Mario Draghi: Keynote address at the Süddeutsche Zeitung Führungstreffen Wirtschaft 2013

Keynote address by Mr Mario Draghi, President of the European Central Bank, at the Führungstreffen Wirtschaft "Strategies for more growth" organised by Süddeutsche Zeitung, Berlin, 21 November 2013.

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Ladies and gentlemen,

The euro area has been through a difficult period of correcting the imbalances of the past. The necessary adjustment has inevitably put our economies under strain, and it has also caused unemployment that is still unacceptably high, especially among the young.

Yet I see signs today that the euro area is slowly advancing on the road to recovery. The latest data suggest that, little by little, economic growth is again taking hold – although it remains weak, uneven and fragile, while the risks surrounding the economic outlook continue to be on the downside.

This gives policy-makers in the euro area an opportunity to alter their focus – to be less absorbed in short-term crisis management, and more focused on building an economy with more stability, more growth and more jobs.

Today I would like to discuss what we can do individually and collectively to achieve that goal.

My key point is that the return of economic growth is not a signal that reform efforts are behind us. On the contrary, to secure the recovery and create jobs, determined action is more important than ever.

All actors in the euro area have a part to play. A sustainable recovery first and foremost requires price stability, which we at the European Central Bank (ECB) will continue to provide. It requires more competitive economies, for which governments must create the right conditions. And it requires dynamic and inclusive business models, which social partners and business leaders can deliver.

We all benefit from a prosperous and dynamic euro area economy, so we all have a responsibility to make it a success – national governments, social partners, businesses and European actors.

Monetary policy

Let me first describe what the ECB is doing to maintain price stability in the euro area. I will start with a quick review of the key principles underlying our monetary policy strategy.

As you know, the Treaty establishes price stability as the ECB's primary mandate. This mandate has guided our monetary policy since monetary union began. And it will continue guiding our monetary policy in the future.

To put our mandate into practice, the ECB's Governing Council has established a transparent, ambitious and verifiable objective – namely, to keep average inflation in the euro area below but close to 2% over the medium term.

The rationale behind this objective was explained at the time we clarified our strategy in 2003, notably in remarks by our then chief economist Otmar Issing. It ensures that inflation remains low enough to avoid distorting the decisions of firms and households in the economy – while preserving a sufficient buffer away from zero.

We need this buffer away from zero to provide a safety margin against deflationary risks at the euro area level. It also prevents countries experiencing inflation rates well below the euro

area average as part of their adjustment processes from being forced to operate in deflationary territory for protracted period.

These considerations are the backdrop against which we decided to cut our main policy rates two weeks ago.

The rationale for action

The context of this decision was a gradual but sustained downward drift in inflation that we had observed over several months. Inflation projections by ECB staff, as well as by other major forecasting institutions, had been revised down repeatedly over the last year – from already low levels.

And the process of gradual disinflation did not just affect individual, volatile components of inflation such as energy. Instead, it reflected a broad-based reduction in all major inflation components since last summer.

The disinflationary trend was further confirmed by the latest yearly inflation figures published by Eurostat. These were revised down by almost half a percentage point to 0.7% in October.

Overall, we have been witnessing a disinflation "in slow motion" for several months now. And combined with still weak economic and monetary dynamics, the latest data suggest that we may experience a prolonged period of low inflation going forward.

So why did we act?

It was not because we see deflation risks materialising in the euro area. With the recovery taking hold, we still expect inflation to return very gradually to levels below but close to 2%. This view is also supported by inflation expectations, which over a longer-term horizon remain firmly anchored at levels close to 2%.

Rather, we acted to restore an appropriate safety margin from zero as prescribed by our price stability objective.

By rebuilding the safety margin, our accommodative stance also has an important side effect: it facilitates the continuing process of internal rebalancing in the euro area.

Countries with past competitiveness deficits should accept low inflation rates relative to the euro area average. And monetary policy cannot and should not discourage the ambitious reform efforts that are necessary to achieve such rebalancing.

But if average inflation is allowed to drift too low at the euro area level, it is much harder for those countries to undershoot the average. And in the process, adjustment runs into major headwinds as demand suffers and real debt burdens rise.

Addressing the concerns

I am of course aware that our rate cut has raised some concerns.

One concern is the effect of this decision on different countries in the euro area.

However, it is important to understand that setting monetary policy for a union of 17 member states is not the same as for a single country.

What is the same is the objective – price stability. But what is different is the institutional setting, the decision-making procedures and the instruments for the implementation of monetary policy. And crucially, in monetary union price stability is defined for the euro area as a whole.

This is the mandate that was given to us by the euro area member states and, since the launch of the euro, we have delivered it continuously and in full. Euro area price stability is confirmed and anchored into the future.

Another concern is the implication of low interest rates for savers. This concern is understandable. But the effect of monetary policy on the returns on savings cannot be seen in isolation.

First, we need to take account of the state of the economy.

Interest rates are low because the economy is weak. Accommodative monetary policy is a response to this, designed to restore sustainable growth in an environment of price stability. If we were to raise rates in this situation, it would only depress the economy further.

And this would in turn affect savings.

Why? Because people would lose their jobs or have their wages cut in a prolonged and entrenched recession, thus reducing the amount they can save. Or because they would see returns on assets fall, thus reducing their investment income. When the economy contracts, incomes fall, and savings necessarily fall in tandem.

Moreover, the interest rate that matters most to long-term savers is not the main ECB refinancing rate, but the rate on safe long-term investments – in Germany, that is long-term Bunds.

