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, 20 November 2017.

* * *

Mr Chairman,

Honourable Members of the Economic and Monetary Affairs Committee,

Ladies and gentlemen,

I am glad to be back at the European Parliament for my last hearing of this year.

Since we last met, the ECB Governing Council has taken important decisions on the recalibration of its monetary policy instruments beyond the end of the year.

Therefore, in my remarks today, I will first discuss the outlook for the euro area economy and the recalibration of our monetary policy measures.

Then, at the request of this committee, I will discuss the role of TARGET2 in supporting financial integration and the implementation of our monetary policy, which in turn have implications for interpreting TARGET balances.

The economic outlook

The economic expansion remains solid and broad-based across countries and sectors in the euro area, mainly supported by domestic demand.

According to the recent Eurostat flash estimate, real GDP growth has continued in the third quarter at a rate of 2.5% year on year. This amounts to four-and-a-half years of continuous quarterly expansion, and the latest survey data point to unabated growth momentum in the near term. GDP growth is also increasingly broad-based across countries and sectors. The dispersion of GDP growth rates across euro area countries has fallen to its lowest level since 1997, caused by a general upward convergence.[1]

The labour market continues to benefit from the recovery and the deep and painful employment losses recorded during the crisis have now been offset, at least in the aggregate. The number of people unemployed in the euro area declined from 18.6 million in the second quarter of 2014 to 14.6 million in the last quarter. Relative to past patterns, employment growth has been broad-based across countries and sectors. 16 of the 19 euro area countries have experienced positive annual employment growth since mid-2014 and employment has been increasing in about 60% of sectors, compared with zero in mid-2014.

These employment gains, together with increasing household wealth, are supporting the private consumption outlook. Business investment also remains on an upswing, aided by improvements in corporate profitability.

Our monetary policy measures have played a key role in supporting both consumption and investment demand by ensuring favourable financing conditions for euro area firms and households. Since end-May 2014, bank lending rates for non-financial corporations, for instance, have fallen by around 120 basis points and those for households by around 100 basis points. Lending rates for very small loans, which can be taken as a proxy for loans to small and medium-sized enterprises (SMEs), have declined by almost 190 basis points. The significant improvement in funding conditions for SMEs is especially encouraging as they provide two-thirds of total private sector employment in the euro area.

This improvement in financing conditions has been accompanied by reduced heterogeneity across countries in bank lending rates. For example, the difference between rates for firms in euro area countries most severely affected by the crisis versus the other countries has narrowed by around 100 basis points since mid-2014.[2]

Despite the firm economic recovery, inflation dynamics have yet to show convincing signs of a self-sustained upward trend. Headline inflation was 1.4% in October and is expected to temporarily decline towards the turn of the year, mainly owing to a weaker energy component as a result of base effects.

Underlying inflation pressures are still subdued as labour market slack remains significant. The improvements in labour markets that we have observed still need time to translate into more dynamic wage growth.

The ECB's recent monetary policy decisions

In the light of this economic outlook, at our monetary policy meeting in October, we decided to recalibrate our monetary policy instruments.

The re-calibration of our policies for the period beyond the end of this year is meant to preserve the degree of monetary stimulus that is still necessary to secure a sustained return of inflation rates towards levels below, but close to, 2% in the medium term. Let me briefly explain the four main decisions the Governing Council took.

First, the improved outlook and our growing confidence in the gradual convergence of inflation rates towards our inflation aim allowed us to adjust the pace of our asset purchase programme (APP). Accordingly, we announced that, starting in January 2018, net asset purchases are intended to continue at a monthly pace of €30 billion until the end of September 2018, 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.

Second, as regards our re-investment policy, we stated that the Eurosystem will reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary. This will contribute both to favourable liquidity conditions and to an appropriate monetary policy stance. In this context, let me also mention that we provided additional information on the redemption amounts for each component of the APP, as our policy to maintain the stock of our securities holdings and continue to re-invest the proceeds of those securities that come to redemption for an extended period of time has become more important as the size of that portfolio has grown. Our website now reports all the details of the expected monthly redemption amounts for the next 12 months.

