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COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
MONETARY DIALOGUE WITH MARIO DRAGHI,
PRESIDENT OF THE ECB
(pursuant to Article 284(3) of the FEU Treaty)
STRASBOURG,
MONDAY, 14 JULY 2014

1-002

IN THE CHAIR: ROBERTO GUALTIERI

(The hearing opened at 19.30)

1-003

Chair. – President Draghi, this is our first monetary dialogue for this new committee and we really welcome you. Thank you for being here. We are sure that our cooperation will be as fruitful as it has been in the previous parliamentary term. Two items in particular have been identified to be discussed in this dialogue. These are the strength of the euro and non-standard policy measures and development of the ECB balance sheet in comparison to the FED and Bank of England.

Colleagues, as you know, there will be an introductory statement by Mr Draghi for about 10 minutes, then the usual procedure of slots of speaking time of five minutes each, and then some final thoughts by President Draghi.

1-004

Mario Draghi, *President of the European Central Bank***. –** Mr Chair, allow me to start by congratulating you and all the honourable Members on their election to this House, and you, Mr Chair, on your appointment as chair of the committee in the new legislative period.

The architects of monetary union conceived the ECB as a central bank with a clear mandate and with strong provisions for its independence. But for a public institution in a democratic society, independence can never come without being commensurately transparent and accountable to the elected representatives of the people. The monetary dialogue is a key channel for the ECB to discharge its duty of central bank accountability; hence it plays an essential role in providing the ECB with the necessary legitimacy to fulfil the tasks assigned to it by the Treaties. To underscore our commitment to transparency, the ECB has recently decided to go a step further by publishing regular accounts of the monetary policy meetings of the Governing Council, which is intended to start in January next year.

It is in this spirit that I am looking forward to our exchange of views over the next five years. And, therefore, without further ado, let me go into the substance for today: first, I will share with you our assessment of the economic outlook for the euro area. Second, I will explain the package of policy measures we adopted at the beginning of June. Finally, I will briefly touch upon the challenges that await us in the next five years.

Let me start with the economic outlook: in the first quarter of 2014, euro area GDP grew by 0.2%. Growth was thus positive for the fourth quarter in a row. In line with earlier expectations, domestic demand has increasingly become the main source of growth. For the second quarter, monthly indicators have been more mixed; however, they partly reflect technical factors. Overall, looking through the usual volatility in monthly indicators, the ongoing moderate recovery is expected to continue.

Looking further ahead, domestic demand can be expected to continue to support growth – together with both the further monetary policy accommodation that was introduced in June and the ongoing improvement in financing conditions. The progress made in fiscal consolidation and structural reforms, as well as gains in real disposable income, is expected to provide positive impetus to growth over the next two years. Furthermore, demand for exports should benefit from the ongoing global recovery, and should thereby reinforce the growth momentum in the euro area.

Although labour markets have shown some signs of improvement, unemployment remains high in the euro area. Unutilised capacity continues to be sizeable. Moreover, credit growth to the private sector remains subdued, and the necessary adjustment of balance sheets in the public and private sectors will probably continue to dampen the pace of recovery.

The risks surrounding the economic outlook remain on the downside. Geopolitical risks, as well as developments in both emerging market economies and global financial markets, may have a negative effect on economic conditions in the euro area, through their impact on energy prices and global demand for euro area products. Further downside risks include an inadequate implementation of structural reforms in the Member States and weaker than expected domestic demand.

Looking at price developments, we see that euro area HICP inflation declined sharply from late 2011 to October last year, and has since been fluctuating around very low levels below 1%. According to the latest data (Eurostat's flash estimate), euro area annual HICP inflation stood at 0.5% in June 2014, unchanged since May.

Annual HICP inflation is expected to remain at low levels over the coming months, before increasing gradually in 2015 and 2016. At the same time, medium to long-term inflation expectations remain firmly anchored in line with price stability.

Upside and downside risks to the outlook for price developments are both seen as limited and broadly balanced over the medium term. We will monitor the possible repercussions of geopolitical risks and exchange rate developments closely in this context. The exchange rate is not a policy target for the ECB. Nevertheless, the exchange rate remains an important driver of future inflation in the euro area. Certainly, the appreciation that took place since mid-2012 had an impact on price stability. In the present context, an appreciated exchange rate is a risk to the sustainability of the recovery.