The ECB's decisions influence these long-term rates but there are also other factors at play. For example, on the day of our rate cut of 25 basis points, interest rates on 10-year Bunds fell by less than 7 basis points. Since then those rates have risen by about 2 basis points.

The current low level of interest rates on long-term Bunds is largely explained by investors that have sought safe assets in the context of sovereign debt tensions in the euro area.

A third concern about low interest rates is that they undermine incentives for reform in the euro area.

It is true that monetary policy decisions can have side effects – I mentioned a positive side effect earlier. Yet we act for the euro area as a whole in line with our mandate, not for individual countries.

If there is concern about reform incentives, we need to ask whether the framework of economic governance is being sufficiently enforced, and if not, what could be done to strengthen it. After all, ensuring sound fiscal and economic policies is ultimately the task of political authorities, not monetary authorities.

Economic policy

In the same vein, we know that monetary policy alone cannot create a sustainable recovery. Restarting growth ultimately depends on governments, business leaders and social partners working together. Governments need to create the conditions that allow entrepreneurs to generate growth.

There is no short cut to growth through debt. Growth ultimately has to come from increasing the productive capacity of the economy – that is, through raising competitiveness and productivity.

This country presents a good example of how to build solid foundations for growth.

Germany has competitive and innovative firms that are embedded in global value chains, notably the Mittelstand. The country has enacted labour market reforms that have helped maintain price competitiveness, and that limit the impact of economic downturns on the young. And it has done this while working in cooperation with social partners, who understand that business models have to adapt to a globalised economy.

In short, Germany has oriented itself in a direction that in my view would benefit all euro area countries: being forward-looking, open to the world and focused on competitiveness and productivity.

Abraham Lincoln famously said that “you cannot make the weak stronger by making the strong weaker”. Similarly, the answer to the problems of the euro area is not to weaken its stronger economies. Rather, it is to strengthen its weaker economies.

And in fact, this is what we are seeing in the euro area today.

Most countries that lost competitiveness are regaining it. They are converging towards the most competitive countries, not vice versa. They have learned the fundamental lesson – for which Germany is the model – that in a monetary union, wages have to reflect productivity to maintain price competitiveness.

For example, the countries under full EU-IMF programmes have seen their unit labour costs fall by more than 15 percentage points since 2009, relative to the euro area average. Current accounts are in balance or surplus in all the countries under strain, meaning that they are no longer accumulating external debt and “living beyond their means” – and larger countries would be well advised to follow.

And even though declines in import demand play an important role, the rebalancing in countries under strain is also coming from growth in exports and increasing market shares. In Spain, for example, export volumes are up by more than 20% since 2009.

For this reason, I do not agree with those who say that Europe is in a “lost decade”. Euro area countries are using the second decade of the euro to undo the mistakes of the first – and in doing so, laying the foundations for sustainable growth in the decades to come.

The challenge ahead

The task of restoring sustainable growth is still far from complete. Regaining competitiveness is only one part of the challenge. Another essential component is to reverse the damage to the economy caused by the crisis. It has reduced the euro area’s output level and perhaps also its growth rate.

To turn that around requires higher investment in human and physical capital – and in all euro area countries. In Germany, for example, investment is still around 1 percentage point of GDP lower than it was in 2007, and in that year it already had the lowest investment ratio in the euro area.

Both the public and private sectors have a role to play here. Generating higher investment is ultimately the job of the private sector. But public authorities have to create the conditions that facilitate and encourage this process.

I see three conditions as crucial: a stable macroeconomic environment; growth-enhancing structural reforms; and a healthy banking sector.

First, a stable macroeconomic environment provides the certainty that is so important for investment.

That entails medium-term price stability, which the ECB is providing. And it entails medium-term economic stability, which governments have to ensure through sustainable fiscal and economic policies and adhering to the euro area rules.

Second, structural reforms are vital to raise growth potential and make new investment attractive – especially in the current environment where firms may have become less optimistic as a result of the crisis.

Of particular importance are reforms that increase competition, which in turn drives innovation, efficiency and productivity growth. Such reforms include opening up protected sectors and removing barriers for new firms to enter the market.

Third, we need a healthy banking sector to ensure that capital can be allocated where productive investment is needed.

Bank lending in the euro area is currently very weak, having fallen for 16 straight months. This in part reflects the state of the economy; in part it reflects balance sheet constraints in the banking sector.

But as the economy picks up next year, we need to ensure that those balance sheet constraints do not hinder the recovery. This is why the rigorous and comprehensive assessment of banks' balance sheets currently being undertaken by the ECB is so important. Prompt corrective actions by banks themselves are welcome.

Taken together, these three conditions will provide firms with the certainty, optimism and financing they need to restart investing – and hence to get the euro area back to a higher growth trajectory.

Conclusion

Let me conclude.

I have today described the actions being taken by all actors in the euro area to ensure stability and raise growth. A great deal of progress has been made, but a great deal still remains to be done. For the sake of those who remain unemployed, we have to persevere.

Now is not the time to relax reform efforts. Nor is it the time to become fractious.

We all benefit from an environment of inflation at below but close to 2% in the euro area. We all benefit from measures to raise productivity and improve competitiveness. It is never the case that sound economic policies are good for some in the euro area but not for others.

I trust that this audience understands our shared responsibility for the euro area. After all, we are the euro area – its citizens, its firms and its institutions. It is only by acting together that we can put the crisis behind us, and move forward towards a brighter, more prosperous future.