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 February 2018.

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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 first hearing of this year before your Committee.

The two issues you have chosen for today's debate are very topical and I will address them in turn. I will first discuss the euro area inflation outlook and the main factors impacting on the relationship between growth and inflation. I will then emphasise the relevance of financial market infrastructures for monetary policy. In doing so, I will explain why the central bank of issue needs to have the necessary tools to address possible risks in a limited number of areas which are crucial from the perspective of its monetary policy mandate.

Inflation, growth and the ECB's monetary policy

As I said in my introductory statement to the European Parliament plenary earlier this month, the euro area economy is expanding robustly.[1] Growth is stronger than previously expected and more evenly distributed across sectors and geographies than at any time since the financial crisis. According to the latest data, the euro area economy grew by 2.5% in 2017, reflecting strong domestic momentum in private consumption and investment.

These positive developments have been fostered and supported by the pass-through of the ECB's monetary policy measures, which have significantly eased borrowing conditions for households and firms, notably also for small and medium-sized enterprises.

Considering all of the monetary policy measures taken between mid-2014 and October 2017, the overall impact on euro area growth and inflation is estimated, in both cases, to be around 1.9 percentage points cumulatively for the period between 2016 and 2020. Our measures have put the euro area economy on a solid growth pathway, driven by endogenous domestic dynamics and thus more resistant to a potential slowdown in global demand.

At the same time, inflation has yet to show more convincing signs of a sustained upward adjustment. After lingering at levels well below 1% for three years, with occasional dips into negative territory, euro area headline inflation has fluctuated between 1.3% and 1.5% since May last year. Annual inflation stood at 1.3% in January. The changes in headline inflation have been driven by movements in the more volatile components, namely energy prices and, to a lesser extent, food prices. Measures of underlying inflation – which we monitor for their information content concerning inflation dynamics – have remained subdued. Inflation excluding energy and food was 1% in January, and has ranged between 0.9% and 1.2% since April 2017.

Let me now focus on the factors behind these moderate inflation developments from a longer-term perspective. The recent period of low inflation may appear surprising from a cyclical perspective given that we have seen positive economic growth over the past four years, supporting a steady and gradual absorption of economic slack. This has raised the question of which factors, cyclical or structural, may have played a role in the growth-inflation relationship.

A comprehensive analysis by the Eurosystem has concluded that adverse cyclical factors have played a crucial role in explaining low underlying inflation. These notably consisted of dampened economic activity and high unemployment in the aftermath of the sovereign debt crisis, and subsequently subdued foreign demand and low oil prices.[2] Yet, these factors are of a temporary nature and should not affect inflation over a medium-term horizon, even though they might impact on the speed of adjustment in inflation. Moreover, given the uncertainty surrounding the measurement of economic slack, the true amount may be larger than estimated, which could slow down the emergence of price pressures. This is particularly visible in the labour market, where wage growth has remained subdued despite strong employment gains. Nonetheless, these factors should wane as the economic expansion continues and unemployment further declines. In fact, wage growth in the euro area has already picked up recently and the labour market is expected to improve further.

On the structural side, globalisation may have reduced the responsiveness of inflation to domestic cyclical conditions but empirical evidence for the euro area is not clear-cut.[3] Other potential factors include demographic trends or changes in behaviour triggered by technological developments, which may contain price pressures, for instance through increased price transparency. However, even if these factors are somewhat more persistent, they should still not exert a permanent impact on inflation.

Overall, the analysis indicates that the relationship between growth and inflation remains largely intact, even if it has temporarily weakened in recent years to the extent that the speed of adjustment in inflation towards our aim has been affected.

Looking ahead, we anticipate that headline inflation will resume its gradual upward adjustment, supported by our monetary policy measures. At the same time, uncertainties continue to prevail. In particular, the recent volatility in financial markets, notably also in the exchange rate, deserves close monitoring with regard to its possible implications for the medium-term outlook for price stability.

Therefore, while the strong momentum of the euro area economy has clearly strengthened our confidence in the inflation outlook, patience and persistence with regard to monetary policy is still needed for inflation to sustainably return to levels of below, but close to, 2%. In fact, the evolution of inflation remains crucially conditional on an ample degree of monetary stimulus provided by the full set of our monetary policy measures: our net asset purchases, the sizeable stock of acquired assets and the forthcoming reinvestments, and our forward guidance on policy interest rates.

The relevance of central clearing for monetary policy and the role of the central bank of issue

Let me now turn to the interactions between financial market infrastructures and monetary policy, which you have chosen as a topic for today’s hearing. This is indeed an important and timely issue, particularly in relation to central clearing, on which I will focus today.