Let me now move to explaining our monetary policy stance.

We decided on a number of monetary policy measures in early June. These measures were aimed at providing additional monetary policy accommodation by supporting lending to the real economy. In line with our price stability mandate, these decisions are an essential contribution to bringing inflation rates closer to 2%. They will also contribute to a further strengthening of the recovery.

Specifically, we lowered all key interest rates further. Our main refinancing rate now stands at 0.15%. Accordingly, our deposit facility rate has been cut to a negative level and now stands at –0.10%.

Second, we will conduct targeted longer-term refinancing operations (TLTROs) as of September 2014. In these operations, banks will be entitled to borrow from the Eurosystem, conditional upon their lending to the private non-financial sector, with loans to households for house purchase being excluded.

In addition, we are intensifying our work in preparation of possible outright purchases in the market for asset-backed securities (ABSs).

Furthermore, we also decided that, at least until the end of 2016, we will continue to fully meet the demand of banks for liquidity in our refinancing operations – of course, against adequate collateral.

Finally, we have suspended the weekly operations to absorb the liquidity injected under the Securities Market Programme.

We took these decisions to enable our accommodative monetary policy stance to better feed through to the wider economy. Weak credit growth in the euro area, particularly to small businesses, has been a major headwind for the recovery. Indirectly, it has been a continuous drag on inflation over the recent past. In fact, despite significant reductions in policy interest rates and, overall, more contained macroeconomic risks, bank-intermediated credit growth remains subdued and lending rates for small businesses are well above the levels usually observed in similar phases of the business cycle.

To address this challenge, our TLTROs are tailored to incentivise bank lending to the real economy in the euro area. The TLTROs will provide long-term funding to participating banks. This should ease their financing costs, allowing banks to pass on such attractive conditions to their customers. This will ease credit conditions and stimulate credit creation. Moreover, the growth of our balance sheet as a result of a significant take-up in our TLTROs will put downward pressure on interest rates in the money markets. This will contribute further to lowering the banking sector's funding costs.

However, the TLTROs will not merely provide long-term funding. The TLTROs are targeted operations: the stronger the flows of new net lending to non-financial corporations and customers (relative to a specified benchmark), the higher the amount that banks will be permitted to borrow from the Eurosystem at very attractive terms and conditions over a period of up to four years. Hence, we have built in strong incentives for banks to expand their lending beyond original plans – both banks with a recent record of positive lending and those that have been deleveraging.

Overall, the measures adopted last month have already provided additional monetary policy accommodation. Even though substantial easing measures had already been priced in by markets before the Governing Council's June meeting, money market rates and bond yields declined further after the announcement of our decisions. Expectations with respect to short-term money market rates have come down some basis points from their already very low levels.

Looking forward, we will maintain a high degree of monetary policy accommodation. In view of the outlook for inflation, we will keep the key ECB interest rates at current levels for an extended period of time. Moreover, the ECB continues to stand ready to take action, if necessary, to further address risks of too prolonged a period of low inflation. This could also include the use of other unconventional instruments in line with our price stability mandate.

Let me now turn to the challenges that the euro area will face in the years to come. In the last legislative period, a great deal has been done to restore stability as a key prerequisite for economic dynamism. This has resulted in a return of confidence to the euro area. But high public and private debt, low growth and unacceptably high unemployment are reminding us that the most pressing matter now is to bring the euro area back onto a path of shared prosperity.

To achieve this, the focus in the next five years should lie on thoroughly implementing the reinforced policy framework that was agreed in the last term, and on further increasing the resilience of euro area countries' economies. For us at the ECB, this means assuming a new role in the banking union by supervising the euro area banks as from November. With the comprehensive assessment exercise that we are currently conducting, we

will contribute to putting euro area banks on a healthy footing, so as to enable them to provide financing to the real economy.

For euro area Member States, this means undertaking the necessary structural reforms to foster growth, and to avoid any new build-up of macroeconomic imbalances. It also means continuing fiscal consolidation to rebalance public finances in line with the rules underpinning the Stability and Growth Pact. The euro area policy framework was strengthened considerably by the agreement between this House and the Council on the six-pack and the two-pack. We should take great care not to roll back this important achievement, or to water down its implementation to an extent that it would no longer be seen as a credible framework.

