International Monetary and Financial Committee

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Statement by Mario Draghi,
President of the European Central Bank

On behalf of the European Central Bank (ECB)

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at the Twenty-Eighth Meeting of the IMFC

Washington, D.C., 12 October 2013

I would like to focus on the euro area economic outlook, the ECB's monetary policy and current policy challenges.

Economic activity in the euro area bottomed out in the first half of the year and is expected to strengthen gradually in the period ahead. Recent economic indicators, which have been predominantly positive, support expectations of a modest and gradual recovery. Output is expected to recover at a slow pace, driven by a gradual improvement in domestic demand supported by the ECB's accommodative monetary policy stance and a gradual strengthening of external demand. Furthermore, the improvements in financial markets seen since August 2012 appear to be gradually working their way through to the real economy, as should the progress made in fiscal consolidation. The risks surrounding the economic outlook for the euro area continue to be on the downside. Developments in global money and financial market conditions and related uncertainties may have the potential to negatively affect the economic outlook. Other downside risks include higher commodity prices in the context of renewed geopolitical tensions, weaker than expected global demand and slow or insufficient implementation of structural reforms in euro area countries.

Underlying price pressures in the euro area are expected to remain subdued, reflecting the broad-based weakness in aggregate demand and the modest pace of the recovery, as well as subdued monetary and credit dynamics. Medium to long-term inflation expectations continue to be firmly anchored in line with price stability. The risks to the outlook for price developments are expected to be still broadly balanced over the medium term, with upside risks relating in particular to higher commodity prices as well as stronger than expected increases in administered prices and indirect taxes, and downside risks stemming from weaker than expected economic activity.

The ECB's monetary policy stance continues to be geared towards maintaining the degree of monetary accommodation warranted by the outlook for price stability. It thereby provides support to a gradual recovery in economic activity. Looking ahead, our monetary policy stance will remain accommodative for as long as necessary. In line with the guidance provided in July, the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time. This expectation is based on an overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the economy and subdued monetary dynamics. In the period ahead, the ECB will monitor all incoming information on economic and monetary developments and assess any impact on the medium-term outlook for price stability.

With regard to money market conditions, the ECB will remain particularly attentive to developments which may have implications for the stance of monetary policy and is ready to consider all available instruments.

Further reducing fragmentation of euro area credit markets and improving confidence in the euro area banking sector are essential to ensure an adequate transmission of monetary policy to the financing conditions in the euro area countries and to further repair the credit channel. Financial stability risks have diminished in the euro area. Measures taken by European and national authorities have helped to ease the severe market stress that earlier weighed on sovereigns and banks. The euro area banking sector has made progress in balance sheet repair by improving its regulatory capital ratios, by reducing its leverage since the outbreak of the financial crisis and by shifting its funding structure towards more stable funding sources. Net inflows of capital from abroad as well as a reduction in excess liquidity conditions continue to be observed, reflecting an improvement in financial market confidence. Repayments of funds taken up in the context of the ECB's three-year longer-term refinancing operations conducted in December 2011 and February 2012 have resulted in a decline in the size of the Eurosystem's balance sheet since end-August 2012. We will remain attentive to all developments that influence an adequate transmission of monetary policy to the financing conditions in euro area countries.

Further decisive steps towards establishing a genuine banking union are needed so as to further reduce financial fragmentation, enhance the resilience of the banking sector and strengthen the institutional framework of the euro area. The ECB welcomes the approval of the legal framework of the single supervisory mechanism (SSM) by the European Parliament on 12 September and we look forward to its urgent adoption by the EU Council in the course of October. The entry into force of the SSM legal framework will allow us to further speed up the preparation process, which is well under way. We are committed to delivering on our new supervisory responsibilities by November 2014.

We also strongly support the envisaged timeline for the establishment by the end of 2014 of the single resolution mechanism (SRM), which is a necessary complement to the SSM. The Commission's proposal for the SRM contains three essential elements for the effective resolution of banks, namely: a single system, a single authority and a single fund.

The ECB's forthcoming comprehensive assessment of banks' balance sheets, which will take place before the ECB assumes its supervisory responsibilities, will be an important confidence-building tool, and we are committed to ensuring its consistency and transparency. The effectiveness of this exercise will also depend on the availability of necessary arrangements for recapitalising banks, if and when needed, including through the provision of a public backstop, if private funds cannot be acquired. These arrangements must be in place before we conclude our assessment, in line with the declaration of the European Council of June 2013. It is also noteworthy that strong efforts to repair bank balance sheets and enhance transparency have already been undertaken in all euro area countries, especially in those that have experienced severe stress.

As regards fiscal policies, substantial fiscal adjustment has been undertaken by the euro area countries over the last few years. The average fiscal position of the euro area countries is much stronger than that of global peers. The authorities should not unravel their multi-year efforts to cut deficits but should reduce the debt ratios without delay, in line with the EU's fiscal framework, which has been considerably reinforced over the past few years. As part of this enhanced framework, the draft budgetary plans that countries will now deliver for the first time under the "two-pack" regulations need to provide for sufficiently far-reaching measures to achieve the fiscal targets in 2014.

Euro area governments must also decisively strengthen their efforts to implement the needed structural reforms in product and labour markets. These reforms are required not only to help the respective countries to regain competitiveness and to rebalance within the euro area, but also to create more flexible and dynamic economies that will generate sustainable growth and employment. As regards intra-euro area imbalances, there has been a major external adjustment in euro area countries with previously high current account deficits. Improved competitiveness indicators, in particular declining unit labour costs and the relatively robust export performance, point to a more lasting effect of the structural reforms undertaken so far. The framework of the European Semester and the macroeconomic imbalance procedure have provided additional tools to secure further progress in terms of structural adjustments in the euro area that will put the euro area in a position to make a positive contribution to global growth and employment creation.