Vítor Constâncio: Presentation of the ECB Annual Report 2013 to the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Vítor Constâncio, Vice-President of the European Central Bank, to the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 7 April 2014.

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Madame Chair,

Honourable members of the Committee on Economic and Monetary Affairs,

I am delighted to be back here in Brussels before the Committee on Economic and Monetary Affairs for the presentation of the European Central Bank's Annual Report for 2013.

Almost a year ago to the day I presented to you the ECB's Annual Report for 2012. This was the starting point of an intensive work stream in this house that led to the adoption of a resolution by the Plenary in December 2013. We have read this resolution carefully, as the recommendations and thorough assessments we receive from you constitute valuable input to our policy preparation and discussions. As was explained to you, the ECB takes these recommendations into account. For example, in 2013 the ECB decided to adopt targets to substantially increase the number of female managers over the coming years, an HR policy that is already paying dividends. We also published the rules governing the ECB's role in the granting of emergency liquidity assistance on our website.

In my initial remarks today I would like to focus on three topics. First, I will present the monetary policy conducted by the ECB in 2013. Second, I will discuss the progress made in the area of financial legislation, most importantly in the context of banking union. Finally, allow me to share my reflections on some upcoming legislative dossiers.

Economic and monetary developments in 2013

In 2013 we conducted monetary policy in an environment that remained challenging, despite improvements in economic confidence, financial market sentiment and financing conditions.

Real GDP declined by 0.4% for the year as a whole, but the economic recovery gradually took hold over the second half of the year, aided by receding financial market tensions, improving economic confidence and a pick-up in foreign demand.

Average annual inflation stood at 1.4% in 2013, with inflation declining markedly over the year, from 2.2% in December 2012 to 0.8% in December 2013. Low inflation mainly reflected a strong decline in energy and food price inflation.

At the same time, medium and long-term inflation expectations remained firmly anchored at levels consistent with our aim of keeping inflation rates below, but close to, 2% in the medium term.

Monetary and, in particular, credit dynamics remained subdued throughout the year. M3 growth was 2.4%, compared with 3.1% in 2012, but declined throughout the year to the low level of 1% in December. In 2013, loans to the private sector, and to enterprises in particular, contracted by more than 2%. To a large extent, this contraction reflected the weak economic situation and outlook, risk aversion and the balance sheet adjustment of banks, households and enterprises.

At the start of 2013 our balance sheet started to shrink, predominantly reflecting repayments of funds that banks had borrowed under the two 3-year longer-term refinancing operations (LTROs). These two LTROs, which amounted to almost €1 trillion, represented in net terms an increase of €500 billion of our monetary base. However, more than €500 billion have already been paid, and excess liquidity came down from a peak of €800 billion to a little over €100 billion. The high levels of inflation that some voices predicted never materialised, and we are now in a regime of low inflation. We closely monitor developments in money markets that may result from the concurrent reduction in abundant liquidity. We continue to stand ready to take measures to ensure stable money market conditions.

In order to safeguard price stability in the environment of weak economic activity and downward revisions to the inflation outlook, we lowered key ECB interest rates in May and again in November 2013.

In late spring and summer we noted a sustained increase in expected interest rates in money markets, partly as a result of contagion from the United States. This development was unwarranted given the underlying macroeconomic conditions, and was not in line with our policy dispositions. Therefore, in July 2013 we started to provide forward guidance, stating that we expected the key ECB interest rates to remain at prevailing or lower levels for an extended period of time. The new policy was successful, leading to a reduction in the short-term forward rates, and we have confirmed this message since then. Today these expectations are based on an overall subdued inflation outlook extending into the medium term, given the broad-based weakness of the economy, the high degree of unutilised capacity, and subdued money and credit creation.

As mentioned, in November we lowered interest rates given the overall subdued outlook for inflation extending into the medium term. Following this decision, rates stand at 0.25% for the main refinancing rate, 0.00% for the rate on the deposit facility and 0.75% for the rate on the marginal lending facility. We also extended our pledge to guarantee full liquidity provision at a fixed rate to our counterparties against eligible collateral for as long as needed and at least until July 2015. We are resolute in our determination to maintain a high degree of monetary accommodation, given expectations of a prolonged period of low inflation, to be followed by a gradual upward movement towards levels closer to 2%. We are ready to act swiftly if needed, and the Governing Council has stated unanimously its "commitment to using also unconventional instruments within our mandate to cope effectively with the risks of a too prolonged period of low inflation."

