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IMFC Statement by Mario Draghi
President
European Central Bank

Statement by Mario Draghi, President of the ECB, at the Thirty-Fourth meeting of the International Monetary and Financial Committee, Washington DC, 8 October 2016

The euro area economy is continuing to expand at a moderate and steady pace, with slightly less momentum than envisaged at the time of the Spring IMFC meeting. Incoming information continues to point to the economy being resilient to economic and political uncertainty in Europe as well as globally. Nevertheless, the prospects for euro area growth remain moderate, at slightly below 1¾% according to the ECB staff projections for the current year and the next two years. This is mainly due to subdued foreign demand, the aforementioned uncertainties and the sluggish implementation of structural reforms that could support in particular a stronger recovery in investment as well as boost potential growth.

The ongoing economic expansion of the euro area is largely supported by developments in domestic demand. Real GDP rose by 0.3%, quarter on quarter, in the second quarter of this year, following a 0.5% increase in the first quarter. Survey indicators have shown some resilience in the aftermath of the UK referendum outcome and point to ongoing growth in the near term. The ECB's very accommodative monetary policy stance and its impact on financing conditions are supporting domestic demand. In addition, relatively low oil prices and sustained employment gains, in part owing to past structural reforms, should continue to support disposable income and private consumption. Reduced leverage ratios and improving corporate profitability should further promote investment. The risks to this growth outlook remain tilted to the downside.

Headline inflation has remained low and is still being influenced by past declines in oil prices. The current lack of momentum also partly reflects the indirect effects of low oil prices. Meanwhile, domestic cost pressures, in particular wage growth, continue to be subdued, also weighing on underlying inflation. Looking ahead, inflation rates are expected to pick up in the remaining months of 2016, to a large extent owing to energy-related base effects. Thereafter, inflation rates should recover further in 2017 and 2018, supported by our monetary policy measures and the continued economic recovery gradually closing the output gap. In the current context of inflation rates still being very low, the ECB will continue to ensure that harmful second-round effects do not become entrenched in price and wage-setting.

The comprehensive monetary policy measures taken by the ECB since June 2014 are providing effective support to the euro area's recovery and thus reinforce its resilience to shocks stemming from the global environment. They continue to filter through to the borrowing conditions available to households and firms, which have already markedly improved, and they support credit flows across the euro area.

In June we began our corporate sector purchase programme as part of our expanded asset purchase programme (APP), with monthly purchases of €80 billion. In September we allotted the second operation of our new series of targeted longer-term refinancing operations (TLTRO-II). These operations allow banks to secure long-term funding under very attractive conditions provided they can demonstrate strong lending performance. As a result of these built-in incentives, the exceptionally favourable borrowing conditions that banks enjoy under TLTRO-II are being passed through to their customers and are reaching the broader economy. Two more TLTRO-II operations will take place in December 2016 and March 2017. Alongside our APP, they will provide additional stimulus.

We have confirmed our forward guidance on asset purchases and our policy interest rates, indicating that the ECB intends to run asset purchases until the end of March 2017 or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation towards levels below, but close to, 2% over the medium term. We continue to expect the ECB's key policy rates to remain at current or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

Negative interest rates on our deposit facility have empowered the transmission of our asset purchase programmes and contributed to very accommodative financing conditions. Even though some banks were more negatively affected than others by this policy measure, the aggregate of euro area banks' net interest income showed resilience in 2015, which was the first full year with negative rates. The decline in gross interest income that we observed in the first quarter of 2016 was, to a large extent, offset by a fall in banks' funding and impairment costs.

Overall, our measures have improved the transmission of monetary policy across all euro area countries. Our very accommodative monetary policy stance provides the impetus that is necessary for the euro area recovery to strengthen and for inflation to gradually return to levels that we consider consistent with our objective. Looking forward, we will preserve the very substantial amount of monetary support that is necessary to secure a return of inflation rates towards levels that are below, but close to, 2% without undue delay. If warranted, we will act by using all the instruments available within our mandate.

In recent years, banks have strengthened their capital positions substantially and stress resilience has been enhanced. However, challenges remain, notably regarding profitability.

The current weak economic growth outlook remains a key issue, with the environment of low interest rates and flat yield curves particularly impacting those banks that rely heavily on maturity transformation. In response to structural factors, banks will need to adapt their business models. Although the burden of non-performing loans (NPLs) has become somewhat lighter compared with the peaks observed in late 2013, the process of reducing NPLs is very gradual and therefore continues to weigh on some banks' capacity to extend new loans. Determined action by all relevant stakeholders is needed to further reduce NPL levels. The ECB has launched a public consultation on guidance for banks on NPLs. The draft guidance recommends that banks with a high level of NPLs establish a clear strategy aligned with their business plan and risk management framework to effectively manage and ultimately reduce their NPL stock in a credible, feasible and timely manner. However, cooperation among all major stakeholders, including governments, banks, legislators and investors, at national and European level, is fundamental in order to make substantial progress in this field. In parallel, the development of a capital markets union in Europe needs to be pursued.

Our very accommodative monetary policy stance creates a unique window of opportunity to step up the implementation of structural reforms in various areas. At the same time, an ambitious and well-sequenced structural reform effort, in combination with a fiscal policy that supports growth, will enable the euro area economy to reap the full benefits of our monetary policy measures, leading to higher sustainable economic growth and making our economy more resilient to shocks. Successful examples of structural reforms implemented in some euro area countries in the first phase of the crisis confirm that well-targeted and credible reforms can support the ongoing cyclical recovery. Fiscal policies should also support the economic recovery. However, full and consistent implementation of the Stability and Growth Pact over time and across countries remains crucial to ensure confidence in the fiscal framework and safeguard the sustainability of public debt. In particular, all euro area countries should strive for a more growth-friendly composition of fiscal policies, prioritising public investment and reducing the tax burden on labour.

A balanced three-pronged policy approach with a particular focus on structural reforms must be pursued with determination in order to lift long-term growth prospects, dispel feelings of economic insecurity and lay the foundations for a better and fairer life for citizens everywhere. A strong and sustainable recovery of the euro area economy is the best contribution we can make to promoting balanced and inclusive growth around the world. The ECB will continue to play its part by delivering on its mandate.