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, 26 September 2016.

*   *   *

Mr Chairman,

Honourable Members of the Economic and Monetary Affairs Committee,

Ladies and gentlemen,

I am grateful to be back speaking to your committee less than a week away from an important anniversary for the European Parliament: 40 years ago the act that made direct European elections possible was signed, and I am happy to be speaking to you – the direct representatives of the people of Europe.

Europeans are calling on our institutions to bring tangible benefits to their everyday lives. We need to respond to this appeal with action within our respective competences. This is why I am here today: not only to demonstrate once again the importance that the ECB places on being accountable to EU citizens, but also to discuss with you how the ECB is acting to fulfil the mandate that was democratically conferred upon us.

Therefore, in my remarks today I will first review the state of the euro area recovery and the impact of our monetary policy measures. Then, at the request of this committee, I will discuss financial market conditions in the euro area and, in particular, the evolution of financial market integration.

The economic outlook and the ECB's monetary policy

The recovery in the euro area is expected to continue at a moderate and steady pace, but with slightly less momentum than envisaged in June.

On the positive side, incoming information continues to point to the euro area economy being resilient to global and political uncertainty, notably following the UK referendum outcome. The initial impact of the vote has been contained and the strong financial market reactions, such as equity price falls, have largely reversed.

At the same time, the substantial weakening of the foreign demand outlook since June is expected to dampen export growth. Along with other factors, it will continue to pose downside risks to the euro area's growth prospects. According to the September ECB staff macroeconomic projections, annual real GDP growth is expected to increase by 1.7% this year, and by 1.6% in each of the next two years.

Inflation continues to remain at low levels, reflecting past declines in oil prices and weak wage growth. Annual inflation is expected to be 0.2% this year and to increase to 1.2% in 2017 as the impact of past oil price falls unwinds. The continued economic recovery and a decline in the level of slack are expected to gradually push inflation further up to 1.6% in 2018.

Against this background, our comprehensive policy measures continue to filter through to the real economy. Borrowing conditions for households and firms have eased considerably and credit creation has strengthened, thus supporting aggregate spending across the euro area.

Let me now focus on the description of the credit easing components of our policy measures. They act as critical transmission channels for the monetary stimulus by facilitating meaningful reductions in funding costs for the real economy.

In June of this year and last week we conducted the first two operations of our new series of targeted longer-term refinancing operations (TLTRO-II), which attracted significant demand. Two additional operations will take place in December and March. These operations allow banks to secure long-term funding at very attractive conditions that they can pass on to their customers.

Likewise, the credit easing components of our expanded asset purchase programme (APP), namely the asset-backed securities (ABSPP), covered bond (CBPP3) and corporate sector (CSPP) purchase programmes, further boost the pass-through of our monetary policy by directly lowering the financing costs for crucial actors in our economy. While the ABSPP and CBPP3 empower the monetary pass-through by containing banks' funding costs, the CSPP directly lowers the cost and improves the availability of market-based funding for non-financial corporations.

Let me stress, in that respect, that the CSPP is benefiting not only the large companies, which can directly access the bond market, but also smaller companies. Buoyant bond market conditions for large companies incentivise them to obtain more funding from bond markets, thus leaving more space on banks' balance sheets for providing loans to small and medium-sized enterprises (SMEs).

Overall, our projections indicate that the accommodative monetary policy stance will continue to provide effective support to the cyclical recovery and the upward path in inflation.

But financing conditions must remain supportive for our baseline scenario to materialise. Therefore, the Governing Council will continue to monitor economic and financial market developments very closely. We will preserve the very substantial amount of monetary support that is embedded in our staff projections and that is necessary to secure a return of inflation to levels below, but close to, 2% over the medium term. If warranted, we will act by using all the instruments available within our mandate.

Financial market conditions in the euro area

I am grateful that today you decided to discuss the state of financial market fragmentation in the euro area. I remember that almost four years ago, in this same building, in my statement to you I commented that "the impact on financial and monetary conditions of past reductions in key ECB interest rates differed considerably within the euro area".

Compared with the financial market situation in the autumn of 2012, the situation has largely improved. Financial market fragmentation has declined substantially and the financing conditions of firms and households have improved markedly across the euro area.

