Christine Lagarde: European Parliament plenary debate on the ECB Annual Report

Speech by Ms Christine Lagarde, President of the European Central Bank, at the plenary session of the European Parliament, Strasbourg, 26 February 2024.

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As we approach the end of this legislative term, I wish to sincerely thank this Parliament for collaborating in guiding Europe through economic headwinds and geopolitical upheavals, always with the shared vision of bolstering prosperity and fortifying our resilience.

Building on this collaborative spirit, today's debate on your draft resolution on the ECB Annual Report is a pillar of the ongoing dialogue between our two institutions; indeed, it is fundamental to the ECB's accountability which ensures the democratic legitimacy of our actions.

Let me start by outlining the current state of the euro area economy and our monetary policy stance. I will then focus on the need for a common European response to strengthen euro area resilience and competitiveness.

Bringing inflation back to target in a challenging economic and geopolitical environment

The euro area has been facing significant headwinds from a series of sudden and consecutive shocks which pushed inflation very high in the wake of the post-pandemic recovery. Having peaked at 10.6% in October 2022, inflation has since declined significantly thanks to the unwinding of energy shocks and various supply-side disruptions along with determined policy action.

After expanding by 3.4% in 2022, euro area economic activity has been weak in 2023, with real GDP growth having stagnated in the final quarter. Subdued demand for euro area exports – owing mainly to weaknesses in global trade and earlier losses in competitiveness – and tight financing conditions are weighing on growth. Weakness in manufacturing activity has been extending to the services sector since the end of 2023. However, there are increasing signs of a bottoming-out and some forward-looking indicators point to a pick-up later this year.

Despite the sluggish economy, the labour market has remained resilient. Unemployment stood at a historical low of 6.4% in December amid robust demand for labour, which is, however, showing some signs of weakening.

Inflation decreased slightly to 2.8% in January. Energy prices declined by 6.1%, and food inflation, while still elevated, came down further to 5.6%, primarily reflecting a lower inflation rate for processed food.

Core inflation – excluding energy and food price developments – also decreased further to 3.3%, reflecting lower inflation in goods, while services inflation remained more persistent.

Wage pressures, meanwhile, remain strong. Wage growth is expected to become an increasingly important driver of inflation dynamics in the coming quarters, reflecting employee demand for inflation compensation and tight labour markets. At the same time, the contribution of profits – which has recently accounted for much of the increase in domestic cost pressures – is declining, suggesting that, as expected, labour cost increases are partly buffered by profits and are not being fully passed on to consumers.

Regarding your concerns about the risks of second-round effects, as mentioned in your draft resolution, let me emphasise that our restrictive monetary policy stance, the ensuing strong decline in headline inflation and firmly anchored longer-term inflation expectations act as a safeguard against a sustained wage-price spiral.

Looking forward, we expect inflation to continue slowing down, as the impact of past upward shocks fades and tight financing conditions help to push down inflation.

This brings me to our current monetary policy stance.

At our January Governing Council meeting, we considered that the incoming information was broadly in line with our December assessment of the medium-term inflation outlook. We therefore decided to keep our key policy interest rates unchanged.

These interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to ensuring that inflation returns to our two per cent medium-term target in a timely manner. The current disinflationary process is expected to continue, but the Governing Council needs to be confident that it will lead us sustainably to our 2% target. We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction, taking into account the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission.

Building euro area resilience in turbulent times

The shifting economic and geopolitical landscape calls for strengthening the euro area's resilience.

As you note in your draft resolution, high energy prices and increased geopolitical instability are posing a threat to euro area competitiveness. And they are adding to Europe's existing structural challenges such as ageing, climate change and digitalisation.

To maintain monetary sovereignty and economic prosperity in these challenging times, it is essential for Europe to build up resilience to shocks and invest in its strategic autonomy.

A unified European policy response should strive to unlock Europe's potential, focusing on progress in three key dimensions: *independence*, *investment* and *integration*.

First, we need to make progress on energy *independence*.

Given its proximity to Russia's war of aggression against Ukraine, Europe was hit particularly hard by its dependence on energy imports from Russia. To reduce the bloc's vulnerability to global shocks, improvements in energy security, efficiency and affordability will be vital. European firms' ability to compete globally will hinge on being less energy dependent.

As energy security becomes imperative, Europe will need to boost the roll-out of renewables by increasing investment in clean energy and green technologies, such as green hydrogen and smart energy grids.

But the path to greater energy independence also entails considerable investment needs.

This brings me to my second point: we need to foster *investment*.