Allow me to recall the important role played by central counterparties – or CCPs – in financial markets: by interposing themselves in a network of financial transactions, CCPs reduce counterparty credit risk and increase market transparency. However, under crisis conditions, the disruption of clearing activities can have a significant negative impact on our ability to conduct monetary policy tasks. For instance, it may cause significant liquidity strains for CCP users, which in many cases are also our monetary policy counterparties. In particular, these strains may arise from large and sudden calls to provide additional resources to a CCP under stressed market conditions. In addition, disturbances affecting a CCP active in the money markets can impair normal monetary policy transmission channels. These are just two examples of the links between the operation of CCPs and the transmission of monetary policy.

While these links are not new, they now warrant closer attention for two reasons. First, the financial system has come to rely more on central counterparties. The introduction of mandatory central clearing requirements in response to the crisis has made financial markets safer and more transparent. This is in large part thanks to the European Parliament's push for stronger financial regulation, such as the European Market Infrastructure Regulation (EMIR). While this strengthening is of course welcome, it also means that CCPs have become more systemic. Second, the United Kingdom's decision to leave the EU means that, under the current legislative regime, several CCPs clearing significant volumes of euro-denominated business will be operating outside the framework of EU regulation and the safeguards this provides.

In this context, the Commission's EMIR II proposal, currently being discussed by this committee, is a welcome and necessary initiative. The existing regime was never intended to cope with large-scale euro-denominated clearing activities being carried out in a country outside the EU. The EMIR II proposal would enable EU authorities to directly supervise systemically important third-country CCPs on the basis of EU regulatory requirements using EU supervisory instruments. The proposal provides for an enhanced role for the central bank of issue in this context, reflecting the strong links between clearing and monetary policy.

The indispensable corollary to the EMIR II proposal is the recommendation to amend Article 22 of our Statute, which was unanimously adopted by the ECB's Governing Council last June. The General Court in Luxembourg held in its judgment in 2015[4] that it would be for the ECB to request the EU legislature to amend Article 22, should the ECB consider that having the power to regulate CCPs is necessary for the proper performance of its tasks under the Treaties. In particular, revising Article 22 is a necessary step for us to carry out the tasks foreseen under EMIR II. Considering the risks the ECB faces with regard to the implementation and transmission of its monetary policy, it is imperative that it be equipped with the necessary tools vis-à-vis CCPs, particularly in a crisis situation.

I want to make clear that such measures would aim to address risks in a limited number of areas which are crucial for the implementation of the single monetary policy and the smooth operation of payment systems, which ultimately affect our primary objective of maintaining price stability as mandated by the Treaties. Areas of particular relevance from this perspective are liquidity arrangements, settlement processes, collateral, margins and interoperability arrangements. Let me add that such measures would only be triggered in the event of a clear threat to the conduct of our monetary policy, and would in no way encroach upon the prerogatives of CCP supervisors or the frameworks established by EU legislators. The ECB will act only within its competence, which is to formulate and implement the monetary policy of the euro area. Furthermore, any measures taken on this basis would need to be proportionate, and fully justified by the need to fulfil our monetary policy tasks. I also want to stress that, as a rule, the implementation of the regime for non-EU countries should continue to rely as much as possible on cooperation with, and deferral to, local authorities.

Let me also stress the crucial importance of finalising the adoption of key pieces of EU legislation – such as EMIR II – well in advance of Brexit, in order to be prepared for all possible contingencies, including a no-deal scenario. Failing to do so could leave central banks and supervisors without the appropriate tools to handle the risks linked to systemic euro CCPs operating outside the umbrella of EU regulation. Naturally, we are available to provide any assistance in the context of these discussions.

Finally, we should not overlook the systemic cross-border implications of central clearing *within* the EU. We should therefore also strive to achieve enhanced supervisory convergence within the Union. This would contribute to ensuring the integrity of the Single Market and a level playing field, consistent with the objectives of the capital markets union. The European Parliament can play a key role in furthering these objectives.

Conclusion

Let me conclude.

Our monetary policy measures have had tangible benefits for the euro area economy. Further policy initiatives are however needed to reduce vulnerabilities, strengthen resilience in crisis situations and increase growth potential. Only ambitious policies will deliver concrete benefits for the people of Europe.

This is also what our common history tells us. This year marks the 25th anniversary of the Single Market and of the Maastricht Treaty's entry into force. Those were bold decisions and we continue to benefit from them today: goods, people, services and capital can move freely and EU legislation ensures that commensurate rights and obligations apply throughout our Union. With the creation of Economic and Monetary Union (EMU) we went further by adopting the single currency.

It is in this spirit that I look forward to the coming months and the pivotal discussions we will have on reforming EMU governance.

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

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1 www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180205.en.html

2 See "Low inflation in the euro area: Causes and consequences", ECB Occasional Paper Series, No 181, January 2017.

3 See "Domestic and global drivers of inflation in the euro area", ECB Economic Bulletin, Issue 4 /2017.

4 General Court's judgment in Case *T-496/11 United Kingdom of Great Britain and Northern Ireland v European Central Bank*. ECLI: EU:T:2015:133.