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

Introductory statement by Mr Mario Draghi, President of the European Central Bank, at the ECON committee of the European Parliament, Brussels, 29 May 2017.

*   *   *

Mr Chairman,

Honourable Members of the Economic and Monetary Affairs Committee,

Ladies and gentlemen,

It is a pleasure to be back speaking to your committee for the second regular hearing of this year. I am also pleased that you have chosen as the topic for today's hearing the role of financial innovation. This is only one element in the broader process of innovation which is taking place in the economy. But it is a decisive one, given the essential role played by financial markets in resource allocation.

Before addressing this topic, let me first review the economic outlook and discuss the monetary policy stance.

The economic outlook

The economic upswing is becoming increasingly solid and continues to broaden across sectors and countries. Real GDP in the euro area has expanded for 16 consecutive quarters, growing by 1.7% year-on-year during the first quarter of 2017. Unemployment has fallen to its lowest level since 2009. Consumer and business sentiment has risen to a six-year high, supporting expectations of a further strengthening of growth in the coming months.

Downside risks to the growth outlook are further diminishing, and some of the tail risks we were facing at the end of last year have receded measurably. The fact that domestic consumption and investment are the main engines driving the recovery makes it more robust and resilient to downside risks, which relate predominantly to global factors.

Despite a firmer recovery, and looking through the volatile readings in HICP inflation over recent months, underlying inflation pressures have remained subdued. Domestic cost pressures, notably from wages, are still insufficient to support a durable and self-sustaining convergence of inflation toward our medium-term objective. For domestic price pressures to strengthen, we still need very accommodative financing conditions, which are themselves dependent on a fairly substantial amount of monetary accommodation.

At its June monetary policy meeting the Governing Council will receive an update of the staff projections and a more complete information set on which it will be able to formulate its judgement on the distribution of risks around the most likely outlook for growth and inflation Overall, we remain firmly convinced that an extraordinary amount of monetary policy support, including through our forward guidance, is still necessary for the present level of underutilised resources to be re-absorbed and for inflation to return to and durably stabilise around levels close to 2% within a meaningful medium-term horizon.

You asked me to discuss with you today the dynamics of long-term interest rates. Over the past few decades long-term bond yields have been trending down in both nominal and real terms. While lower *nominal* rates in part reflect monetary policy among other factors, the decline in *real* yields has been driven by structural factors. These factors include notably rising net savings as ageing populations plan for retirement, relatively less public capital expenditure in a

context of high public indebtedness, and a slowdown in productivity growth.[1] If long-term real interest rates are to rise again to sustainably higher levels, it is those underlying causes that need to be addressed. And this requires structural action at national and European level.

Our monetary policy, for its part, has been instrumental in addressing the *cyclical* component of the balance between the supply of savings and investment demands, and its price stability implications. By supporting nominal incomes, our monetary policy measures stimulate investment and consumption, which are preconditions for inflation to climb back to levels below, but close to, 2%. And a more dynamic economy, over time, will favour a healthy return to higher policy interest rates.

The relevance of financial innovation for the ECB and the euro area

The relation between savings and investment leads me to the topic you have chosen for today's hearing. Greater financial efficiency in the euro area is crucial in improving the allocation of capital and ensuring it is put to productive use. Innovation in financial instruments, services and infrastructure, as well as changes in the organisation of financial markets, can play a useful role in that respect.

Financial innovation is a continuous process. Innovations had constantly arisen in the past. Past examples of innovation include the introduction of secured debt and of preferred stock, which were developed to align incentives between parties and address information asymmetries. Some innovations of the past were instead introduced to minimise transaction costs and they have become part of our everyday lives, like credit cards or ATMs.

Today, fintech – the application of new technologies to banking and financial services – is a potentially transformative force. We are closely monitoring its development for several reasons: to better understand its impact, to assess the risks and to adjust the regulatory environment and supervisory approaches where needed; and also to adapt as an institution and support innovation where justified.

Let me now give you some concrete examples of why fintech is directly relevant to our tasks.

A deep knowledge of the channels through which monetary policy affects the economy is of crucial importance to us. As fintech, and financial innovation more broadly, have the potential to impact the way the economy is financed, in the future they may affect the transmission mechanism of monetary policy and ultimately financing conditions. As the central bank for the euro area, we thus remain vigilant and make sure that changes in the financial landscape are closely tracked.

