Hearing before the Plenary of the European Parliament on the occasion of the adoption of the Resolution on the ECB's 2010 Annual Report

Introductory statement by Mario Draghi, President of the ECB, Brussels, 1 December 2011

President,

Honourable members of the European Parliament,

I am delighted to be making my first appearance here as President of the European Central Bank (ECB) and I am honoured to present to you the ECB Annual Report for 2010.

Je souhaite tout d'abord rendre ici hommage à mon prédécesseur. Tout au long de son mandat, Jean-Claude Trichet a su entretenir un dialogue fructueux et constructif avec le Parlement européen. Dialogue que j'entends poursuivre avec tout autant de vigueur.

Die EZB ist sich ihrer großen Verantwortung als Hüterin der Geldwertstabilität bewusst. Die Unabhängigkeit der EZB ist und bleibt unverhandelbar.

Impegno, forte senso di responsabilità e corretta attuazione delle politiche sono condizioni essenziali della partecipazione all'Unione Economica e Monetaria.

Monetary policy decisions in 2010 and 2011

Today's session is an opportunity for us to take a wider perspective on ECB policies. In that way, I will also touch on a number of the broader themes of the Resolution of the European Parliament.

Let me begin with a few words on the main monetary policy decisions we have taken and the challenges we have faced during 2010 and 2011.

As you know, the ECB's monetary policy is constantly guided by the goal of maintaining price stability in the euro area over the medium term. And when I say this, I mean price stability in either direction. This applies to both the setting of official interest rates and the implementation of non-standard measures.

This autumn, tensions in financial markets have intensified again with very adverse effects on financing conditions and confidence. Downside risks to the economic outlook have increased. The weaker degree of activity is moderating price, cost and wage pressures. It is in this context that the ECB decided to reduce its key interest rates by 25 basis points in early November 2011.

Dysfunctional government bond markets in several euro area countries hamper the single monetary policy because the way this policy is transmitted to the real economy depends also on the conditions of the bond markets in the various countries. An impaired transmission mechanism for monetary policy has a damaging impact on the availability and price of credit to firms and households.

This is the very important monetary policy reason for the ECB's non-standard measures. But of course, such interventions can only be limited. Governments must – individually and collectively – restore their credibility vis-à-vis financial markets.

Tensions in sovereign bond markets have been accompanied by stress in the banking sector given the financial interlinkages between governments and banks. The ECB has taken several measures in 2010 and 2011 to ensure that banks continue to have access to funding sources. This has enabled them to continue lending to firms and households.

Most importantly, the ECB has extended its policy of fully allotting liquidity demanded by banks at fixed rates against collateral. The maximum maturity of these liquidity-providing operations was first extended to six months and later to 12 and 13 months. A new Covered Bond Purchase Programme has recently been initiated, with a size of 40 billion euros.

In addition, liquidity in US dollars has been offered to banks for three-month periods. Yesterday, in a globally coordinated action with the Federal Reserve, the Bank of Japan, the Bank of England, the Bank of Canada and the Swiss National Bank, we have agreed to lower the price on US dollar provision in other constituencies including the euro area. We have furthermore agreed, as a contingency measure, to establish temporary bilateral liquidity swap arrangements so that liquidity can be provided in each jurisdiction in any of the currencies, should market conditions so warrant.

As the ECB's Governing Council meets on Thursday next week, we are now in the pre-decision period, and nothing that I say should in any way be interpreted in terms of future monetary policy decisions. But as far as the current situation is concerned, there is not much more to say beyond what I have said in recent statements.

We are aware of the continuing difficulties for banks due to the stress on sovereign bonds, the tightness of funding markets and scarcity of eligible collateral in some financial segments. We are also aware of the problems of maturity mismatches on balance sheets, the challenges of raising levels of capital and the cyclical risks related to the downturn.

Challenges for Europe's Economic and Monetary Union

Let me now turn to the overall functioning of Europe's Economic and Monetary Union. Looking back at 2010 and 2011, notable progress has been achieved in reinforcing economic governance – though I recognise that this may not be evident in times of crisis.

The European Parliament has contributed decisively to that progress, and the ECB commends that work. The "six pack", the European Semester, the Euro Plus Pact: all these initiatives have set the stage for closer coordination and more intensive scrutiny of economic policies in the EU, particularly in the euro area.

Yet we are at a difficult stage at present. We have set up these new mechanisms, but their positive effects on the credibility of government fiscal policies are not yet visible. And the government changes that have taken place in some of the more exposed countries have not yet had much of an effect on the continuing fragility of financial markets.

Fundamental questions are being raised and they call for an answer. At the heart of these questions are not only the credibility of governments' policies and the actual delivery of the promised reforms, but also the overall design of our common fiscal governance.

I am confident the new surveillance framework will restore confidence over time. I am also quite sure that countries overall are on the right track. But a credible signal is needed to give ultimate assurance over the short term.

What I believe our economic and monetary union needs is a new fiscal compact – a fundamental restatement of the fiscal rules together with the mutual fiscal commitments that euro area governments have made.

Just as we effectively have a compact that describes the essence of monetary policy – an independent central bank with a single objective of maintaining price stability – so a fiscal compact would enshrine the essence of fiscal rules and the government commitments taken so far, and ensure that the latter become fully credible, individually and collectively.

We might be asked whether a new fiscal compact would be enough to stabilise markets and how a credible longer-term vision can be helpful in the short term. Our answer is that it is definitely the most important element to start restoring credibility.

Other elements might follow, but the sequencing matters. And it is first and foremost important to get a commonly shared fiscal compact right. Confidence works backwards: if there is an anchor in the long term, it is easier to maintain trust in the short term. After all, investors are themselves often taking decisions with a long time horizon, especially with regard to government bonds.

A new fiscal compact would be the most important signal from euro area governments for embarking on a path of comprehensive deepening of economic integration. It would also present a clear trajectory for the future evolution of the euro area, thus framing expectations.

On the precise legal process that brings about a move towards a genuine economic union, we should keep our options open. Far-reaching Treaty changes should not be discarded, but faster processes are also conceivable.

Whatever the approach, companies, markets and the citizens of Europe expect policy-makers to act decisively to resolve the crisis. It is time to adapt the euro area design with a set of institutions, rules and processes that is commensurate with the requirements of monetary union.

Thank you for your attention.