Notwithstanding the significance of the reinforcements put in place for the policy framework, I believe that there is still room for further legislative action where the financial sector is concerned. In addition to a better performing banking sector, an increased role of capital markets could help to support both growth in Europe and the financing of the real economy. To fully reap the benefits of capital market integration, the regulatory environment needs to be harmonised further and, potentially, needs to be adapted. The joint paper of the ECB and the Bank of England on a better functioning securitisation market in the EU has set out a number of proposals in this regard.

Furthermore, a better regulation of financial benchmarks is necessary to restore the confidence and trust of citizens and market participants in the financial system. A swift adoption of the relevant Commission proposals is of utmost importance. Discussions will also continue on the shape and structure of our banking sector and the regulation of the shadow banking sector.

Finally, over and beyond this focus on concrete short and medium-term measures, we should bear in mind that economic and monetary union still remains an incomplete structure. Let us seize the opportunity of a new Parliament and a new Executive to reflect further on how to develop the architecture of our European monetary union in order to enhance its functioning.

In particular, I think there is a case for some form of common governance over structural reforms. This is because the outcome of structural reforms – a continuously high level of productivity and competitiveness – is not merely in a country's own interest. It is in the interest of the Union as a whole. For example, one could consider embedding the process of undertaking necessary structural reforms in a common framework of convergence towards policies and institutions aligned to best practices.

As EU institutions, the central bank and the Parliament of the European Union are duty bound to maintain a close and fruitful relationship of cooperation. I sincerely hope that in this respect, we can continue in the same spirit as we left off three months ago.

And now I am looking forward to hearing your questions.

1-005

Chair. – I think that this committee will try to contribute to the reflection on the future developments of the new architecture. We shall now start with a round of speakers from the political groups. We have five minutes for each question, including the answer and a possible follow-up if there is time.

1-006

Burkhard Balz (PPE). – Mr Draghi, it is good to have you back in the Committee on Economic and Monetary Affairs and to be continuing the monetary dialogue with you. I am very happy that we are going on with it in the new parliamentary term.

At the end of 2014, the Commission will be assessing the Stability and Growth Pact. The European Central Bank has already indicated its position through the media, warning that the Pact will forfeit its credibility if many Member States' governments advocate relaxing its terms or – worse still – making it even more flexible. Your colleague Benoît Cœuré has said, inter alia: 'Let us not make the same mistakes as in 2003.'

I should be interested to know how in your opinion, from the point of view of the President of the ECB, the path of structural reform and indeed of consolidation can be continued. It certainly cannot be in the interests of the European Central Bank to increase government borrowing in Europe by circuitous means – or to reinterpret government debt ratios, either.

As you have already mentioned structural reform, what is your assessment – perhaps you could go into this in somewhat greater depth – of the current state of structural reform within the European Union, which after all is ultimately intended to increase competitiveness, which is so important, particularly in certain Member States that are badly affected by the crisis.

The European Central Bank's policy of maintaining extremely low interest rates is unquestionably viewed critically in various Member States, where references are made to the expropriation of savers and holders of life insurance policies. On the other hand, booming property markets are of course also a sign of reallocation of assets. I should like to ask you today whether in this context the next speculative bubble is not perhaps being anticipated and accepted, with all the negative consequences that it would also have.

1-007

Mario Draghi, *President of the European Central Bank***. –** First, the view of the ECB as far as flexibility is concerned is that the present rules already contain enough flexibility. The second point is: under what circumstances could this flexibility, which is already in the rules, be utilised? Here it is quite clear that there should be a profound structural reform process in place, where one can actually quantify the budgetary impact that these reforms might have.

There is a good reason for having this approach. To think about flexibility as the only way countries have to restart growth is actually pretty limited. One grows out of debt through growth, not through spending, not through creating further debt. That is the key point. So: flexibility within existing rules, using structural reforms on the side.

As another way of saying this, the ECB has created this term of 'growth-friendly fiscal consolidation'. Growth-friendly fiscal consolidation means lower current government expenditure, especially where it is unproductive. Possibly, if there is room, higher government expenditure for infrastructures, but especially lower taxes; and all this can be done only if it is accompanied by structural reforms in the labour market and in the product market through increased competition and the completion of the single market, which stopped many years ago. That is the way in which the ECB views this.