In particular, the reductions in the key ECB interest rates have been passed through in vulnerable euro area countries to a larger extent, and the fragmentation in funding costs and loan conditions across different countries has receded. To give an example, from October 2012 to July 2016 the composite cost-of-borrowing indicator for new loans to non-financial corporations declined by almost 287 basis points in Portugal and 200 basis points in Italy, compared with 117 basis points for the euro area as a whole.

A similar phenomenon has been observed for SMEs, which have benefited substantially from improved financing conditions and reduced fragmentation. As a result, the spread between lending rates for small loans and large loans was similar in July 2016 in vulnerable and non-vulnerable euro area countries (at 135 and about 120 basis points, respectively), a situation not seen since spring 2011.

Addressing new challenges

While the challenges of financial fragmentation have been largely overcome, there are new ones we have to face. The low interest rate environment you selected for today's discussion is indeed one of them.

Low rates are a symptom of the underlying economic situation. They reflect weak long-term growth trends and the protracted macroeconomic slump that has resulted from the crisis.

The ECB's monetary policy has provided significant accommodation to limit the negative effects of the global and euro area-specific shocks on the economy, thereby mitigating their disinflationary impact.

Nevertheless, monetary policy cannot determine the sustainable level of real interest rates in the long run, as they in turn depend on long-term growth prospects.

This means that other policy actors need to do their part, pursuing fiscal and structural policies which will contribute to a self-sustaining recovery and increase the economic growth potential of the euro area, as I discussed with you in June.

In the meantime, the low interest rate environment has a range of implications for economic actors that need to be carefully monitored. I am sure that this was part of your exchange today with the Chairs of the European Supervisory Authorities, and I am of course happy to continue this discussion in answering your questions.

Another, more recent, challenge is the outcome of the UK referendum on EU membership and its economic implications for the euro area. The extent to which the economic outlook will be affected depends on the timing, development and final outcome of the upcoming negotiations. So far, the euro area economy has been resilient, but due to this uncertainty our baseline scenario remains subject to downside risks.

Regardless of the type of relationship that emerges between the European Union and the United Kingdom, it is of utmost importance that the integrity of the single market is respected. Any outcome should ensure that all participants are subject to the same rules.

But more generally, it is important to ensure that the European Union meets the expectations of its people. This requires three lines of action.

First, new common European projects should focus on the immediate concerns and needs of its people. For those challenges that unequivocally go beyond national borders, effective solutions require joint European action. From that perspective, today's priorities notably include the fields of migration, security and defence.

Second, for further European integration to be feasible and acceptable, trust among its nations and people is essential. To bolster such trust, it is important that agreed rules are respected. In our Economic and Monetary Union, in particular, the economic governance framework is essential to avoid imbalances that would eventually risk destabilising the euro area. And for the euro area to thrive, actions by national governments are needed to unleash growth, reduce unemployment and empower individuals, while offering essential protections for the most vulnerable.

Finally, our Economic and Monetary Union remains vulnerable as long as we do not complete the integration projects we have started. We need, in particular, to complete the banking union and develop an ambitious capital markets union (CMU) to ensure the resilience of financial integration in the euro area and support cross-border investment. The European Parliament played a key part in setting up the banking union and has an important role to play to ensure swift progress on the legislative dossiers which are now under discussion as part of the banking union and CMU agendas.

Making determined progress in these fields would significantly strengthen our Economic and Monetary Union, and thus constitute an important step forward in line with the roadmap proposed in the Five Presidents' Report.

Conclusion

In concluding these remarks, I want to recall the words of my late friend and colleague Carlo Azeglio Ciampi when he addressed the European Parliament in 2005:

"*The euro is the greatest demonstration of the united will of the European people, and a driving force of political integration".*

And, indeed, the political commitment underpinning our single currency has been strongly reaffirmed during the crisis. Important efforts have been made.

But widespread feelings of insecurity, including economic insecurity, remain a major concern. We cannot simply wait for better times: we need to renew our efforts to ensure that Economic and Monetary Union offers protection and prosperity. The ECB will do its part.

Thank you for your attention. I am now at your disposal for questions.