The European Commission estimates that an extra €620 billion per year will be needed to finance Europe's environmental and climate objectives, while an additional €125 billion will be required for the digital transition.[1] But making these investments, as well as addressing shortcomings in the functioning of the financial system, requires further progress on deepening our Economic and Monetary Union, something you highlight in your draft resolution.

Faithfully implementing the EU's revised economic governance framework will help ensure that fiscal rules reduce high government debt and promote structural reforms and productive public investment, including for the green and digital transitions. I am pleased that EU policymakers, including this Parliament, have recently reached a provisional agreement on the new framework, which should be swiftly and diligently implemented. This will be essential to enhance credibility and anchor expectations about the future course of fiscal policies.

Completing Europe's capital markets union (CMU) will also be key in financing the twin transition. A fully functioning CMU is needed to foster private financing and complement public investment. We are currently underperforming in this area. Our capital markets remain fragmented and, as a result, lack depth and liquidity, especially when compared with those of the United States. Let me give two examples. First, the EU trading landscape is characterised by many small exchanges, with three times as many exchange groups as in the United States and more than ten times as many exchanges for listings.[2] Second, EU venture capital, relative to the size of the economy, is only a small fraction of the size – around one-fifth – of US venture capital.[3] Measures to promote equity financing would provide an opportunity to broaden European firms' financing options for investing in the technologies needed for the twin transition.

Europe's competitiveness and ability to invest also hinge on further progress being made towards banking union. A complete banking union would support more integrated banking services across the euro area and strengthen the global competitiveness of our banking sector.

Finally, the third key dimension of a unified European response is the need for deeper *integration* of our Single Market to strengthen Europe's overall competitiveness and resilience.

The Single Market remains incomplete. But it is essential for Europe's long-term competitiveness.[4]

A more integrated Single Market would help unleash Europe's growth potential, boosting our shared prosperity. Measures to strengthen the Single Market could, for example, focus on reducing red tape and excessive regulation, both at EU and national levels. This would provide incentives to invest and innovate, as 61% of EU firms consider business regulations to be an obstacle to investment.[5] In addition, a more competitive and integrated electricity market is also crucial for completing the Single Market and supporting the green and digital transitions. The digital transition would also be further supported by a digital euro.

Progress in this direction would support cross-border trade, investment, and growth. It would also enhance innovation through increased incentives for research and development. The impact of such progress would be considerable – ECB analysis shows that the Single Market raised the region's GDP per capita by 12% to 22% between 1993 and 2008.[6]

A more integrated Single Market would also strengthen our resilience. We now know that Europe's heavy reliance on external demand and global supply chains can be a weakness. We should therefore leverage and further exploit the full scale of our internal market for goods and services. This will require comprehensive reform, but it has the potential to re-establish the Single Market as an engine of growth, innovation and competitiveness.

Conclusion

Let me conclude.

Europe has demonstrated its ability to navigate turbulent times. In the face of the current economic and geopolitical challenges, policymakers must be bold enough to take the further steps needed to advance European integration.

As Simone Veil remarked in her inaugural speech as President of the European Parliament here in a plenary session 45 years ago: "If the challenges facing Europe are to be met, we need a Europe capable of solidarity, of independence, and of cooperation." Her words resonate strongly today. We must seize the opportunity to bolster Europe's unity and resilience.

I count on this Parliament – and the next one – to drive the decisive European action needed to strengthen the euro area.

The ECB will continue to play its part, within its mandate. Let me reiterate our unwavering commitment to delivering on price stability, while contributing to the topics I have talked about today and maintaining an ongoing dialogue with you, the elected representatives of EU citizens.

Thank you for your attention. I now look forward to listening to your views during today's debate.

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[1] European Commission (2023), *2023 Strategic Foresight Report – Sustainability and people's wellbeing at the heart of Europe's Open Strategic Autonomy*.

[2] Wright, W. and Hamre, E.F. (2021), "Report: the problem with European stock markets ", *The future of EU capital markets*, New Financial, March.

[3] International Relations Committee Work stream on Open Strategic Autonomy (2023), " The EU's Open Strategic Autonomy from a central banking perspective – challenges to the monetary policy landscape from a changing geopolitical environment", *Occasional Paper Series*, No 311, ECB, March.

[4] European Commission (2023), *Long-term competitiveness in the EU: looking beyond 2030*.

[5] European Investment Bank (2022), *EIB Investment Survey – EU overview*.

[6] Lehtimäki, J. and Sondermann, D. (2020), "Baldwin vs Cecchini revisited: the growth impact of the European Single Market", *Working Paper Series*, No 2392, ECB, April.