It is quite clear – when we come to analyse the process whereby certain countries have undertaken structural reforms and in fact achieved significant progress on this, while other countries have not, and we look at the reality of the last five years – that the countries that have done most were all in a very serious financial situation.

So we should ask ourselves: is this the best way to go, to wait for a financial crisis before we can act? And the answer is probably that there is a better way; after all, the present recession is one of the outcomes of this financial crisis which started four or five years ago, so there must be a better way. A better way to go is the one I suggested, of subjecting the structural reforms area to a discipline which is a Community discipline, a Union discipline, that is not very dissimilar to what we already have in place for the budgetary area. I did not want to go beyond that, because this is very much up to you legislators and to the Commission and to the countries.

1-008
Elisa Ferreira (S&D). – Thank you very much for being here with us again today. Banking union was and is an essential element in strengthening the euro and stabilising the eurozone, and it is on this subject that I would like to put a question to you.

We have a European bank resolution fund and a bail-in system that will come into operation on 1 January 2016. Within three or four months we will have European Central Bank supervision of systemic banks in the eurozone. We have an asset quality review currently underway.

My question concerns the hypothetical scenario where banks run into trouble in the intervening period between the current system and the entry into force of all these new systems. I would like to raise the following issues in particular: is the European Central Bank monitoring the action taken by national supervisors in the national central banks in relation to the systemic banks? What guarantees do taxpayers have that they will not be the ones to pick up the bill yet again, directly or indirectly, for losses incurred by banks that run into trouble in this period? Bearing in mind persisting asymmetries between the various legal frameworks, is there or is there not a risk that more fragile countries, in particular countries emerging from adjustment programmes, will have to enforce bail-ins for such banks, while stronger countries will apply bail-outs? Would it be realistic to expect that, if recapitalisation is required, the ESM will create the necessary framework for this to happen? Finally, is the ECB capable of acting promptly and quickly enough to tackle any problems that arise?

1-009
Mario Draghi, *President of the European Central Bank***. –** Well, the answer to the last question is yes. The ECB will deal with any problem that arises between now and when the system is fully operational, which means the beginning of next year, and the SRM will be fully operational only a year after that.

Let me come to the point of your specific question: what if a bank runs into trouble now or in the next four or five months? This problem is not very different from the problem we might have once we have completed the asset quality review and the comprehensive assessment, and we may well find that some banks are not complying, either with the minimum regulatory requirements in the asset quality review or under stress scenarios. In this case there is an absolutely level playing field; there is no distinction between large and small countries.

We have in place the state aid rules, and so in this sense the banks will have first to exhaust all the private sector sources of capital. They will issue equity, they will sell assets and then they will gradually bail in creditors according to the list prepared by the state aid rules. Only after they have exhausted that list could they use public money. So public money could be used, but again according to the prevailing rules in place now. That is why it is so important – and we have been urging those countries that have not done so yet to do it as quickly as possible – that countries put in place resolution legislation so that they can actually deal with these cases. Such cases may or may not happen, but it is important to have in place the legislative framework for dealing with these cases in compliance with Community rules.

So far we have a mixed record of compliance with countries, some of which have put in place this legislation while others are working on it, but we definitely wish and are acting so as to have all countries with their resolution legislation in place before the year end.

1-010
Elisa Ferreira (S&D). – Could the ESM somehow anticipate the role of the future resolution fund?

1-011
Mario Draghi, *President of the European Central Bank***. –** The ESM cannot participate through direct

recapitalisation of banks according to the agreement that has been made. However, if there are countries that do not have room in their budget to access the means to be used in a public recapitalisation process, in principle – obviously it is subject to the ESM Treaty clauses and so on – they could have access to the ESM resources that would finance their budgets so that the banks could be recapitalised.

1-012

Bernd Lucke (ECR). – Mr Draghi, I should like to begin by asking you a question about the introduction of the euro in Lithuania. We have just adopted Mr Langen's report on the subject, in which it was noted that the convergence criteria were fulfilled. However, the fact is that, as regards the price stability criterion, there are serious reservations. The rate of inflation in Lithuania in 2008 was still in double figures. Since then it has fallen very rapidly, almost taking the country to the brink of deflation.

