

Working together for growth in Europe

Introductory remarks by Mario Draghi, President of the ECB,

at Deutscher Bundestag, Berlin, 28 September 2016

Introduction

Mr Chairman,
Honourable Members of the Bundestag,
Ladies and gentlemen,

Thank you for your invitation. It is a pleasure to speak here in the halls of the Committee on the Affairs of the European Union, where you bring the debate about European integration to the Bundestag, the heart of German democracy.

As President of the ECB, I am here today to explain our policies and discuss with you how the ECB is acting to fulfil the mandate that was democratically conferred upon us by the Treaty. As members of the Bundestag, you know what the concerns of the German people are. I look forward to hearing about these concerns and addressing them today.

When I came to the Bundestag four years ago, we were at the height of the crisis. Today, the euro area is in better shape. To protect price stability, the ECB used its instruments in a manner it had not done before and developed new tools – all within our mandate. We reduced our interest rates to very low levels, provided targeted financing to support banks' lending to firms and households, and started a large-scale asset purchase programme.

In my introductory remarks I want to make three points.

First, I want to explain *why* we are pursuing our policies. I want to show how our monetary policy has maintained price stability and countered the threat of a new "Great Depression". Our measures are working: they are contributing to keeping the recovery on track, thus creating jobs and ensuring a recovery that ultimately also benefits savers and pensioners in Germany and the euro area as a whole. But I do understand that people have concerns. We take these concerns seriously.

I will therefore discuss in more detail – and this is my second point – *how* our measures affect people's finances and welfare. As with any monetary policy decision, our measures have distributional effects on citizens. But, on balance, savers, employees, entrepreneurs, pensioners and taxpayers across the euro area, including in Germany, are better off because of our actions – today and tomorrow.

Finally, I will talk about *what else* is needed. The ECB does not operate in a vacuum: other economic policies are essential to complement our monetary policy. Without them there will be no strong and sustainable recovery. These other policies are a precondition for interest rates to rise again.

The ECB's actions have safeguarded price stability

Let me start with the reasons for our actions. The ECB acted because inflation drifted away from our aim of below, but close to, 2% over the medium term.

The EU Treaties gave the ECB the primary objective of maintaining price stability in the euro area as a whole. This objective binds me and my colleagues in the ECB Governing Council, where our decisions are the result of collegial debate. We are held accountable for these decisions in the European Parliament, where I attend four regular hearings per year. Furthermore, our decisions are subject to judicial review. This is what I mean when I say: with our measures, we follow the law.

Sometimes people wonder whether price stability doesn't mean inflation of 0%. It does not, because both inflation that is too high and inflation that is too low for too long can damage the economy. A steady, measured rate of inflation below, but close to, 2% in the medium term acts like a cushion that protects our economies from drifting into the dangerous territory of negative inflation even when there is just a minor economic shock.^[1]

Once expectations of falling prices become ingrained, consumers postpone purchases in anticipation of even lower prices, while firms hold off making investments because they do not know whether they will pay off. This downward spiral continues until the economy collapses.

There are therefore very good reasons why central banks are so careful to avoid inflation that is either too high or too low. You would rightly expect us to act if inflation is significantly above our objective of price stability. We also need to act when inflation is close to 0%.

How do we achieve our price stability objective? When inflation is too high, central banks raise interest rates to break the upward trend; when inflation is too low, they lower interest rates to achieve the opposite. Lower interest rates ease overall financing conditions in the economy. This in turn stimulates investment and consumption, which then induces inflation to pick up.

But when lowering interest rates alone may not be sufficient to return to inflation rates that are in line with price stability, central banks may need to use other instruments to ease monetary and financial conditions. This is why we launched other measures, such as our asset purchase programmes. And we are by no means unique in this. Around the globe, central banks of the major advanced economies like the US, the UK and Japan have all embarked on large-scale sovereign bond purchase programmes to fulfil their mandate.

Our measures have delivered. We estimate that they will raise the inflation rate by more than half a percentage point, on average, over 2016 and 2017. They will also contribute to increasing real euro area GDP growth by more than one and a half percentage points cumulatively between 2015 and 2018, which will support job creation.

