Luis de Guindos: Presentation of the European Central Bank Annual Report 2018 to the Committee on Economic and Monetary Affairs of the European Parliament

Introductory remarks by Mr Luis de Guindos, Vice-President of the European Central Bank, to the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 1 April 2019.

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Mr Chairman,

Honourable Members of the Committee on Economic and Monetary Affairs,

Ladies and gentlemen,

I am honoured to appear for the first time before this Committee in my capacity as ECB Vice-President and I am delighted to present the ECB Annual Report for 2018.

The Annual Report is the ECB's main vehicle for discharging its accountability obligations, as stipulated in the EU Treaties, but of course our relationship with the European Parliament has long evolved well beyond the Treaty requirements. As part of this healthy and constructive relationship, and in line with what is now well-established practice, we are today also publishing written feedback on your resolution on our previous Annual Report. Among other issues, we report the full amounts of profit made through the Securities Markets Programme, in response to the resolution's request for the ECB to disclose them.

In my remarks today, I will discuss the monetary policy decisions taken by the ECB in 2018 and their impact on the euro area economy. As stated in the Annual Report, ample monetary stimulus is still necessary for inflation to converge to levels that are below, but close to, 2% over the medium term. In this context, I will also provide a brief overview of the decisions taken by the ECB's Governing Council on 7 March this year. I will then discuss key issues on the European financial agenda as we approach the end of this Parliament's term and the beginning of a new legislative cycle.

The ECB's monetary policy in 2018 and its impact on the euro area economy

Our monetary policy measures continued to contribute to very favourable financing conditions, supporting the euro area expansion throughout 2018. Lending rates for euro area firms and households remained close to their historical lows and growth in bank lending volumes continued the gradual upward trend observed since the beginning of 2014.

Firms in particular benefited from our purchases of bonds from the non-bank corporate sector, via the corporate sector purchase programme. This programme has made market-based financing more affordable for corporations and freed up lending capacity in banks' balance sheets, which has had a positive impact on credit supply, in particular for small and medium-sized enterprises.

While monetary policy supported domestic demand, the growth momentum moderated in 2018. For the year as a whole, GDP rose by 1.8%, compared with 2.4% in 2017. This was mainly due to weaker global trade, as well as some temporary factors at both the domestic and global levels. One such factor was the transition to new car emissions standards, which caused some bottlenecks in the European car production sector.

Measures of underlying inflation remained generally muted throughout 2018, but there was no risk of deflation, and inflation was projected to be on a gradual upward path. The underlying strength of the domestic economy, underpinned by our accommodative monetary policy, and tighter labour markets, which were pushing up wages, supported our confidence that inflation was indeed on its way to converge to levels below, but close to, 2% over the medium term.

Against this background, we decided to end net asset purchases by December 2018. At the same time, we moved back to using our policy interest rates and the forward guidance on their likely future path as the principal tool for preserving the ample degree of policy accommodation that was still needed.

As a result, we enhanced our forward guidance on policy rates, adding an explicit date-based component to the state-contingent component. This anchors interest rate expectations more firmly. In particular, the combination of the two components reflected our commitment to provide the accommodation needed to deliver on our mandate of price stability.

Our forward guidance on the key ECB interest rates has been reinforced by our ongoing reinvestments of the sizeable stock of acquired assets. These reinvestments will maintain the size of our securities portfolio and, together with the forward guidance on the reinvestment horizon, continue to support favourable financing conditions.

The ECB's recent monetary policy decisions

In the second half of 2018, the pace of the euro area economic expansion started to moderate more strongly than expected. Incoming information continued to disappoint in early 2019, suggesting that the moderation would extend into the current year.

The impact of the temporary domestic factors dampening growth has turned out to be longer-lasting than anticipated, and the global economy has become less supportive. The persistence of uncertainties related, in particular, to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets has appeared to dent economic sentiment. In our latest staff projections, the euro area growth outlook for 2019 has been revised down substantially, to an annual growth rate of 1.1%.

The effect of the adverse factors weighing on growth is expected to unwind over time. Growth is expected to come in at 1.5% in 2021, unchanged from previous projections. Supportive financing conditions, further employment gains and rising wage growth, and the ongoing – albeit slower – expansion in global activity, will continue to underpin the euro area expansion.

Nevertheless, the weaker growth momentum will leave its mark on domestic price pressures, slowing the adjustment of inflation towards our aim. Underlying inflation continues to be muted and our staff projections see a somewhat slower path for headline inflation, which is now foreseen to reach 1.6% at the end of 2021. Significant monetary policy accommodation therefore remains essential.

At our March meeting, we decided to adjust the date-based leg of our forward guidance. By confirming that rates would remain at their current levels at least through the end of 2019, we extended the period of very low interest rates further by minimising expectations of a rate hike before the end of this year. Of course, the second, state-based leg of our forward guidance continues to provide additional accommodation.

