Christine Lagarde: Hearing of the Committee on Economic and Monetary Affairs of the European Parliament

Speech by Ms Christine Lagarde, President of the European Central Bank, at the Hearing of the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 30 September 2024.

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Charts accompanying the speech

Transcript of the hearing

It is a great pleasure to return to this Committee for the first time since the European elections. I very much look forward to my exchanges with all of you, new and not-so-new members, over the course of this parliamentary term.

First, let me congratulate each of you on your election to this Parliament. Europe faces significant challenges, and critical decisions will need to be taken over the next five years. Your work will be crucial in guiding us forward.

As Members of the European Parliament, you play an essential role in channelling citizens' questions and concerns about the ECB's policies. I am committed to maintaining an open dialogue with you, building on the positive and constructive relationship between our two institutions. By working together, we can fulfil our joint accountability obligations under the Treaty and build trust in the ECB.

In my remarks today, I will start by providing an update on the euro area's economic outlook and the ECB's monetary policy stance, the first topic you have selected for today's hearing. I will then discuss the need to advance the capital markets union – the second topic you have chosen.

The outlook for the euro area economy

Economic activity has recovered slowly since the end of the pandemic. The post-pandemic reopening allowed the euro area economy to grow during the first nine months of 2022, but economic activity broadly stagnated thereafter. This was due, among other factors, to the energy price shock following Russia's invasion of Ukraine and the increased geopolitical uncertainty, but also to the tightening of our monetary policy.

Growth resumed in early 2024. The euro area economy grew by 0.2% in the second quarter, after 0.3% in the first quarter. However, growth in the second quarter stemmed mainly from exports and government consumption. Domestic demand remained weak as households consumed less, firms cut business investment and housing investment dropped. The services sector is holding up, with signs of deceleration, while activity in the manufacturing and construction sectors remains subdued.

Looking ahead, the suppressed level of some survey indicators suggests that the recovery is facing headwinds. We expect the recovery to strengthen over time, as rising real incomes should allow households to consume more. The latest ECB staff projections foresee the economy growing by 0.8% in 2024, 1.3% in 2025 and 1.5% in 2026.

The labour market remains resilient, with the unemployment rate standing at 6.4% in July – broadly unchanged over the past year. At the same time, employment growth slowed to just 0.2% in the second quarter, and recent indicators point to a further deceleration in the coming quarters. According to ECB staff, the unemployment rate is projected to remain around its current low level.

Turning to price developments, disinflation has been accelerating over the last two months. Headline inflation fell to 2.2% in August 2024 and is expected to drop further in September, mainly on account of falling energy costs. Core inflation – excluding energy and food – edged down to 2.8% in August driven by a decline in goods inflation that outweighed an increase in services inflation.

The indicator of domestic inflation, which only includes items with a low import intensity, remained high in August as wages continued to grow at an elevated pace. At the same time, the overall growth in labour costs has been moderating in recent quarters, and profits have been buffering the impact of higher wages on inflation.

Looking ahead, inflation might temporarily increase in the fourth quarter of this year as previous sharp falls in energy prices drop out of the annual rates, but the latest developments strengthen our confidence that inflation will return to target in a timely manner. We will take that into account in our next monetary policy meeting in October. The ECB staff projections from September foresee inflation to average 2.5% in 2024, 2.2% in 2025 and 1.9% in 2026.

The ECB's monetary policy stance

Let me now turn to our monetary policy stance – the first topic chosen for today's hearing.

We have come a long way in the fight against inflation. In October 2022 inflation peaked at 10.6%. By September 2023, the last time we raised interest rates, it had dropped by more than half, to 5.2%. The decline in inflation and the anchoring of longer-term inflation expectations showed that our strong response was bearing fruit. Then, after nine months of holding rates steady, we saw inflation halve again to 2.6% in June when we started lowering interest rates.

The new data available at the time of the September Governing Council meeting reinforced our confidence in the timely return of inflation to our 2% target. We therefore lowered the rate on the deposit facility, which is the rate through which we steer the monetary policy stance, by another 25 basis points to 3.5%.

