

## 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, 6 February 2017.

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I am pleased to be speaking before your committee on the eve of the 25th anniversary of the signature of the Treaty on European Union in Maastricht. That bold decision marked “*a new stage in the process of European integration*”<sup>1</sup>. It laid the foundations for Economic and Monetary Union, and the European Central Bank. Ten years later, citizens started to have euro in their hands. This amounted to a considerable strengthening of the political commitment that has been keeping us together for 60 years.

It is easy to underestimate the strength of this commitment. But that would overlook the progress we have made. With the single currency, we have forged bonds that survived the worst economic crisis since the Second World War. This was in fact the original *raison d'être* of the European project: keeping us united in difficult times, when it is all too tempting to turn against our neighbours or seek national solutions.

But the objective of Economic and Monetary Union should be to strive to achieve “economic and social progress” as was the intention of the signatories to the Maastricht Treaty. And for this, we need sustained growth and job creation.

The resilient recovery we have witnessed in recent times has been a welcome step towards this objective. Over the last two years GDP per capita has increased by 3% in the euro area, which compares well with other major advanced economies. Economic sentiment is at its highest level in five years. Unemployment has fallen to 9.6%, its lowest level since May 2009. And the ratio of public debt to GDP is declining for the second consecutive year.

These are steps in the right direction. But these are just first steps. We need to continue on this path so that unemployment decreases further and more Europeans can benefit from the recovery.

I will start by discussing our contribution to supporting the recovery and will then lay out why the monetary policy decisions taken in December were the right ones in the current economic context. As you have requested, I will also discuss risks to financial stability, which we are constantly monitoring.

### **Supporting the recovery: the Governing Council's decisions in December**

Our monetary policy has been a key contributor to the positive economic developments I have described. Our measures have worked through the financial system and are benefiting the real economy at large by ensuring very favourable financing conditions.

At the December meeting, the Governing Council saw the need for the recovery to further mature and strengthen to ensure a sustained convergence of inflation rates towards levels below, but close to, 2% over the medium term. For this to happen, financing conditions have to remain supportive, taking remaining uncertainties inside and outside the euro area into account. We therefore decided to safeguard the amount of monetary easing for the period ahead.

Against this background, we decided to extend the asset purchase programme beyond March 2017, with the intention of conducting our purchases until the end of December 2017 or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the

path of inflation consistent with its inflation aim. We will continue to purchase assets at a monthly pace of €80 billion until March. Starting from April, our net asset purchases will run at a monthly pace of €60 billion, and we will reinvest the securities purchased earlier under our programme, as they mature. This will add to our monthly net purchases.

Our December decisions strike a balance between our growing confidence that the euro area's economic prospects are firming up, and – at the same time – the lack of a clear sign of sustained convergence of inflation rates towards the desired level.

On the one hand, the evidence suggests that the acute deflation risks have disappeared and that inflation is set to pick up over the coming years. And contrary to a widespread perception, euro area economic conditions have also been steadily improving. Euro area GDP growth has been solid in every quarter since the beginning of 2015, averaging 1.9 percent in annualised terms. Compared to 2013, there are 3.5 million fewer unemployed in the euro area, a decrease by more than 18%. And in the last quarter, the recovery has been broadening across sectors and across countries. Indeed, the dispersion of value added growth across euro area countries and sectors has declined sharply and stands close to its lowest level since the introduction of the euro.

But support from our monetary policy measures is still needed if inflation rates are to converge towards our objective with sufficient confidence and in a sustained manner. The pickup in headline inflation in December and in January largely reflects sizeable upward base effects and recent increases in energy prices. So far underlying inflation pressures remain very subdued and are expected to pick up only gradually as we go on. This lack of momentum in underlying inflation reflects largely weak domestic cost pressures. The still significant degree of labour market slack and weak productivity developments are weighing down on wage growth.

As I have argued before, our monetary policy strategy prescribes that we should not react to individual data points and short-lived increases in inflation. Our relevant policy horizon is the medium term. We therefore continue to look through changes in HICP inflation if we believe they do not durably affect the medium-term outlook for price stability.

