the ECB attaches utmost importance.

Since 2011 the ECB has taken a number of important measures to address severe distortions in the financial markets and to address fragmentation. Although I have had many occasions to discuss the ECB's policies during my regular hearing before the ECON Committee, today is an opportunity to take a broad view on recent economic developments and monetary policy decisions, as well as to discuss the adjustment in the euro area and the outlook for EMU governance. This will allow me to cover several issues highlighted in the draft resolution.

1. Economic developments and monetary policy decisions

Following two years of recovery, the euro area moved into recession in 2012. Unemployment has reached unprecedented levels, especially among young people. This economic weakness was driven by declining private consumption and faltering investment, in an environment of weak business and consumer confidence and financial market tensions.

We expect a gradual recovery in euro area economic activity for the second half of this year. But this scenario is subject to downside risks.

In 2012, headline HICP inflation in the euro area was 2.5%, reflecting elevated energy prices and increases in indirect taxes and administered prices. Annual inflation rates have since declined to 1.7% in March this year.

The Governing Council remains firmly committed to its price stability mandate. This is fully reflected in long-term inflation expectations which have remained firmly anchored in line with our price stability objective of below but close to 2%.

2011 and 2012 were years in which much of our focus was on the proper transmission of our monetary policy. When changes in policy rates are not appropriately transmitted to the real economy, this is a matter of concern.

In a context of large refinancing needs and persisting funding stress for banks, the ECB launched two long term (i.e three years) refinancing operations in late 2011 and early 2012. These operations, in combination with our measures to enhance the availability of collateral, were pivotal in preventing a disorderly process of lenders' deleveraging and a large-scale credit crunch. This action was instrumental in maintaining price stability.

Later in 2012, a renewed confidence crisis, in part reflecting unwarranted investor fears about the reversibility of the euro, caused a severe deterioration in financial markets. Sovereign bond and bank lending rates in some countries increased dramatically, thereby impairing access to financing of the real economy.

To safeguard the singleness of monetary policy and to ensure an effective transmission of the ECB's policy intentions to the broad economy, in August, the Governing Council announced its readiness to undertake Outright Monetary Transactions (OMT). OMTs have proven to be an effective backstop against unfounded fears of reversibility. Strict conditionality contains moral hazard on the side of governments. It ensures that they will adopt the reforms that are necessary to secure their solvency and to foster conditions of steady growth for their economies. As I said before, the repair of the transmission channel cannot be done by the central bank alone, governments need to do their part. Let me therefore turn to the on-going adjustment in Member States, and the euro area more generally.

2. The adjustment in the euro area

During the past five years, a number of euro area countries have seen a significant correction of their external and domestic imbalances. In Ireland, Greece and Portugal current account balances improved by more than 7 per cent of GDP between 2008 and 2012. A large part of this adjustment has been driven by a contraction in domestic demand, triggered by the unwinding of long accumulated unsustainable developments and by the cyclical downturn. At the same time, in Ireland, Spain and Portugal export performance has been very strong compared with the pre-crisis period. This is a sign that a genuine structural correction is taking place and resources are being moved from the non-tradable sector to the production of traded goods.

We have also seen some improvement in cost competitiveness, which has contributed to the external adjustment. Between 2008 and 2012, in the three programme countries the cumulated unit labour cost growth was about 10pp below the euro area average. The adjustment has been mainly driven by an increase in average productivity, largely reflecting labour shedding, rather than by a reduction in nominal wages. The latter adjustment has been much more limited so far.

This has contributed to increasing the real cost of adjustment and the burden borne by the more vulnerable members of society. It calls for greater determination in further addressing rigidities in wage setting and increasing competition in many segments of the economy. Reducing rents is not only a matter of efficiency in the adjustment process: it is also a matter of equity in sharing the burden of adjustment.

3. The outlook for EMU

Prior to the crisis, Member States did not internalise fully what it means to be part of EMU. Fiscal and economic policies were not sufficiently geared towards the conditions of being a member of a single currency zone. But the lessons of the crisis have been learnt. EU Heads of State and Government have taken action and strengthened the governance framework.

The current deepening of EMU is essential, in particular as regards banking union. It is of utmost importance that the legislation on the Single Supervision Mechanism (SSM) is finalised before the summer break now that a political agreement has been found. This is an absolute prerequisite if we want to embark upon our preparatory work in a timely and effective fashion, so that the SSM is operational by mid-2014. Equally important is the swift set-up of a Single Resolution Mechanism (SRM): it is a necessary complement to the SSM and a key element of banking union. The Commission's intention to put forward a legislative proposal before summer is highly welcome. In the meantime, the Directive on Bank Recovery and Resolution will hopefully be adopted and provide for a coherent EU-wide set of rules.

Deeper economic union means more than fixing the financial system. We therefore welcome the proposal to conduct ex-ante coordination of structural reforms initiatives, which should be implemented as a best-practice benchmarking exercise. In the same vein, reform contracts, in which Member States commit to concrete reforms with specific timelines, would also facilitate the recovery of competitiveness.

But new rules are only as good as the commitment to actually implement them. It is of key importance that the existing legislation is applied forcefully during the ongoing European Semester: this represents a true test of the credibility of EMU's governance framework.

I thank you for your attention and stand at your disposal for questions.