

Mario Draghi: IMFC Statement

Statement by Mr Mario Draghi, President of the European Central Bank, at the thirty-ninth meeting of the International Monetary and Financial Committee, Washington DC, 12 April 2019.

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The euro area economy expanded at a slower pace in 2018, following robust growth in the previous year. The economy grew by 1.9% in year-on-year terms, marking a sizeable moderation in the pace of economic expansion. While there are signs that some of the idiosyncratic domestic factors dampening growth are fading, global headwinds continue to weigh on euro area growth developments. The persistence of uncertainties, related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets, is leaving marks on economic sentiment. At the same time, the economy continues to exhibit a high level of capacity utilisation, and the unemployment rate in the euro area has continued its downward trend, falling to its lowest level since October 2008. The number of people in employment has increased by more than ten million since mid-2013. Nevertheless, since the Annual Meetings in October 2018, incoming data have been weak, in particular in the manufacturing and tradable goods sectors, reflecting a slowdown in external demand. This was compounded by some country and sector-specific factors that are turning out to have somewhat longer-lasting effects than previously expected.

Our monetary policy measures continue to support domestic demand, which remains the backbone of the euro area's economic growth. Private consumption is driven by employment gains and rising wages. Although business investment has lost some momentum, economic fundamentals remain supportive; high levels of capacity utilisation, together with favourable financing conditions and robust demand, are expected to continue to further support investment. In addition, the expansion in global activity is expected to continue, although at a slower pace.

Since the Annual Meetings, short-term economic projections have been revised downwards. The latest ECB staff projections put annual real GDP growth at 1.1% in 2019, 1.6% in 2020 and 1.5% in 2021. At the same time, the persistence of uncertainties related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets poses downside risks to the euro area growth outlook.

Headline inflation in the euro area has lately been hovering around 1.5%, somewhat lower than in the summer of last year, when it was around 2.0%. This largely reflects the volatility in the annual rate of change in energy prices. Measures of underlying inflation remain generally muted, but labour cost pressures have strengthened and broadened amid high levels of capacity utilisation and tightening labour markets. Looking ahead, underlying inflation is expected to increase over the medium term, supported by our monetary policy measures, the ongoing economic expansion and rising wage growth. The latest ECB staff projections foresee annual euro area headline inflation of 1.2% in 2019, 1.5% in 2020 and 1.6% in 2021.

At its last monetary policy meeting on 10 April, the ECB Governing Council confirmed that it continues to expect the key ECB interest rates to remain at their present levels at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term. The Governing Council also intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when we start raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. The Governing Council also reiterated its readiness to adjust all of its instruments, as appropriate, to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner.

In March, the Governing Council had decided to launch a new series of quarterly targeted longer-term refinancing operations (TLTRO-III), starting in September 2019 and ending in March 2021, each with a maturity of two years, with a view to helping to preserve favourable bank lending conditions and the smooth transmission of monetary policy. The Governing Council will communicate the precise terms of the TLTRO-III at one of the forthcoming meetings. In particular, the pricing of the new TLTRO-III operations will take into account a thorough assessment of the bank-based transmission channel of monetary policy, as well as further developments in the economic outlook. In the context of the Governing Council's regular assessment, it will also consider whether the preservation of the favourable implications of negative interest rates for the economy requires the mitigation of their possible side effects, if any, on bank intermediation.

Overall, an ample degree of monetary accommodation remains necessary to safeguard favourable financing conditions and support the economic expansion, and thus to ensure that inflation remains on a sustained path towards levels that are below, but close to, 2% over the medium term. Significant monetary policy stimulus is being provided by the forward guidance on the key ECB interest rates, reinforced by the reinvestments of the sizeable stock of acquired assets and the new series of TLTROs.