Third, on policy rates, we kept them unchanged and reconfirmed that we expect our key interest rates to remain at their present levels for an extended period of time, and well past the horizon of our net asset purchases. This sequenced ordering of the outlook for our net asset purchases and the policy rate path is a central element of our monetary policy at present. The "well past" condition that governs the policy rate horizon lays out a critical enabling factor for asset purchases to have their full impact.

Finally, we decided that our regular refinancing operations would continue to be conducted as fixed-rate tender procedures with full allotment for as long as necessary, and at least until the end of 2019. This will ensure the continued smooth implementation of monetary policy while also safeguarding favourable conditions in euro area money markets.

As the Governing Council concluded at the end of its last monetary policy meeting, the monetary policy support that we provide today comes from the combined effect of the additional net asset purchases, the sizeable stock of acquired assets that have been accrued under our asset purchase programme in the past and the forthcoming reinvestments of the maturing securities, and our forward guidance on interest rates. Taken together, these measures will preserve the current financing conditions and ensure the ample degree of monetary stimulus that is still necessary for a sustained return of inflation rates towards levels that are below, but close to, 2%.

Payment systems and monetary policy implementation

Let me now turn to the topic of TARGET balances.

TARGET2[3] is the Eurosystem's real-time gross settlement system, through which payments in euro can be safely and efficiently processed between banks, both within and across borders. It provides a state-of-the-art payment infrastructure that is used to settle, in central bank money, payments related to a wide variety of transactions, including monetary policy operations, financial market instruments, and interbank and customer payments. Last year, TARGET2 processed a daily average of about 342,000 payments, representing a daily average value of €1.7 trillion. It therefore plays a key role in ensuring the smooth conduct of monetary policy, the correct functioning of financial markets and banking, and financial stability.

By supporting financial integration and the implementation of our monetary policy, TARGET2 represents a cornerstone of our monetary union. In the TARGET2 system each Eurosystem national central bank (NCB) has a debtor or creditor position (a balance) vis-à-vis the ECB, which keeps track of the money entering and leaving each participant country for accounting purposes. The TARGET balances of individual NCBs therefore merely reflect the settlement of cross-border payments executed via TARGET2.

Payments undertaken as part of the asset purchase programme are also settled via TARGET2. APP implementation is distinct from that of refinancing operations because it can entail immediate cross-border payments. Indeed, around 80% of total NCBs' purchases have been by financial market parties that are not resident in the same country as the purchasing central banks, thereby impacting TARGET balances.

Moreover, the sellers of the assets purchased under the APP can reinvest the proceeds, inducing a cross-border rebalancing of their portfolio. This phenomenon, referred to as international portfolio rebalancing, can prompt further changes in TARGET balances, following the same logic I have just outlined.

All this notwithstanding, we have seen TARGET2 has been instrumental in the smooth pass-through of our monetary policy measures to the financing conditions of households and businesses.

Conclusions

Let me conclude.

The EU Treaties gave the ECB the primary objective of maintaining price stability in the euro area as a whole. This is the best contribution we can make to the welfare of our fellow citizens.

Ensuring price stability is a precondition for the euro area economy to achieve a balanced growth path that can be sustained in the long run. But this is not the only condition.

Achieving a balanced growth path also requires to strengthen the euro area ability to deal with risks, whenever they will materialise. The current economic outlook provides a unique opportunity to reduce the likelihood of severe shocks by strengthening the economic structures of Member States, with policy actions both on the fiscal and structural side.

At the same time, boosting the resilience of the Economic and Monetary Union (EMU) implies also reinforcing our common institutional set-up so as to prevent and manage shocks.

I thus welcome the European Parliament's role in such discussions and the renewed efforts by euro area leaders and ministers to tackle the issue, as reflected in, for instance, the recent Eurogroup meeting. It is in this spirit that I look forward to the upcoming Euro Summit meeting on EMU governance.

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

---

[1] Excluding Ireland, due to the country's exceptionally high GDP growth in 2015 linked to specific activities of multinational enterprises.

[2] Using composite cost of borrowing indicators.

[3] TARGET stands for Trans-European Automated Real-time Gross settlement Express Transfer system. TARGET2 is the second generation of TARGET.