The ECB expects inflation to increase in Lithuania during the next year and then observes in its own Convergence Report: 'Given the lack of nominal exchange rate flexibility after the introduction of the euro and the only limited availability of alternative counter-cyclical policy instruments, it may be difficult to prevent new macroeconomic imbalances, including high rates of inflation.' If that is the ECB's assessment, Mr Draghi, can you tell me this? What economic benefit will Lithuania derive from adopting the euro in comparison with the current situation, in which Lithuania has a fixed euro exchange rate set by a currency board, and indeed a rate that is established in a very credible manner? I am not talking about the legal aspects now, the fact that the European Treaties regard accession to the eurozone as more or less automatic, but I would simply be interested to know what economic benefits are anticipated from Lithuania's adoption of the euro, that is, the economic benefit to be derived from surrendering monetary sovereignty.

My second question concerns the problem of low interest rates, which has already been raised in a previous question. As you know, in many countries, including Germany, they are causing the problem that some real interest rates are negative, particularly in the field of secure property investment, that insurance companies which offer old age pension schemes are in some cases no longer able to earn, over a protracted period, revenue equivalent to the interest rate which they have guaranteed to investors. You know that capital-funded pension schemes are very important in Germany because pay-as-you-go pension schemes have suffered badly as a result of demographic problems. What can the ECB do to tackle this problem if at the same time it is required to combat dangerous deflationary trends in other eurozone countries, such as Greece and Cyprus?

1-013

Mario Draghi, *President of the European Central Bank***. –** On the first question, we have looked at the experience of the Lithuanian economy over the last few years and one thing is clear: Lithuania has gone through a very impressive and significant adjustment. The Lithuanians have taken care of many imbalances which were present until a few years ago. However, it is also an economy which is subject to extreme variability – by the way let me also state that Lithuania has complied with all the convergence criteria foreseen by the Maastricht Treaty – so the assessment of the ECB is also looking forwards and is actually saying that the sustainability of a low, adequate inflation rate within the objective of the ECB may be a challenge, and Lithuania and Lithuanian economic policy will have to be extremely careful about this.

How would one deal with problems of this kind, given that monetary policy is for the whole of the euro area and not specifically geared to an objective of price stability in one specific country? Well, clearly the use of macro-prudential instruments will be key in countries like this or in situations similar to Lithuania's.

What is the benefit of joining the currency versus being in a currency board? Well, one benefit – and we have seen how important this is – is that this choice is irreversible, while currency boards are not irreversible. The second, much greater benefit, is that in doing this Lithuania will be sharing in all the monetary policy decisions. This is an example of a situation I refer to very often: in some areas, and mostly in economics, shared sovereignty is the only way to retain sovereignty, and that is what the Lithuanians have understood very well.

On the point of low interest rates – and I would firstly like to apologise because I did not answer this question when I was asked it before, so I will take two extra minutes – we are looking with great attention at this and we take these concerns very seriously. Let us ask, however, whether we should change our monetary policy stance because of this? The monetary policy stance is dictated by the fact that we have a mandate, and the mandate is to keep price stability for the whole of the euro area. So we cannot really change that.

We know, however, that as the recovery gains momentum, interest rates will go back up again. But let me ask something else: how responsible is monetary policy for the low interest rates in Germany? That is where one has to be careful, because the correlation between short-term policy rates and the interest rates that are really important for savers has not been as strong in the last two or three years as it used to be before the crisis.

Let me also make a final point: the low rates, especially for the insurance companies, are a consequence of the fragmentation that has hit the euro area after the crisis. In other words, the insurance companies have nationalised all their liabilities and assets so that they are now investing in German assets against German liabilities and so on. Before the crisis, they were investing in baskets of assets and securities in the whole of the euro area and they were getting naturally higher returns. Again, as we repair fragmentation, the situation will certainly improve there as well. As I said, we are taking these concerns seriously and we are not pushing

them under carpet, and one should be aware that the more we repair the general economic situation of the euro area, the more these concerns will be addressed.

1-014
Sylvie Goulard (ALDE). – Mr President, thank you for coming to see us again. We were worrying that we might not be back but, if I have properly understood the newspapers in the last few days, there were also worries that you would be leaving us. I hope that these rumours are totally unfounded because we need you at the head of a strong and committed central bank.

I see that we have come back to be immediately launched into very interesting but extremely technical questions that are far removed from what we were hearing during the election campaign. That is why I should like to bring you back to what is perhaps rather different ground.