Furthermore, we observed that while bank lending conditions remain very favourable, the weaker outlook could affect the terms and conditions under which banks extend credit to businesses and households. It was therefore essential to preserve bank lending conditions by making sure that the refinancing needs of banks stemming from maturing bank bonds and outstanding targeted longer-term refinancing operations (TLTROs) would not jeopardise the transmission of monetary policy.

We therefore launched TLTRO-III, a new series of quarterly refinancing operations, starting in September 2019 and ending in March 2021, each with a maturity of two years. Banks will be entitled to borrow up to 30% of the stock of eligible loans at a rate indexed to the interest rate on the main refinancing operations over the life of each operation. Like the current TLTRO programme, TLTRO-III will feature built-in incentives for credit conditions to remain favourable for the euro area economy.

Overall, the measures taken in March signal our determination to provide the accommodation needed to underpin the economic expansion and ensure that inflation remains on a sustained path towards our inflation aim.

Key issues on the European financial agenda

Over the course of 2018, the financial stability environment became more challenging, which was reflected in systemic stress indicators. The ECB Annual Report highlights the fact that some developments supported financial stability, including a continued economic expansion and improved bank resilience. However, high risk-taking activities in some financial market segments reflected generally low risk premia.

Moreover, the absence of clarity related to the outcome of the Brexit process contributed to higher political and policy uncertainty. Thanks to the preparations made by public authorities and the private sector, a no-deal scenario poses manageable risks to overall euro area financial stability. However, some vulnerabilities remain which could generate more adverse effects if they interact with risks currently affecting the euro area outlook.

Looking back at this legislative term, the EU's co-legislators have taken important steps in the area of financial regulation, which have helped to make the European financial sector more resilient.

Many of the main regulatory reforms prompted by the outbreak of the global financial crisis have now been completed. Nevertheless, European banks cannot yet operate within a truly integrated framework and European citizens and firms cannot yet reap the full benefits of a genuine single banking market. Further efforts are also needed to develop truly integrated capital markets, while at the same time strengthening the regulatory and supervisory framework for the non-bank financial sector. For these reasons, completing the banking union and fostering the capital markets union will remain of paramount importance in the new legislative term.

As discussed in the Annual Report, the ECB continued to provide expertise and technical advice in these areas in 2018. The next few months before the start of the new legislative period provide a perfect opportunity to reflect on the steps that need to be taken to complete the reforms we have undertaken so far.

A genuine capital markets union and a complete banking union are crucial to the better functioning of Economic and Monetary Union (EMU). More integrated markets would deliver meaningful cross-border private risk-sharing which is currently lacking in the euro area by comparison with the United States. On the institutional side, operationalising the common backstop to the Single Resolution Fund and advancing political discussions on a European deposit insurance scheme are essential steps to bolster the resilience and credibility of the banking union.

The Eurosystem is also playing its role as a catalyst for change by fostering the harmonisation of market standards and directly contributing to the removal of barriers to financial market integration. In order to facilitate the pan-European reach of instant payments, the Eurosystem launched an innovative service, TARGET Instant Payment Settlement (TIPS), in November 2018. TIPS allows individuals and firms to transfer money by settling electronic payments in less than ten seconds.

But, for private risk-sharing and market integration to be effective, they need to be supported by policies on other fronts.

Fully applying the budgetary rules and coordinating economic policies more effectively remain vital to strengthen the resilience of the euro area and create the confidence among Member States that is needed to proceed towards further integration.

In parallel to this, the institutional foundations of EMU need to be fortified.

On the one hand, it is important to strengthen the governance and operational capacity of the European Stability Mechanism while fully respecting EU law. This will better protect euro area countries against severe shocks. On the other hand, establishing a budgetary instrument that supports convergence and competitiveness would help to strengthen the resilience of the euro area as a whole, as well as the resilience of each of its member countries.

Conclusions

Let me conclude.

As we are approaching the end of this parliamentary term, let me take the opportunity to thank this Committee for the very constructive relationship our two institutions have established over the past five years.

These have not been easy times, and the public has rightly asked for effective and tangible responses to economic and financial challenges.

You have played a vital role in relaying those expectations and in ensuring that the ECB's accountability – the necessary counterpart of its independence – was effectively discharged. Moreover, as co-legislators you drafted and adopted the reforms that made it possible to have a stronger Union today.

You know better than I that reform is a continuous endeavour and that the benefits of these efforts are not always easy to communicate. Still, the December Eurobarometer showed that support for the euro rose to 75% in 2018. This provides a solid basis on which to build and advance along the path towards a deeper and more complete EMU.

I am now at your disposal for questions.