As central bank of issue for the euro, the ECB and the Eurosystem also have a statutory interest in the safety and efficiency of payment systems and market infrastructures. One of the most active fields of fintech innovation which might affect the processing of payments and securities is that of distributed ledger technologies (DLTs), such as the blockchain.[2] Given the rapid pace of development in this field, there is a need to constantly monitor and assess potential new or more pronounced risks resulting from the application of new technology such as DLTs to payment, clearing and settlement infrastructures in particular. One such possible risk is an increase in market fragmentation if different DLT approaches were to become firmly established in parallel in different Member States. Moreover, the Eurosystem oversight framework has to remain effective if we are to discharge our responsibility in this new environment. And the Eurosystem will of course continue to act in accordance with its mandate to promote the smooth operation of payment systems.[3]

Fintech also gives the financial sector, more generally, a chance to provide more efficient and effective services to households and companies. Fintech can, for instance, make it easier for

banks to adjust their business models, cut costs and exploit new business opportunities. Fintech companies can also complement the lending capacity of banks by acting as an additional channel for accessing credit, for instance through peer-to-peer lending platforms. This may in turn help to reduce the macroeconomic fallout from disruptions in the provision of bank credit to households and firms, including smaller ones.[4]

At the same time, the increasing relevance of non-banks and digital innovation in the provision of financial services may also harbour new risks. It is, for instance, essential to assess and adapt the prudential framework to cater for the increased role of non-banks and financial innovation, ensure the existence of a level playing field for both new and existing players and provide supervisors with adequate tools to address new risks. To this end, we are actively involved in ongoing work at both European and international levels.

Furthermore, risks stemming from the use of new technologies need to be carefully managed, particularly in the context of heightened cybersecurity concerns.[5] Cyber risk has long been a priority for national and European supervisory authorities. Since day one, the ECB Banking Supervision has also addressed the issue from various angles.[6] As financial market infrastructure overseer, we also need to ensure that individual systems, as well as the network as a whole, are operationally resilient to cybercrime.

While we are closely monitoring potential risks from fintech, we also contribute to financial innovation by acting as operators. The TARGET2-Securities (T2S) platform that went live in June 2015 is now a cornerstone of the capital markets union project and has given a strong impetus to promoting and creating harmonised, integrated and efficient euro payments and securities post-trade services.

The ECB is also acting as a catalyst in the creation of a truly single European market for payments and securities. Financial integration and financial development are distinct, but interrelated concepts. Therefore, in designing the necessary institutional and regulatory frameworks we need to make sure that financial integration and financial development reinforce each other, thus improving the performance of the financial system. This is why EU legislators have an important role to play. A Europe-wide harmonised and principles-based framework to regulate fintech, in the context of the capital markets union agenda, would indeed help to create a level playing field from the outset. This would in turn foster cross-border investment and expansion.

So as you can see, fintech has the potential to improve efficiency in the financial sector, create better products and push prices down for consumers. But it has other dimensions too, in the shape of potential risks and new regulatory questions. It is in all our interests to rise to this challenge. As fintech involves the entire financial sector, different regulatory responses are likely to be needed. Depending on the nature of the fintech activity, those responses may need to encompass prudential, consumer protection and other regulation – but, at the same time, they should not hamper healthy developments.

Conclusions

Allow me to conclude.

The euro area economic outlook is improving and downside risks are moderating. However, these positive signs should not distract from the need for firmer and higher structural economic growth.

In this context higher productivity growth is needed. And that productivity growth requires innovation. Structural reforms are essential to create a business environment that is conducive to innovation and a regulatory environment that adapts accordingly. Both national and European level initiatives can contribute to this effort.

If we want to make sure that our Economic and Monetary Union (EMU) thrives, we need to upgrade its institutional framework. This means that we should be ready to foster innovation wherever necessary, including in the functioning of EMU. In that spirit, I look forward to the debate that will be opened up by the upcoming European Commission reflection paper on deepening the Economic and Monetary Union.

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

---

[1] See Addressing the causes of low interest rates, Introductory speech by Mario Draghi, President of the ECB, held at a panel on "The future of financial markets: A changing view of Asia" at the Annual Meeting of the Asian Development Bank, Frankfurt am Main, 2 May 2016.

[2] The ECB Annual Report 2016 contains a special feature on distributed ledger technology.

[3] The Eurosystem follows all pertinent developments in this field, mindful of the fact that the way they may be adopted by market participants will determine their impact on financial markets. DLT could, for example, facilitate the sharing of data among different parties involved in processing a financial market transaction. But it could also result in risk building up outside regulated markets if it were used to disintermediate financial institutions. Moreover, the emergence of different DLT specifications could lead to fragmentation within the euro area payments system.

[4] Fintech benefits small companies by allowing them to raise capital more cheaply, in the form of both debt and equity, while offering retail investors direct access to an asset class to which they would otherwise not have direct access. For instance, the development of fintech activities such as P2P lending, via numerous marketplace investment platforms targeting the provision of funds both to start-ups and more established small and medium-sized enterprises, may be a useful credit provision channel.

[5] Cyberattacks can severely damage a bank's solvency and liquidity situation as they can affect its reputation and undermine customers' trust. Moreover, a cyberattack on the financial system could disrupt the interconnected and interdependent operational network and its critical nodes, and even ripple through the entire economy.

[6] First, supervisors monitor cyber risk as part of their ongoing operational risk supervision. Second, various specific assessments have been made, such as the 2015 thematic review of cyber security risks or targeted on-site inspections. Last but not least, the ECB has initiated a reporting framework for significant cyber incidents that was implemented as a pilot scheme in 2016 and will be rolled out to all significant institutions in 2017.