Looking ahead, risks to the euro area outlook remain tilted to the downside and relate predominantly to global factors. Our current monetary policy stance foresees that, if the inflation outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council is prepared to increase the asset purchase programme in terms of size and/or duration.

### **Addressing financial risks in the euro area**

You asked me to discuss the financial stability implications of our accommodative monetary policy. In short: the benefits of our policy clearly outweigh potential side effects. And the latter are best addressed – if necessary – through other policies.

As I have just argued, our monetary policy has been key in supporting the ongoing recovery. Going one step further: our measures have played a key role in preserving stability in the euro area – and that includes financial stability.

Let me now elaborate on the potential side effects of a very accommodative monetary policy on financial stability.

One of those side effects concerns the impact on banks' profitability. Let us first look at the data. Following a slowdown in profit generation in the first quarter of 2016, the profitability of euro area banks stabilised in the second quarter. According to preliminary data, developments for the third quarter seem to be in line with those observed for the second quarter.

Monetary policy can have an impact on bank profitability through various channels. Our

assessment is that so far these effects tend to largely offset each other. Low (and negative) rates might dent bank profits through the narrowing of net interest margins. At the same time, in supporting the recovery, accommodative monetary policy reduces delinquency and default. It thus improves the credit quality of firms and households. This improved credit quality in loan portfolios – together with increasing intermediation volumes – is certainly positive for banks. It has been a key factor sustaining banks' earnings over the last year. Moreover, low longer-term interest rates increase the market value of financial assets held by banks. This, in turn, results in capital gains that further support bank profitability. This aggregate picture masks some heterogeneity within the banking sector. In particular, depending on their business models, individual banks might be affected in different ways by the low interest rate environment.

A second issue is the potential risk of credit or asset bubbles. Currently, we do not see compelling evidence at the euro area level of stretched asset valuations. Both corporate bond spreads and equity prices appear to be broadly in line with fundamentals.

Similarly, real estate price growth remains moderate in the area as a whole, although significant cross-country heterogeneity is observable. This assessment is corroborated by the fact that credit growth is still modest, which suggests that asset price developments are not accompanied by increasing leverage.

Nevertheless, the longer the accommodative measures need to be kept in place, the greater the risks of unwarranted side effects on the financial system become. For instance, asset prices may increase to levels that are not in line with fundamentals because investors might be tempted to take on more risk during times of low yields.

Such developments are best addressed by enacting appropriate macro and micro prudential policies.

While our *single* monetary policy is geared towards delivering price stability for the euro area as a *whole*, macroprudential policy measures can be designed to address financial stability risks that may be building up in specific market segments, jurisdictions or individual countries. Addressing potential risks at their origin also reduces the probability of contagion throughout the euro area.

Microprudential policies also help to reduce vulnerabilities in banks. I therefore welcome the European Commission's risk reduction proposals presented last November, which further develop the EU's legal framework for credit institutions and should increase the resilience of banks.

## **Conclusion**

Let me conclude.

As I argued last week in Ljubljana, and as the crisis has shown, the benefits of the single currency can only be fully reaped if we have policies and institutions at national and European level that ensure it works for everyone.

In the run-up to the launch of the euro, there was a strong commitment to advancing along the path of institutional and economic convergence. The crisis showed that this commitment cannot be relaxed. In fact, it remains fully relevant today as we seek to strengthen EMU and the EU in the face of current uncertainties and in preparation for future challenges.

The euro area's resilience in 2016 despite a range of negative shocks shows that we are on the right track. It also suggests that reforms at national and European level are paying off in terms of economic growth.

As the economic situation improves, and even though challenges in other policy realms have

understandably been the recent focus of our attention, we should not stop our efforts to make EMU more resilient and prosperous. We can and should address the remaining, well-identified fragilities at national and European level. On the latter point, I look forward to the continued support of the European Parliament in the second half of this legislative term.

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

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<sup>1</sup> See the full text of the [Treaty on European Union](#)