Mario Draghi: Hearing at the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Mario Draghi, President of the European Central Bank, before the Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 16 June 2015.

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Mr Chairman,

Honourable members of the Committee on Economic and Monetary Affairs,

Ladies and gentlemen,

I am happy to be back to this committee for my regular hearing. Today, I would like to share with you the ECB's assessment of the current economic and monetary conditions in the euro area. I will then touch on the subject chosen for our exchange of views, namely the risks and side-effects of our asset purchase programme. Finally, I will say a few words about the current situation in Greece.

Economic outlook and monetary policy

The latest economic indicators and survey data broadly confirm our assessment that the economic recovery is proceeding at a moderate pace. While growth has been mainly supported by private consumption in recent quarters, we now see encouraging signs that also private investment is picking up, which underlies our expectation that the economic recovery should broaden. This will be supported in particular by our monetary policy measures, which are working their way through to the real economy, by the comparatively low price of oil, and by improvements in external price competitiveness. This is also reflected in the latest Eurosystem staff projections: we project economic growth to increase from 1.5% of GDP in 2015 to 1.9% in 2016 and to 2.0% in 2017.

After some months with negative or zero rates, inflation in May has increased modestly, standing at 0.3% in year-on-year terms, as the negative contributions from energy prices are fading. We expect inflation to remain low in the months ahead before rising stepwise around the turn of the year. Thereafter, inflation is expected to gradually converge toward levels closer to but still below 2%. In the Eurosystem staff projections of June, inflation is projected to increase from 0.3% in 2015 to 1.5% in 2016 and 1.8% in 2017.

Over the last quarter, money and credit dynamics have strengthened overall. The growth of broad money in April stood at 5.3%, and in part reflects the expansion of bond purchases by the Eurosystem. While improving further, loan growth to the private sector, standing at 0.8% in April, has lagged somewhat the pace at which monetary trends have been firming. It remains moderate – atypically so, after such a prolonged phase of credit compression – and uneven across the euro area economies with new loans to enterprises particularly weak.

Overall, we remain prudently confident that all economic and monetary conditions are in place to support a gradual reflation of the euro area economy, with a sustained return of inflation rates to levels below, but close to, 2%.

This assessment is based on the full implementation of all our monetary policy measures. We need to keep a steady monetary policy course and firmly implement those measures, including our expanded asset purchase programme. It is our clear intention to purchase private and public sector securities of EUR 60 billion per month on average until the end of September 2016 and, in any case, until we see a sustained adjustment in the path of inflation that is consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term.

Over recent weeks, financial markets have registered a measurable trend reversal in prices and a surge in volatility, with the fixed-income market the epicentre of the correction.

Let me make two observations in this respect. First, a period of higher volatility is a phenomenon that is frequently observed not long after the start of a large quantitative programme, when short-term rates are pressed against their lower bound. Price discovery is gradual and complex in a world in which central banks intervene in long-dated securities and markets re-appraise prospects for the macro-economy in exceptionally uncertain conditions.

Second, and notwithstanding these developments, financial market conditions remain accommodative and supportive of the economic recovery in the euro area. For example, given the amount of accommodation that was introduced even before our expanded asset purchase programme commenced in March, bank lending rates – a key indicator of financing conditions in the euro area – are still trending down. Since the announcement of the expanded APP, the composite bank lending rates for euro area NFCs declined by 13 basis points to 2.30% in April (and compared with 2.79% in June 2014). Bank lending rates on loans to households for house purchase declined by 25 basis points to 2.25% in April (and compared with 2.87% in June 2014). In addition, most measures of cross-country dispersion show tangible declines for NFCs.

As interest rates on outstanding loans are re-set, and new credit contracts embodying more favourable terms for borrowers replace old ones, financial accommodation reaches a growing number of consumers and investors. This incremental process has not yet run its course. It is still on-going.

This being said, in the process of price adjustment, the term structure of the money market interest rates has come under intense upward pressure. The expected policy rate path implied by money market quotes has shifted up and steepened noticeably as a consequence. The very short end of the curve – because of expanding surpluses of liquidity – has remained well-anchored around levels that are broadly in line with our forward guidance over those horizons.

We are closely monitoring conditions to detect signs of an unwarranted tightening of our stance, to which we would need to react.

Risks and side-effects of APP

Engaging in a large-scale asset purchase programme is not without risks and side effects. Let me focus here on the financial risks of our own balance sheet, on financial stability implications for the euro area, and on effects on income distribution.

We monitor very closely the risks for the Eurosystem's balance sheet associated with our asset purchase programmes and we manage those risks to keep them at levels that do not threaten our capacity to fulfil our policy mandate to maintain price stability. In particular, we manage credit risk by exclusively purchasing assets of sufficient credit quality, by defining an asset allocation and a limit framework that ensures some degree of diversification, and by applying severe due diligence and monitoring processes. With regard to PSPP, we also decided that the purchases of government bonds conducted by the Eurosystem NCBs will not be risk-shared within the Eurosystem. This does not hamper the effectiveness of the purchase programme and the singleness of our monetary policy. The Governing Council has full control over all the design features of the programme. The specific risk-sharing agreement takes into account the unique institutional structure of the euro area, in which a common currency and a single monetary policy coexist alongside 19 national fiscal policies.