Last week in London, on 9 July, you gave what I consider to be an extremely important speech in which – if I have understood correctly – you invited the Member States not only to mutually control their deficits but to commit to much more structured and much more binding economic policy and structural reform procedures.

Could you tell us a bit more about this? Have you tested this idea with the capitals or Mr Juncker, the prospective next President of the Commission? What do you think of Mr Juncker's proposals on external representation of the euro area? We will of course continue to take all the technical measures on which we have worked in recent years; they are of prime importance. But I think we will have completely wasted our time if we are not able to restore the belief among Europeans that the euro does bring prosperity and, within this very restrictive framework, incentives to move forward..

1-015
Mario Draghi, *President of the European Central Bank***. –** Let me say thank you for the trust. Let me add that I am at the ECB and I will stay at the ECB. All the rumours to the contrary, coming from some interested parties perhaps, are unfounded.

The point you make is the key point because most, if not all, the questions that I have received so far have in their background the assumption that we will be able to return to take the euro back to an area of prosperity and of job creation. I think that is the main challenge. How do we go about that? I said before that the idea of spending our way out of the crisis is not a viable one. One of the reasons why we have the crisis is debt – because of the huge amount of debt both in the public and the private sector – and so I think to create further debt to get out of the crisis would not be the right way to go. It is a mixture of things: lower taxes, lower unproductive expenditure but, most importantly, structural reforms.

I am aware of insisting on this each and every time we speak about the situation of the euro area economy, but it is actually true that we have seen from the experience of the countries that were in the programme that they are the ones who I would say are starting to see the first benefits in their markets from the undertaking of their reforms. I think it is important for the other countries to sit down and think deeply about how to move fast and change profoundly their economies. I think that is the combination of things and the monetary policy accommodation of course is quite significant and will continue to accompany this situation while the crisis lasts and while price stability is under discussion.

1-016
Sylvie Goulard (ALDE). – Have you tested your ideas with the next President of the Commission and the capitals? You did not answer on that.

1-017
Mario Draghi, *President of the European Central Bank***. –** Sorry, no not yet. We have not yet discussed this and we will certainly do so as soon as it has been voted by the European Parliament.

1-018
Fabio De Masi (GUE/NGL). – Good evening, Mr Draghi. You mentioned earlier that the ECB had taken various measures to provide liquidity for the banking sector: it has extended time limits, it has announced that it will if necessary buy up unlimited quantities of government bonds from banks and investors through the OMT if they accept austerity and – as I see it – depression. But obviously that has not stimulated lending in the eurozone. And lending is of course the key to reviving investment and thus also overcoming the scourge of youth unemployment in the countries which have been in crisis. In the light of this, I should like to ask whether possibly – because naturally there are reasons why businesses do not invest despite low interest rates, there are reasons why banks also ration credit – you therefore perceive austerity policies as adversely affecting the efficiency of monetary policy.

I should also like to ask whether you perceive a risk of new property price bubbles and whether at the ECB you have ever discussed such approaches as asset-based reserve requirements in order to pursue a kind of credit management. And I should like to ask you to what extent you have taken note of the assessment by the Bruges Thinktank that, even with TLO, loopholes may possibly exist, for example if banks repay loans two years prematurely in order then to invest in more remunerative government bonds again.

I should then like to conclude by asking you to what extent the ECB would be in favour of banks being compelled to pay contributions under the terms of the Banking Union in line with systemic risks, because that would be commensurate with the risk and revenue.

1-019
Mario Draghi, *President of the European Central Bank***. –** The question is really: is our monetary policy creating bubbles since it is so expansionary and will stay so for a long time?

Let me immediately say that we are extremely attentive to this possibility; so much so that in the recent decisions about the TLTROs we have excluded bank operations that would finance the housing sector, more specifically real estate mortgages, because that is precisely one of the areas where we do not see a bubble yet but we do see some, let us say, 'frothy' market conditions: i.e. fast appreciation of the asset values in some parts of the euro area.

By the way, this is neither a local bubble yet, nor in any way a situation which extends to the whole of the euro area. We still have parts of the euro area where we do not observe any movement at all in property prices. But I was just making this point to show how attentive we are to these risks.

The other question that we should ask ourselves concerns these narrow spreads – because simply looking at the financial market conditions there is no question but that we are observing now what people call 'search for yield' investments. In other words, for example, a big movement from bonds to high yield bonds, from investment grade to high yield bonds, a narrowing of the spreads, a very significant narrowing of the spreads, mindful of the situation of the pre-crisis situation.

