Mario Draghi: Introductory remarks at the House of Representatives of the Netherlands

Introductory remarks by Mr Mario Draghi, President of the European Central Bank, at the Tweede Kamer der Staten-Generaal (House of Representatives of the Netherlands), The Hague, 10 May 2017.

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Mr Chairman,

Honourable Members of Parliament,

This year, we celebrate the 60th and 25th anniversaries of the Treaties of Rome and Maastricht. Despite the many challenges that we face as Europeans, we should never forget the significant achievements of European integration in providing peace, security and prosperity. The fact that the Treaty that gave birth to the euro was signed *in this country* symbolises the enduring role of the Netherlands at the forefront of this European project.

I am therefore honoured to be invited to speak here at the Dutch Parliament. Today's event offers an opportunity to provide insight into the ECB's decisions and to listen to your views.

It is indeed important for the ECB to reach out to euro area citizens and their representatives to explain how we fulfil our mandate. The EU Treaties democratically conferred upon the ECB the primary objective of maintaining price stability in the euro area as a whole. This objective binds my colleagues and me on the ECB's Governing Council, where our decisions are the result of collegial debate. And we are held accountable for our decisions by all EU citizens through their representatives in the European Parliament.

In my remarks today, I would like to expand on three points.

First, I want to show how a very severe double dip crisis required the ECB to deploy unconventional instruments to ensure price stability. And our measures are proving effective: incoming data confirm that the cyclical recovery of the euro area economy is becoming increasingly solid and that downside risks have further diminished.

Second, I will discuss the possible side effects of these measures. I will consider the different dimensions in which our monetary policy affects people's finances and welfare, which are sometimes overlooked in the current debate.

Finally, I will outline why the ECB cannot be the only actor contributing to the recovery. Other economic, financial and fiscal policies are essential to ensure a sustained recovery.

Recovering from the crisis: the role of monetary policy

Let me start by recalling where we came from. The Great Recession, as it is called, resulted in a protracted period of low inflation and low growth.

Specifically, the euro area faced two interlinked and successive crises – a financial crisis in 2008 and a sovereign debt crisis that started to emerge in 2011 and derailed the rebound. The recovery that began in mid-2013 lost steam in the summer of 2014 as the external environment became more uncertain. At the beginning of 2014, credit growth was contracting at an annual pace of more than 3%, while overall economic growth was stalling. Since the start of 2013, inflation had drifted consistently away from the ECB's target rate of below but close to 2% over the medium term, reaching levels below 1%. Without counteracting measures, this low inflation could have turned into a deflationary spiral which would have deepened our economies' woes considerably.

It was against this macroeconomic background that the ECB took decisive policy action to maintain price stability in the euro area as a whole, in line with its mandate.

In normal times, when inflation is above target, central banks raise the key interest rates to rein it in. When inflation is below target, they lower the key interest rates to stimulate economic activity and induce an increase in inflation. However, at the start of 2014, the deposit facility rate had already been brought to zero. At the same time, financial fragmentation in the euro area was hampering the transmission of our policy, as our monetary policy impulses were not evenly transmitted across countries or adequately along the yield curve. So in order to provide additional monetary accommodation and to support the recovery in credit, the ECB used a range of non-standard measures to meet its inflation objective. These include a negative deposit facility rate, targeted longer-term refinancing operations, forward guidance and asset purchases. Net asset purchases currently amount to €60 billion per month, and are intended to run until the end of December 2017, or beyond, if necessary. These measures aim to influence short and longer-term interest rates, asset prices and loan volumes, thereby fostering economic growth and supporting price stability. The ECB's actions were not unique. Central banks in the United States, Japan and the United Kingdom also used asset purchases, while central banks in for example Sweden and Switzerland reduced key interest rates to below zero.

Our measures have been very effective: they have led to very favourable financing conditions. Since mid-2014, bank lending rates for both firms and households have dropped by more than 100 basis points. And we have witnessed a pronounced convergence in borrowing conditions across both euro area countries and types of borrowers.

These favourable financing conditions have in turn supported the economic recovery. For 15 consecutive quarters, euro area quarterly GDP growth has been consistently between 0.3% and 0.8%. In 2016, GDP per capita grew faster in the euro area than in any other major advanced economy. Four and a half million jobs were created in the last three years. And unemployment in the euro area is at its lowest point since May 2009.

Our monetary policy has successfully stabilised inflation expectations. In our March ECB staff macroeconomic projections for the euro area, the outlook for headline HICP inflation has been revised upwards significantly for 2017 and slightly for 2018, while remaining unchanged for 2019. These projections foresee annual HICP inflation at 1.7% in 2017, 1.6% in 2018 and 1.7% in 2019. The staff projections are conditional on the full implementation of all our monetary policy measures.

Similar to what we have observed at the euro area level, the economic expansion in the Netherlands has also strengthened. GDP grew at 2.2% in 2016, driven by strong domestic demand on account of improving business and consumer confidence and positive wealth and real-income effects. In addition, unemployment has steadily decreased, registering at 5.1% in March 2017, and the Netherlands has more jobs than before the crisis. Supported by low interest rates and a strengthening recovery, the Dutch government ran a 2.9 billion euro surplus last year, its first surplus since 2008. And, as an export-oriented country, the Netherlands is currently benefiting from the recovery in other euro area countries, especially as growth in global trade remains tepid.

The side effects of our policies

I am aware that these very accommodative financing conditions have raised various concerns, also in this House. Monetary policy measures always have side effects. So far, the potential negative side effects have been limited. We are monitoring these various effects carefully, taking into account our price stability mandate.

To ascertain the overall impact of our measures on citizens, it is important to differentiate between the various ways in which they affect economic actors, such as households, pension funds and banks.