Key developments towards banking union

By putting in place and finalising legislative and practical steps towards banking union, 2013 marked a quantum leap in European integration. Today, not even two years after the EU Heads of State or Government committed to build a genuine banking union, the two cornerstones of this ambitious project – the Single Supervision Mechanism (SSM) and the Single Resolution Mechanism (SRM) – are in place.

The SSM will create genuine European supervision, requiring the ECB to take responsibility for ensuring that the European banking sector is sound and safe. In the process of establishing the SSM, we need to further restore the health of the banking sector and confidence in it, thereby creating the conditions for a revival of credit provision to the real economy. The ECB's comprehensive assessment is designed for this purpose. At the ECB, we are very conscious of the huge responsibility that we have been asked to shoulder, and this exercise will be executed in a credible and consistent manner. Let me assure you that we will under no circumstances compromise the rigour of the comprehensive assessment.

As regards the SRM, we welcome the political agreement that was reached on 20 March 2014. The intense negotiations between the co-legislators produced an SRM that is more efficient, more credible and more European. The European Parliament undoubtedly played a decisive role in achieving this outcome.

Let me highlight three aspects of the agreement that the ECB deems particularly important. First, we had insisted all along on the need for adequate funding for the Single Resolution

Fund (SRF). We therefore welcome the fact that the SRF will be mutualised faster and that the pace of mutualisation will be significantly frontloaded. Taken together, this means that it will have more common firepower already in the early years, and will thus be more effective in breaking the link between banks and sovereigns, and protecting taxpayers' money. There will also be a clear reference to establishing an enhanced borrowing capacity for the Fund, and we look forward to concrete progress being made in this field.

A second essential requirement from the ECB's viewpoint was the need for a swift and efficient decision-making process, allowing for the resolution of a bank over a weekend. We welcome the fact that the text now caters for a swifter procedure, ensuring timely resolution decisions.

Finally, we note with satisfaction that the ECB as supervisor will have the primary role in deciding whether a bank is failing or likely to fail.

In the field of financial regulatory reform more broadly, the EU has also taken key steps in 2013, with the European Parliament playing an important role. The single rulebook, which is aimed at providing a single set of harmonised prudential rules throughout the EU, will be the cement that holds together the single market for financial services. The adoption of the Capital Requirements Regulation and Capital Requirements Directive in April 2013 was therefore an essential step towards strengthening the stability and resilience of the banking sector. In parallel, banks will have to satisfy the requirements of the bank recovery and resolution directive which comes into force in 2015, by developing recovery plans, cooperating with resolution authorities and making necessary changes to capital holdings, business activities, legal and operating structures.

With these measures, we have the possibility to bring banks and financial services back to their core mandate of being at the service of the real economy and protecting savers.

Looking ahead

Therefore, it is of the utmost importance to maintain this momentum and to continue with the rapid adoption of a number of pending legislative proposals. First, the proposed regulation on indices used as benchmarks in financial instruments and financial contracts needs urgently to be adopted and implemented, as regulatory uncertainty has been one of the factors leading to banks leaving the EURIBOR panel. Second, regulatory reforms of shadow banking, in particular the Commission's proposal on money market funds, will ensure that money market funds are safer and better managed. Third, the legislative work will have to proceed on the European Commission's proposal on the structural reform of the EU banking sector, as it would contribute to reducing the potential fragmentation caused by different national regulations.

Beyond these pending legislative proposals, the coming months will also provide the opportunity to review a number of legislative packages adopted during the crisis.

First, the review of the six-pack and of the two-pack will allow stock to be taken of what has been achieved and to identify gaps in the EMU architecture that still need to be filled. I trust that with its European perspective, the European Parliament will ensure that this review will consolidate those achievements that have proven successful, while at the same time strengthening the governance framework in those areas where there is room for improvement.

Second, the review of the European System of Financial Supervisors may enable us to cater to new realities. Three years ago the creation of the European Supervisory Authorities and of the European Systemic Risk Board certainly constituted the right step at the right time. This upcoming review could be an opportune moment to reflect on how to fine-tune the regulatory and supervisory landscape in Europe to account for the changes brought about by the establishment of the SSM.

Honourable members,

I understand that today is the last meeting of your committee in this legislature. Let me take the opportunity to thank all of you for the very constructive relationship that we have established over the past five years.

I am now at your disposal for questions.