The effects of our policies

Low rates are a symptom of the underlying economic situation. They reflect weak long-term growth trends and the protracted macroeconomic slump that has resulted from the crisis. And the ECB's monetary policy has provided significant accommodation to limit the negative effects of the global and euro area-specific shocks on the economy, thereby mitigating their disinflationary impact. But very low rates are not innocuous. They affect people's finances and welfare. Let me start with the effects of our policies on savers. Yes, the current low interest rate environment reduces the nominal return on saving accounts. But what counts for savers is not the nominal interest rate but the real interest rate, which is the nominal interest rate minus inflation. Real rates are also low, but there have been many episodes of low, or even negative real interest rates in Germany well before the introduction of the euro, as a recent Bundesbank study has shown.^[2]

Moreover, savers can on average still earn satisfactory rates of return from diversifying their assets, even when interest rates on deposit and savings accounts are very low. This has also been the case in Germany according to another recent Bundesbank study.^[3]

But most importantly, whatever financial assets savers hold, they will benefit from a recovery of the economy. So the interest of all of us, including German savers, is the highest possible sustainable growth in Germany and the euro area.

Through our efforts to bring inflation back towards 2%, we have contributed to higher growth and the creation of more jobs. In Germany, exports are benefitting from the recovery in the euro area, unemployment is at its lowest level since reunification, people's take-home pay is increasing noticeably, and venture capital is pouring into Berlin's silicon alley.

We should also not forget that people in your constituencies are affected in different ways by our measures. They are affected as savers, borrowers or taxpayers, and in many cases as all three. What a household may lose in terms of little interest on their bank account, it might save in lower

mortgage payments for their home. And it might benefit from rising bond and stock prices in their retirement fund. In fact, evidence shows that between 2008 and 2015 interest *payments* by households in Germany, as a percentage of gross disposable income, fell more sharply than interest *earnings*.^[4]

And the low financing costs for government bonds help to balance the budget and reduce debt at a considerable speed. This is good news for the Finance Ministry - and thus for taxpayers - which saved in 2015 alone approximately EUR 28 billion on lower than expected interest payments.

We should also consider the full effect of low interest rates on banks. Those who blame ECB policy for the mixed performance of certain German financial firms have been very vocal. But what has been forgotten is that many banks have been able to more than offset declining interest revenues with higher lending volumes, improved loan performance and lower interest expenses, all of which are beneficial to both the banks and their customers.^[5]

The ECB's monetary policy is not the main factor for the low profitability of banks. While some banks' business models may indeed need to adapt to the current low interest rate environment, they also need to address their own structural issues, such as overcapacity, the stock of non-performing loans and the potential impact of technological innovation. Low profitability is closely linked to low operational efficiency. In Germany cost to income ratios are on average relatively high compared to other jurisdictions. Let us be clear, however, there is no one size fits all banking model and we have different types of banks that are successfully operating in Germany and in the euro area.

Of course, low interest rates for a long period might carry the risk of overvaluation in asset markets as a result of the search for yield. This is why we closely monitor potential risks to financial stability that might emanate for instance from local real estate markets. But at the moment we are not seeing any overheating in the euro area or the German economy as a whole. While we do observe a somewhat stronger increase in residential real estate prices, notably in large cities in Germany, such increases are not the reflection of a bubble, as lending is growing only moderately. Moreover, overall household debt-to-income levels are comparatively low and stable. Where signs of excessive risk-taking emerge, macroprudential measures at the national level should be the instrument of choice. They allow exuberant financial developments to be addressed in a more targeted way, while monetary policy contributes to the stability of the euro area as a whole.

So far I have discussed the reasons for our measures and their effects. To summarise, our policies allow the recovery to take hold so that we will be able to raise interest rates again. After all, the interest earnings that the savers understandably crave need to be generated first in the real economy. In a stagnant economy there is little to be shared out. It should also be noted that the level to which real interest rates can eventually return when the economy strengthens is not determined by monetary policy. Instead, it depends on the economy's *long-term* growth prospects. Productivity and demographics play a decisive role in this, and the development of these factors has not been favourable in Europe in recent years. This is a phenomenon we also see in Germany.