We are determined to ensure that inflation returns to our 2% medium-term target in a timely manner. We will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction, focusing on the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission. Policy rates will be kept sufficiently restrictive for as long as necessary to achieve our aim. We are not pre-committing to a particular rate path.

Moreover, as we announced on 13 March 2024, some changes to the operational framework for implementing monetary policy took effect from 18 September.[1] In particular, the spread between the interest rate on the main refinancing operations and the deposit facility rate was set at 15 basis points. The aim is to steer short-term money market rates more closely in line with monetary policy decisions.

In parallel to our policy deliberations, we have also launched an assessment of our monetary policy strategy. This assessment will be more limited in scope than our last review, which we completed in July 2021, and will include two work streams. One work stream will focus on the changed inflation environment and the other on the implications for our monetary policy strategy, including what we can learn from the periods of both low and high inflation.

We expect to conclude the assessment in the second half of 2025 and I intend to keep you informed in our regular hearings and interactions.

Advancing capital markets union

Let me now turn to the second topic of this hearing – the capital markets union.

The ECB has long emphasised the need for progress in this area to integrate our fragmented markets and thus foster risk diversification and shock absorption across the EU. Doing so would support financial stability and facilitate the transmission of monetary policy.

But a deep and integrated single market for capital is also essential for achieving some of the EU's other key goals, from financing the green and digital transitions to enabling savers to earn higher returns. Additionally, young and innovative firms need to grow and become more productive, which will ultimately benefit all Europeans. For the time being, however, a lack of access to equity financing is a key factor holding these firms back.

Advancing the capital markets union must therefore be a cornerstone of the EU's competitiveness strategy.

Significant efforts have been made over the past decade to move forwards, and I want to pay tribute to the role the European Parliament has played in promoting an ambitious, European approach. But vested interests and competing national priorities have hampered progress.

Now, at the beginning of a new legislative term, we are at a crossroads. The current political momentum needs to be converted into a concrete agenda with clear priorities. And this agenda must be swiftly followed up with genuine actions.

The ECB's Governing Council laid out its priorities for European capital markets in a statement in March.[2] Let me highlight three key areas where progress is essential.

First, we must improve the way we save in Europe. In 2022, European household savings exceeded EUR 1.1 trillion.[3] However, around a third of these savings are held in deposits[4] – significantly more than in the United States. Mobilizing even a small portion of these funds and investing them in European capital markets could greatly contribute to the more than EUR 700 billion needed annually to achieve the EU's key strategic objectives. This is also likely to provide better long-term returns for our citizens while improving European companies' access to equity finance.

Second, we need a single regulatory and supervisory ecosystem that promotes market integration.

And third, for EU capital markets to be more attractive to investors and issuers, they need to achieve greater scale and depth. This can only happen through integration – especially in our trading and post-trading infrastructure.

Conclusion

To conclude – the world is changing rapidly, and Europe is falling behind.

The diagnosis and the remedy are clear – the EU must come together and address its structural challenges to increase its competitiveness.

Advancing the capital markets union is an important part of this agenda, but not the only one. Significant efforts to boost Europe's economic resilience and decarbonise the economy will also be needed. This will require substantial investment in the coming years, which needs to come from both private and public sources.

Progress in these areas will not only enhance Europe's ability to withstand future economic shocks, but also help the ECB to maintain price stability.

As Jacques Chirac once observed, "The construction of Europe is an art. It is the art of the possible."

This Parliament has found ways to push Europe forwards before, and I trust you will do so again. The future of Europe is in your hands.

Thank you for your attention – I look forward to your questions and to engaging with you throughout what will be a decisive period for Europe.

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[1] ECB (2024), "Changes to the operational framework for implementing monetary policy", ECB, *press release*, 13 March.

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

[3] Eurostat and European Commission (2024), "The future of European competitiveness: A competitiveness strategy for Europe".

[4] Approximation based on Eurostat, ECB, and OECD data.