Let me start with households. An accommodative monetary policy means households accrue fewer nominal returns on their savings. However, an accommodative policy supports the economic recovery, which in turn bolsters employment, income, returns on investment and tax revenues. It therefore benefits households in their capacity as workers, entrepreneurs, investors, borrowers and taxpayers.

Similarly, there are several channels through which our policies affect pension systems. Yes, lower rates increase the present value of future liabilities of pension schemes. However, the liability side of pension schemes is only one part of the equation. What happens on the asset side is also important. And our monetary policy has had a beneficial impact on this side of the equation as the value of the investment portfolio has increased. Also, let's not forget that our monetary policy supports pension systems indirectly by supporting employment growth and thus pension contributions. In any case, it is ultimately up to sound governance structures and long-term strategies to ensure the financial health of pension systems.

Equally, 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 in aggregate terms. Low rates might reduce bank profits through the narrowing of net interest margins. Yet, at the same time, by supporting the recovery, accommodative monetary policy reduces delinquencies and defaults, including on mortgages. Improved credit quality coupled with higher lending volumes and an improved market value of assets supports bank profitability. Of course, depending on the strength of their balance sheet, some banks may be more affected than others. Also banks facing structurally high cost-to-income ratios or limited diversification of income sources might have to revamp their business models regardless of the low interest rate environment.

Finally, let me also address the risks of overheating in some parts of the financial markets. We do not currently see compelling evidence of overstretched asset valuations at the euro area level, but we do see that real estate dynamics or high household debt levels in some countries signal the risk of increasing imbalances. Such risks also exist in the Netherlands: they relate to the continued very high level of household indebtedness and the low level of mortgage collateralisation. For this reason, we share the concerns expressed in the warning issued by the European Systemic Risk Board in November 2016 and recognise that there is a case for mitigating measures. That being said, monetary policy is not the appropriate tool for addressing local and sectoral financial risks. Rather, targeted macroprudential policies, which can be tailored to local and sectoral conditions, are the right answer.[1]

The way forward

Against the backdrop of a recovery that is becoming increasingly solid, the benefits of our policy clearly outweigh potential side effects. Also due to the pass-through of our monetary policy, there is now more and more evidence that economic growth is firming and broadening. Incoming data confirm that the cyclical recovery of the euro area economy is becoming increasingly solid and that downside risks have further diminished.

Nevertheless, it is too early to declare success. Underlying inflation pressures continue to remain subdued and have yet to show a convincing upward trend. The domestic drivers of inflation, namely wages, are not yet responding to the recovery and the narrowing output gap. Maintaining the current very substantial degree of monetary accommodation is still needed for underlying inflation pressures to build up and support headline inflation in the medium term.

However, beyond the contribution of monetary policy, we also need measures to address the legacy of the crisis, lift potential growth and upgrade our economic ecosystem to increase resilience to future shocks.

This requires action at the Member State level. Ambitious, country-specific, structural reforms are needed to raise productivity, make economies more resilient, and address persistent fragilities, including those inherited from the crisis. And Member States need to pursue prudent fiscal policies to build up buffers for difficult times. National parliaments can play a central role in supporting such efforts. Our accommodative monetary policy provides a window of opportunity for pursuing such policies, for example by alleviating some of the short-run costs of structural reforms and allowing their benefits to materialise faster[2].

Action at the European level is also required. The crisis has revealed significant fragilities not only at Member State level, but also in the economic governance of Economic and Monetary Union. Some of the fragilities could be addressed already by applying the common rules we have all agreed on. Others, however, need to be addressed by upgrading our governance. How? Banking union needs to be completed by making parallel progress on risk reduction and risk sharing. This includes adopting the European Commission's risk reduction package which, among other things, implements some of the remaining Basel III reforms and further strengthens prudential rules in the banking sector. At the same time, we need to establish a European deposit insurance scheme and a common backstop to the Single Resolution Fund. Ambitious progress towards a fully fledged capital markets union would also create more effective channels of private risk sharing in the euro area and reduce the need for fiscal stabilisation. The Five Presidents' Report[3] also emphasises the need to strengthen our union from an economic, fiscal and legitimacy perspective. And in a world tempted by protectionism and ring-fencing, completing Economic and Monetary Union is perhaps more urgent than ever before.

Conclusion

Allow me to conclude.

The euro area has certainly faced its fair share of challenges in recent years. But things are clearly improving. In the euro area, the economic recovery has evolved from being fragile and uneven into a firming, broad-based upswing. The ECB's monetary policy measures have been supporting this recovery.

We have established four criteria to confirm a sustained adjustment in the path of inflation consistent with our definition of price stability in the medium term that would warrant a scaling-back of the current degree of monetary policy accommodation. First, that headline inflation is on a path to levels below, but close to 2% over a meaningful medium-term horizon; second, that inflation will be durable and stabilise around those levels with sufficient confidence; third, that inflation will be self-sustained, meaning it will maintain its trajectory even with diminishing support from monetary policy. And finally, the relevant metric in each case is euro area inflation, not the inflation rates of any individual country.

However, in order to reap the full benefits of our monetary policy measures, other policy areas must contribute much more decisively to strengthening economic growth. This depends on the policies pursued by Member States, where national parliaments have a key role to play. But it also depends on our collective ability to further strengthen the architecture of Economic and Monetary Union in a way that fully reflects the interdependence among the euro area economies. Pursuing such policies will ensure a higher growth trajectory.

I am now at your disposal for questions.

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1 See ECB press release of 15 December 2016: Governing Council statement on Macroprudential Policies

2 See Structural reforms, inflation and monetary policy, Introductory speech by Mario Draghi, President of the ECB,

ECB Forum on Central Banking, Sintra, 22 May 2015.

[3] The Five Presidents' Report: Completing Europe's Economic and Monetary Union