But then the question we should ask is: are these situations of very low volatility and very narrow risk spreads accompanied by an increasing level of leverage, by increasing debt with respect to assets? Because it was the combination of these two which was actually at the root of the financial crisis: a high and misperceived level of leverage combined with mispricing of risk and of volatility. We do not have great evidence of this increase in leverage. If we look at both the financial and the non-financial private sectors we do not have evidence of an increase in the level of leverage. If anything leverage has been going down. Now there are different measures here but basically all of them point to a decrease in the level of leverage.

So far we do not see a situation of systemic bubbles, but having said that there are two questions: the first is what would we do if we were to see these bubbles? Would we change monetary policy and raise interest rates for example? The answer is clearly no. We think that our monetary policy stance is appropriate for the current situation of price stability in the euro area. So the answer is that the first and the last lines of defence are macro-prudential instruments against bubbles and that is why the work that the ECB is doing together with the Supervisory Board, is actually so important.

Finally, let me say one more word about leverage. Credit flows remain – I would use the word 'subdued' – weak, and very low throughout all the euro area; both in the stressed and the non-stressed countries but especially so of course in the stressed countries. We do not have the general conditions that accompany the creation of systemic bubbles.

1-020
Ernest Urtasun (Verts/ALE). – Mr Draghi, welcome and thank you for coming here today.

The decision to postpone once again the implementation of a wide-scale asset purchase programme or quantitative easing (QE) among the decisions you presented on 5 June came as a surprise. During your hearing you did, however, leave open the possibility of launching such a programme – I quote your words – 'if necessary' and making use of future quantitative easing measures.

Last week, however, we read ECB Executive Board Member Lautenschläger say the exact opposite in a recent interview in the *Frankfurter Allgemeine Zeitung* in which she states that she would be the first to ask for an increase in interest rates and a reduction in liquidity, as soon as this could be justified.

My first question – while I am obviously not asking you to give me advance notice of your monetary policy decisions – is if you can confirm what you said on 5 June to the effect that the QE is still on the table and that interest rates will, as you said, remain at their current low level for an extended period of time. I would also like to know whether or not the decision to rule out QE at the moment is directly related to the German Federal Constitutional Court proceedings relating to OMTs.

My second question – very quickly – concerns the fact that in all your appearances before us and your assessments we keep hearing you give instructions on structural reforms both in the fields of taxation and the labour market. You did it again the other day at your hearing, and you have repeatedly done it here today. In my opinion, Mr Draghi, following the unfortunate episode of the letter sent by your predecessor, Mr Trichet, to the then Spanish Prime Minister Zapatero giving orders on labour market and taxation reforms, it would seem high time to me that the European Central Bank refrain from linking its monetary policy decisions to individual reforms in its public statements.

You have done this again today on several occasions, in which context I would like you to make it clear to me if ECB action on strengthening reforms is also lurking behind these statements, and more specifically – to get to my question – whether you have at any point made funding for a commercial bank in any eurozone country conditional on the completion of structural reforms.

1-021
Mario Draghi, *President of the European Central Bank***.** **–** You have actually asked several questions. I will try to answer all of them.

First of all, on whether or not we will be adopting quantitative easing (QE), the stance of the Governing Council, published in the introductory statement – I believe for the first time in May – and then reiterated in June and July, is that it is unanimous on using also unconventional measures to address the risk of a too-prolonged period of low inflation. That is the stance of the Governing Council and that is what defines its monetary policy.

The second point is an implication of this. Yes: interest rates will stay low at the present level – and again this is in the introductory statement – for an extended period of time.

Thirdly, as to QE, no: the answer is purely for monetary policy reasons. QE falls squarely within our mandate because you should remember that we have price stability as a mandate. So this instrument, if utilised for that purpose, falls within our mandate.

Your final question was: why should a central bank talk about labour markets, product markets, taxation and so on? The reason is that these aspects of the economy are fundamental to the transmission of our monetary policy. Let me give an example which is relevant in the light of our latest monetary policy measures. With the targeted long-term refinancing operations (TLTROs), we are going to make funding for the banks very attractive, with very low rates for up to four years. So, in principle, banks should lend more but, at the same time, if on the demand side it takes nine months to a year for a young entrepreneur to open a new business, and once it is open, before he has even started to work, he is already overtaxed, how much credit do you think he is going to ask us for? That is why we are talking about these aspects because if the structural conditions are not in place our monetary policy effectiveness is at stake.

