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, 26 November 2018.

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Mr Chairman,

Honourable members of the Economic and Monetary Affairs Committee,

Ladies and gentlemen,

It is a pleasure to be back at the European Parliament and to appear again before your Committee for our last exchange of views of the year.

As you have chosen very topical issues for our discussion today, I will get started on the substance without further ado. First, I will share with you our assessment of the economic outlook for the euro area and the implications for the ECB's monetary policy. Second, I will discuss why designing and implementing the necessary reforms to Economic and Monetary Union (EMU) would support the ECB's monetary policy – and thus the euro area economy at large.

The euro area outlook and the ECB's monetary policy

The data that have become available since my last visit in September have been somewhat weaker than expected. Euro area GDP grew by 0.2% in the third quarter. This follows growth of 0.4% in both the first and second quarter of 2018. The loss in growth momentum mainly reflects weaker trade growth, but also some country and sector-specific factors.

Do we think this slowdown is temporary or more long-lasting?

A gradual slowdown is normal as expansions mature and growth converges towards its long-run potential. Indeed, looking further ahead, employment growth is expected to slow somewhat as labour supply shortages become more binding. Savings ratios will also normalise and temper consumption dynamics to some degree. This is also reflected in our staff projections from September, which see annual growth at 2.0% for this year, and then slightly lower rates of 1.8% in 2019 and 1.7% in 2020.

Some of the slowdown may also be temporary. In fact, the latest data already show some normalising of production in the car industry which has been impeded by one-off factors. In addition, insofar as world trade stabilises, albeit at a lower level, its drag on growth could also be temporary. At the same time, risks relating to protectionism, vulnerabilities in emerging markets and financial market volatility remain prominent.

Underlying drivers of domestic demand remain in place. Household income, which underpins domestic demand, continues to be supported by high levels of capacity utilisation and further improvements in labour markets. The unemployment rate declined to 8.1% in September 2018, which is the lowest level observed since late 2008, and employment continued to increase in the third quarter. Moreover, business investment is supported by still very favourable financing conditions in the euro area, together with solid demand and rising profitability.

Regarding price developments, HICP inflation increased to 2.2% in October 2018, from 2.1% in September. Measures of underlying inflation continue to be muted, but have increased from earlier lows. Generally, there is good reason to be confident that underlying inflation will gradually rise in the period ahead. Wages are rising as labour markets continue to improve and labour supply shortages become increasingly binding in some countries. Higher wage growth, as well as a recovery in producer and import prices, is expected to continue to support the upward adjustment in underlying inflation. In addition, long-term market and survey-based inflation expectations are reasonably well anchored and broadly in line with this outlook.

Overall, recent developments confirm the Governing Council's earlier assessments of the medium-term inflation outlook. The underlying strength of domestic demand and wages continues to support our confidence that the sustained convergence of inflation to our aim will proceed, and will be maintained even after a gradual winding down of our net purchases. The Governing Council therefore continues to anticipate that, subject to incoming data confirming our medium-term inflation outlook, net asset purchases will come to an end in December 2018.

At the same time, prevailing uncertainties still call for patience, prudence and persistence in calibrating our monetary policy stance. Significant monetary policy stimulus is still needed to support the further build-up of domestic price pressures and headline inflation developments over the medium term. To ensure that inflation continues to move towards our aim in a sustained manner, a significant degree of monetary policy stimulus will be maintained, even after the end of net asset purchases. This will be provided by the enhanced forward guidance pertaining to the path of interest rates and by the sizeable stock of acquired assets and the associated reinvestments.

EMU reform and the ECB's monetary policy

In keeping with the topics you have chosen for today's exchange, let me now discuss why a more complete EMU would support the ECB's monetary policy.

In particular, I will discuss two sets of challenges which arise in an incomplete EMU where monetary policy is truly European, while other important parts of economic policy are still handled at the national level.

First, the euro area is exposed to shocks arising from global shocks or common vulnerabilities. The 2007–08 financial crisis and its aftermath were a case in point, causing growth to go into negative territory in all euro area countries in 2009.

What made the euro area different from other economies was the absence of a readily available area-wide fiscal capacity to complement monetary policy.

Moreover, the lack of a robust regulatory, supervisory and crisis management framework when the crisis hit gave rise to increased doubts in the solidity of the European banking system. This in turn affected the financing of the real economy and the transmission of monetary policy.