In the euro area, in order to reap the full benefits of our monetary policy measures, other policy areas must contribute more decisively to raising the longer-term growth potential and reducing vulnerabilities. The implementation of structural reforms in euro area countries needs to be substantially stepped up. The mildly expansionary euro area fiscal stance and the operation of automatic stabilisers are providing support to economic activity. At the same time, countries where government debt is high need to continue rebuilding fiscal buffers. All countries should reinforce their efforts to achieve a more growth-friendly composition of public finances. The transparent and consistent implementation of the EU's fiscal and economic governance framework, over time and across countries, remains essential.

Continued domestic economic growth last year, together with micro- and macroprudential actions, also helped support the resilience of the euro area financial sector. The aggregate Common Equity Tier 1 ratio of significant institutions reached 14.2% at the end of the third quarter of 2018. Outstanding non-performing loans (NPLs) declined by €94 billion in the first three quarters of 2018, and euro area significant institutions' aggregate NPL ratio stood at 4.2%, down from 5.2% a year earlier. However, banks' profitability in the euro area, as in some other jurisdictions, remains low.

Risk-taking in parts of the financial and real estate markets contributed to mild signs of overstretched valuations in some areas, with marked cross-country differences, while risks continued to grow in the non-bank financial sector. In view of the current conditions, it is particularly important to continue improving the resilience of the financial sector and to ensure that it has sufficient buffers in place that can be released in times of stress.

The euro area is now more robust than before the crisis. The Economic and Monetary Union (EMU) needs to be strengthened, first and foremost by implementing what has already been agreed and finishing the common projects we have started: completing the banking union, strengthening the operational capacity of the European Stability Mechanism in full compliance with Union law, and making ambitious progress on the capital markets union. In particular, the agreement on establishing a backstop to the Single Resolution Fund, which demonstrates the euro area's commitment to completing the banking union, now needs to be operationalised to ensure that it works swiftly and effectively. We should also rekindle trust in our economic and fiscal framework by making it more effective in ensuring sound policymaking at national level. These actions are also further supported at the European level by the recent decision to launch a euro area budgetary instrument for convergence and competitiveness. A more complete EMU will be a better foundation for a stable and resilient euro area economy that contributes to global

economic growth and financial stability.

We take note of the fact that the European Council has agreed on an extension of the United Kingdom's membership of the EU until 31 October 2019, provided the UK participates in the forthcoming European Parliament elections in accordance with Union law. While this means that the risk of a cliff edge has likely been avoided in the short term, the financial sector should continue to prepare for all possible contingencies, including a disorderly Brexit.

The outlook for the euro area fundamentally depends on global growth momentum. The escalation of trade tensions, the downturn in global manufacturing and a turn in the tech cycle have increased the euro area's external headwinds. Multilateral cooperation is needed to reduce trade frictions and mitigate risks of major disruptions to global economic activity and financial stability. Preserving openness is crucial if the global economy is to thrive and secure its growth potential.

The key elements of the post-crisis regulatory reforms have been agreed. We must remain committed to implementing them and evaluating their effects to ensure they are working as intended. At the same time, while progress has been made towards more resilient market-based finance, it is important to continue monitoring emerging risks and vulnerabilities in the financial system and to address them if necessary.

The ECB sees a need for the Global Financial Safety Net (GFSN) to be further strengthened with a strong, quota-based and adequately resourced IMF at its centre. In the absence of an agreement on an increase in IMF quotas, the ECB would strongly welcome a substantial increase in the New Arrangements to Borrow as a second-best outcome towards ensuring that the Fund has adequate resources. While the first line of defence for national and international stability is to have sound domestic policies in place, the IMF's role at the centre of the GFSN strongly supports global financial stability.

The ECB welcomes the start the G20 has made in addressing some of the proposals from its Eminent Persons Group. We look forward to further proposals on the finance track being taken up in the second half of the year.

Finally, as regards the forthcoming Financial Sector Assessment Program Review, the ECB would welcome an agreement for holding a regular euro area review along the same frequency as for other major currency areas in the future.