Luis de Guindos: Presentation of the European Central Bank Annual Report 2023 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, 18 April 2024.

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Introduction

I am pleased to appear before this Committee to present the ECB's Annual Report for 2023[1], a year in which the ECB consolidated progress in its fight against inflation. As well as assessing economic developments in the euro area in 2023, our Annual Report gives an account of the Eurosystem's monetary policy and other activities conducted by the European System of Central Banks (ESCB). In response to European Parliament resolutions, it also includes a box explaining how the ECB's secondary objective is considered in the conduct of the ECB's monetary policy and reporting activities.

Today we are also publishing our written feedback statement, which provides responses to the European Parliament's resolution on our previous Annual Report.[2]

In my remarks today, I will start by focusing on the economic outlook for the euro area and the monetary policy decisions taken at our recent monetary policy meeting. I will then briefly update you on our current financial stability assessment before going on to discuss the importance of a resilient financial system.

The euro area economy and our monetary policy

As detailed in the Annual Report, euro area growth slowed to 0.4% in 2023 after expanding by 3.4% in 2022. This slowdown was to some extent attributable to the economic repercussions of Russia's war against Ukraine. The impact of higher interest rates alongside spillover effects from the weak industrial sector to services also weighed on growth.

Euro area headline inflation declined by 6.3 percentage points over the course of 2023 to reach 2.9% at the end of the year. The decline was broad based across all the main components of inflation, reflecting the fading impact of previous large supply shocks, lower energy commodity prices and tight monetary policy.

This year, economic indicators suggest that activity has got off to a weak start and will recover only gradually. Consumer spending is set to remain sluggish in the near term but should strengthen as real disposable income continues to recover. Private investment is expected to show continued weakness in the period ahead before the impact of weak final demand and tight financing conditions starts to fade.

Inflation has fallen further this year and is expected to continue declining in the medium term, but at a slower pace. Measures of underlying inflation have been easing but domestic price pressures remain elevated. Wage growth has remained strong amid robust labour markets but has been moderating recently, while profits are absorbing part of the effects of wage increases on prices.

The ECB reacted forcefully to heightened inflation: it raised its key policy rates by a cumulative 450 basis points between July 2022 and September 2023 and has kept them unchanged since then. We are determined to ensure that inflation returns to our 2% medium-term target in a timely manner. At our most recent monetary policy meeting on 11 April 2024 we considered that the key ECB interest rates are at levels that are making a substantial contribution to the ongoing disinflation process. Our future decisions will ensure that our policy rates will stay sufficiently restrictive for as long as necessary. If our updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase our confidence that inflation is converging to our target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. In any event, we will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction, and we are not pre-committing to a particular rate path.

Let me also give you a brief update on the operational framework review we concluded in March, which you have discussed on previous occasions with the ECB President.[3] The changes will affect how central bank reserves will be provided as excess liquidity gradually declines. The Governing Council will continue to steer the monetary policy stance by adjusting the deposit facility rate (DFR) and short-term interest rates are expected to evolve in the vicinity of the DFR with tolerance for some volatility. Liquidity will be provided through a broad mix of instruments, including existing regular refinancing operations as well as – at a later stage – new structural longer-term credit operations and a structural portfolio of securities. Our existing regular refinancing operations will continue to be conducted through fixed-rate tender procedures with full allotment against broad collateral, and the interest rate on the main refinancing operations will be adjusted later in the year to 15 basis points above the deposit facility rate. The key parameters of the framework will be reviewed in 2026 or earlier if necessary.

The importance of a resilient financial system

Let me now turn to our assessment of the financial sector.

During my last appearance before this Committee, we discussed the importance of maintaining a resilient financial system following the banking sector turmoil in the United States and Switzerland.

Since then, the euro area financial system has remained strong, aided by declining inflation. Confidence in euro area banks has benefited from strong rules and supervision. Banks have maintained sizeable liquidity and capital buffers, and nonperforming loan ratios remain close to historically low levels. At the same time, firms and households have shown resilience in the face of rising debt servicing costs resulting from higher interest rates.

However, this positive outlook for financial stability in the euro area should not be taken for granted. It could face significant challenges if growth prospects weakened, inflation stayed above target for a longer period or further geopolitical risks materialised.

We are also closely monitoring developments in euro area real estate markets as tighter financing costs, a move towards hybrid working practices as well as environmental, social and governance requirements are likely to continue to put pressure on this market segment. Although mild signs of asset quality deterioration are becoming visible in commercial real estate (CRE) lending, risks to this asset class are broadly contained given that banks' CRE exposures, standing at around 5% of total assets, are limited. Our Financial Stability Review, which is due to be published mid-May, will provide more details of our assessment on this.

To support continued financial sector resilience, legislators still have a lot of work to do in the coming years to close the gaps in our banking union. Besides urgent reform of the bank crisis management and deposit insurance framework, we must set up a European framework for liquidity in resolution and, most importantly, a fully-fledged European deposit insurance scheme. We also need a solid institutional and policy framework for the non-bank financial sector and we welcome the European Commission's forthcoming macroprudential framework review.

Moreover, during the next EU institutional cycle, the level of ambition and commitment devoted to the capital markets union (CMU) agenda must finally match the urgent need to make progress. Completing CMU is key to strengthening resilience, enhancing EU competitiveness, growing our economy and achieving the EU's policy objectives, such as funding the green and digital transitions. In this spirit, the ECB Governing Council recently published a statement on advancing CMU.[4]

Conclusion

As this parliamentary term comes to an end and a new one begins in a few months' time, let me reiterate that the ECB is counting on this Parliament to support these efforts with ambition and commitment.

Thank you for your attention. I now stand ready to answer your questions.

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[1] ECB Annual Report 2023.

[2] Feedback on the input provided by the European Parliament as part of its resolution on the ECB Annual Report 2022. This feedback statement provides responses to the issues raised and requests made by the European Parliament in its resolution on the previous year's ECB Annual Report. The statement, which is structured by topic, serves to better explain the ECB's policies and promote dialogue with the European Parliament

and the public regarding the important issues highlighted by the Members of the European Parliament. The ECB has been publishing such feedback statements since 2016 following a suggestion by the European Parliament.

[3] ECB (2024), ECB announces changes to the operational framework for implementing monetary policy, press release, 13 March.

[4] ECB (2024), Statement by the ECB Governing Council on advancing the Capital Markets Union, press release, 7 March 2024.