Second, as we have seen in the past crisis, the euro area can be exposed to the risks originating from unsustainable domestic policies resulting in excessively high levels of debt, financial sector vulnerabilities and/or a lack of competitiveness.

Through financial, confidence and trade channels, these risks can spill over to other countries which have similar fragilities or strong interlinkages with the country where the risk originated. Such policies can also fragment economic and financial conditions, thereby hampering the homogeneous transmission of our single monetary policy across the euro area. And unsustainable policies eventually force socially painful and financially costly economic adjustments which can undermine cohesion in EMU.

In other words, an incomplete EMU impacts the economic and financial environment in which we conduct monetary policy.

Europe has learned this lesson the hard way.

And we have made significant progress in fixing the gaps in EMU's architecture. For instance, we now have a much stronger and more integrated framework for financial regulation, supervision and crisis resolution. You played an essential role in bringing this about. And the framework has also helped contain any financial stability risks that may emerge during a long period of low rates.

But more progress can and should be made. I would like to mention three areas where work is still needed.

First, an effective system for policy coordination is vital for promoting sound national policies, thus reducing the domestic sources of such shocks and increasing countries' shock-absorption capacity when they materialise. This pertains to promoting sound economic and fiscal policies. For that, we need to rekindle faith in our common rules and ensure that they are respected. Additional support from the EU level, as recently proposed by the European Commission, could be beneficial in implementing reform priorities identified in the European Semester. If euro area economies had a greater level of resilience, they would also be more likely to react to a common shock in a similar way, thus reducing costly macroeconomic divergences which cannot be addressed by our single monetary policy. Developing sound economic structures and institutions would also lift potential output.

Second, as recently advocated by the ECB in its opinion on the establishment of a European Investment Stabilisation Function[1] , the euro area needs a fiscal instrument to help maintain convergence in the face of large exogenous shocks, thereby also supporting the single monetary policy. A fiscal stabilisation function should focus on cyclical developments, and it should be conditional on economic and fiscal policies being sound and fully respecting the EU's governance framework. This would in turn contribute to macroeconomic stability both at the euro area level and, crucially, in each of its Member States. And it would allow action to be taken before recourse to the ESM needs to be made.

For situations where market instability materialises, the ESM remains essential to credibly address the causes of financial instability and contagion. It is important that the ESM is provided with the financial instruments necessary to achieve its objectives and to support the banking union. I thus welcome the ongoing discussions on making the ESM more effective, as also advocated in an ECB opinion on the subject[2].

Last but not least, completing the banking union and building an ambitious capital markets union are essential. If we want to avoid repeating the mistakes of the past, it is crucial to strengthen the resilience and integration of the financial sector, thereby also improving the transmission of our monetary policy.

Of course, the policy agenda I have just outlined would support the ECB's monetary policy. However, its benefits would not end there. The main motivation for these policy initiatives would be to deliver the tangible benefits of the common currency for all Europeans. Their support for the euro has increased as EMU has recovered from the crisis, and it now stands at a record high. We need to ensure they are not disappointed.

Conclusions

I would like to end by saying that the coming days, weeks and months until the end of this legislature will be decisive in making concrete steps on EMU reform.

This institution has repeatedly played a crucial and constructive role in ensuring that such discussions focus on a truly European dimension and on building effective common institutions.

We know that such a shift from coordination to common decision-making, from shared rules to institutions, is necessary but it requires time.

This should not be an excuse for inaction. Many of the basic steps for this to happen need to be taken now, namely designing an ambitious reform plan and building trust among all parties.

I am confident that you and the EU leaders will again play an instrumental role in moving this EMU agenda forward, so that we can deliver tangible results to mark the 20th anniversary of the euro.

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

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1 Opinion on a proposal for a regulation on the establishment of a European Investment Stabilisation Function (CON/2018/51), 9.11.2018. www.ecb.europa.eu/ecb/legal/pdf/en_con_2018_51_signed.pdf

2 Opinion on a proposal for a regulation on the establishment of the European Monetary Fund (CON/2018/20), OJ C 220, 25.6.2018, p. 2. www.ecb.europa.eu/ecb/legal/pdf/celex_52018ab0020_en_txt.pdf