For long-term interest rates to rise in the future we therefore need more investment and structural reforms to lift growth and productivity. As Wolfgang Schäuble said in this house a couple of weeks ago when he presented the budget for 2017: we will only get out of this phase of low interest rates if we have more sustainable growth in Europe.

The need for decisive action at the national and European level

This leads me to my final point: policy-makers across the euro area, need to seize the opportunity to deliver reforms.

At the height of the crisis, all Member States and citizens showed an enormous commitment to keeping the euro area together when the critics were already talking about the euro's demise. But we cannot stop here: we need to make sure not only that the euro survives, but that our Economic and Monetary Union thrives.

If we want to succeed, we will need to find common solutions for the problems that we all face. If we want to preserve the European social model, we will need to bring labour and product markets in line with the realities of the digital and globalised world of the 21st century. If we want savers to benefit from higher interest rates in the future, we will need to create investment opportunities to put these savings to a productive use. This is about raising productivity and employment.^[6]

This is about structural reforms that are a necessary complement to our monetary policy. And Member States have to do their part. I have highlighted this many times in the past.^[7]

In fact, I emphasise it every six weeks at the ECB's press conference.

And where we face common supranational challenges, and currently there are several such challenges, there is no alternative to acting jointly as Europeans. Consider the transformative power of the deepening of the Single Market at the end of the 1980s. This opened up new opportunities and it continues to benefit European companies and individuals alike. Consider what can still be achieved with the Digital Single Market, the energy union and the capital markets union. Without a well-functioning Single Market, our firms would lose access to a market of 500 million consumers. Without a Single Market, we Europeans would have little global leverage to uphold our values, such as our respect for the right to privacy on the internet. Together we are immeasurably stronger.^[8]

Conclusion

Let me conclude.

The ECB is vigorously counteracting risks to price stability using all necessary tools within its mandate. Our monetary policy has supported growth and employment and will eventually bring inflation back to our aim of below, but close to, 2%. Low interest rates today are necessary for a return to higher interest rates in the future. What we need now is to allow our measures to develop their full impact. And in order to reap the full benefits of our monetary policy measures, other policy areas must contribute much more decisively, both at the national and at the European level.

Thank you for your attention. I look forward to your questions.

^[1]See Praet, P., “The ECB’s fight against low inflation: reason and consequences”, speech by Peter Praet, Member of the Executive Board of the ECB, at Luiss School of European Political Economy, Rome, 4 April 2016.

^[2]See Deutsche Bundesbank, “Nothing new about negative real interest rates on deposits”, 30 June 2014, https://www.bundesbank.de/Redaktion/EN/Topics/2014/2014_06_30_nothing_new_negative_interest_rates.html

^[3]See Deutsche Bundesbank, “German households’ saving and investment behaviour in light of the low interest rate environment”, Monthly Report October 2015

^[4]See ECB, “Low interest rates and households’ net interest income”, Box 3, Economic Bulletin, Issue 4/2016. And this is without taking into account the positive impact on households’ income and wealth of rising stock and bond prices as a result of lower interest rates.

^[5]See Cœuré, B., “Assessing the implications of negative interest rates”, speech at the Yale Financial Crisis Forum, Yale School of Management, New Haven, 28 July 2016.

^[6]See Cœuré, B., “Structural reforms on the way to a complete Economic and Monetary Union”, speech at the International Conference on Structural Reforms in Advanced Economies, Hertie School of Governance, Berlin, 17 June 2016.

^[7]See Draghi, M., “On the importance of policy alignment to fulfil our economic potential”, 5th Annual Tommaso Padoa-Schioppa Lecture at the Brussels Economic Forum 2016, Brussels, 9 June 2016.

^[8]See Draghi, M., “Reviving the spirit of De Gasperi: working together for an effective and inclusive Union”, speech at the presentation ceremony of the De Gasperi award, Trento, 13 September 2016