As regards possible financial stability risks, we assess these risks as rather contained for now. Looking in particular at housing markets in the euro area, we don't see any signs of general overvaluation. Important indicators for increasing financial imbalances are real estate prices and credit growth, but so far we have witnessed low growth rates of both. For instance, the annual growth rate of prices for houses and apartments in the euro area

increased on average by 0.8% in the last quarter of 2014. The annual growth rate of loans for house purchases stood at 0.1% in April 2015. Nevertheless, we monitor developments closely. If needed, macro-prudential policy tools should be used to safeguard financial stability.

Finally, large-scale asset purchases – as any other monetary policy measure – have distributional consequences. In the short run, the current combination of low interest rates, forward guidance and asset purchases is conducive to a change in asset prices and to wealth gains for investors holding a wide spectrum of assets. But this mechanism of asset price changes lies at the heart of monetary policy transmission and is set in motion every time a central bank activates its instruments of monetary policy, whether conventional or unconventional, in the pursuit of its objective. Interest rate changes always alter the attractiveness of saving relative to consumption and can influence the debt burden of borrowers.

Likewise, the current accommodative monetary policy stance eases financing conditions throughout the economy, boosting consumption and investment and, ultimately, inflation. This is an absolute precondition for interest rates to return to more normal levels consistent with sustainable growth and price stability. By reducing the cyclical component of unemployment, it also contributes to reducing a major source of inequality, particularly amongst the young and lower-income groups. In the end, all citizens across the euro area will benefit most from an environment of stable prices, macroeconomic stability, economic growth and job creation in the longer run.

The current situation in Greece

Finally, let me say a few words on the situation in Greece and the ECB's role. As is the case for any member country of the euro area, the ECB, in the context of the euro system, fulfils its mandate as central bank toward Greece. Furthermore, the SSM Regulation you adopted together with the Council in 2013 made the ECB the supervisor of the Greek banking system through direct and indirect supervision. And in the two-pack, Parliament and Council have asked the Commission to liaise with the ECB when negotiating the conditionality attached to the adjustment programmes and when reviewing their implementation.

When it comes to monetary policy and supervisory action, the ECB will continue to take its decisions in full independence and in accordance with our legal framework. This rules-based approach is what is required from us. This is what we have been following and will continue to follow.

In this context, the Eurosystem has provided support to allow Greek banks to continue financing the economy. Currently, the central bank liquidity extended to Greek banks amounts to around EUR 118 billion, more than double the amount at end 2014. The current liquidity support represents around 66% of Greece's GDP, the highest level as a share of GDP of any euro area country. Last week, the Governing Council decided not to object to a further increase in the ELA ceiling, by EUR 2.3 billion to EUR to 83 billion. Liquidity will continue to be extended as long as Greek banks are solvent and have sufficient collateral.

However, in a situation where the Greek government does not have market access, this liquidity can not be used to circumvent the prohibition of monetary financing, as laid out in Art. 123 of the Treaty on the Functioning of the European Union. This, together with supervisory considerations, explains why there is a ceiling on the Greek T-bills held by the Greek banking sector.

For the Governing Council to reconsider the T-Bills ceiling, there should be a credible perspective for a successful conclusion of the current review and subsequent implementation which would imply the disbursement of programme funds by euro area Member States. This would also significantly improve the outlook for future market access by the Greek government.

It should be absolutely clear that the decision on whether to conclude the review of the current programme and disburse further financial support to Greece lies entirely with the Eurogroup, so ultimately with euro area Member States. Hence this is a political decision that will have to be taken by elected policymakers, not by central bankers.

In the meantime, we will continue to provide our advice on the adjustment programmes. It is within this context, that we need a strong and comprehensive agreement with Greece, and we need this very soon. By strong and comprehensive I mean an agreement that produces growth, that has social fairness, but that is also fiscally sustainable, ensures competitiveness, and addresses the remaining sources of financial instability. I can assure you that the ECB is doing all it can to facilitate a successful outcome.

Such a strong and credible agreement with Greece is needed, not only in the interest of Greece, but also of the euro area as a whole. While all actors will now need to go the extra mile, the ball lies squarely in the camp of the Greek government to take the necessary steps.

Conclusion

The situation in Greece reminds us again that the Economic and Monetary Union is an unfinished construction as long as we do not have all tools in place to ensure that all euro area members are economically, fiscally and financially sufficiently resilient. To complete the Economic and Monetary Union, we need a quantum leap towards a stronger, more efficient institutional architecture. As you know, my colleagues and I are currently working on a report that will aim at showing a roadmap for this. We are in the final stages of this process, and I hope you understand that also out of respect for my colleagues, I will not be able to tell you more than what I have already said repeatedly: That we will need to put our institutional framework on a much stronger footing; that we need, as I just said, a quantum leap.

I am now looking forward to our discussion.