1-022
Steven Woolfe (EFDD). – Mr Draghi, thank you for attending this monetary dialogue meeting of the newly-constituted Committee on Economic and Monetary Affairs, with the new Members who will be reviewing and challenging your views over the next five years.

At the European Central Bank Conference of 5 June you did indeed announce the targeted long-term refinancing operations (TLTROs), and you said then as you did today that they were aimed at improving bank lending to the euro real businesses, i.e. to the non-financial private sector. On 3 June of this year the ECB announced the modalities of the TLTROs. In the regulation, there appear to be no obligations on any bank to lend to any small or medium-sized business. In fact, as you stated a moment ago, the funding is very attractive for the banks. In Italy, as my colleagues have noted, millions have already been made on trading long-term refinancing operations (LTROs) and surely millions will be made again on trading TLTROs. During the crisis the LTROs simply traded private bank debt and made it public debt. The liabilities of the ECB have grown extraordinarily.

At a time of crisis, is the failure to set out definable steps in the modalities of bank lending to small and medium-sized businesses not simply an additional gift to private banks – aiding their balance sheets, focusing far too much on the markets and not on real people, and ensuring continued suffering for the poor, the dispossessed and the unemployed throughout Europe, while leaving a potential liability disaster for future generations? You are effectively permitting banks to leverage off the ECB's balance sheet, not in the financial markets. TLTROs are simply the credit default swap of the future. They reflect the eurozone's inability to stave off crisis today, and the modalities do not force banks to lend to small businesses and the real economies.

On a separate matter, did you really just say that the only way to get out of debt is by growth? Is there no other way?

1-023
Mario Draghi, *President of the European Central Bank***. –** Let me just say from the outset that I would not agree with two of your points immediately. One is that the liabilities of the ECB balance sheet have increased enormously: they did and now they have shrunk down. The ECB is the only central bank in the world whose balance sheet has been going down. If you compare it with the Bank of England, if you compare it with the FED, if you compare it with the Bank of Japan, theirs have been expanding, ours has been shrinking and it is by and large what it was at the end of 2011.

The second point: well I am not sure – but that is a qualitative judgment – I am not sure that these TLTROs are actually a potential disaster for future generations but this is a matter of emphasis here. However, you have a point: the first LTROs were used to carry trades, namely money, buying bonds and getting financing cheaply from the ECB. That was an unwanted consequence. At the same time the situation for the banking system at that time was such that it did require the LTROs to be done.

The general assessment of the situation in the last months of 2011/first months of 2012, was that we were very close to a systemic banking crisis because there was a hump in bond redemptions which had 300 billion plus from the governments and 200 billion or more from the banking sector, and it was quite clear that many banks were not able to cope with this; either not able to cope at all or they were only able to cope with this with a wild credit crunch. So we avoided a systemic bank collapse and I think it was the right thing to do at the time. The banks actually bought government bonds.

First of all, the general situation, the market situation, is such that these carry trades are going to be much less profitable than they were in the early months of 2012. The reason is that in the meantime, thanks again to the ECB OMT plan, interest rates for ongoing bonds have gone down far more than they would have done if we had used QE – far more – so the convenience of using ECB cheap money to buy government bonds is much less.

This convenience is also much less on the two-year term maturity. So if a bank which has not much convenience to buy bonds does so in the first two years, it will have to return the money. That is the other clause we have in our TLTROs. If banks do not lend to the private sector, to the non-financial private sector, they will have to repay. That is very different from what we had in the early months of 2012.

1-024

Danuta Maria Hübner (PPE). – President Draghi, I would like to go back to the issue of the relationship between the macro-prudential instruments that you have mentioned and monetary policy. I understand that monetary policy with a zero interest rate for such a long time must, by definition, generate some imbalances, and that to curb them you had the macro-prudential rules, but for how long do you think you can carry on with the divergence between a monetary policy of this type and action to address the challenges of that policy through the macro-prudential rules? Do you not think that the moment might come when responsibility for preventing an asset price bubble will have to shift to the interest rate itself? Do you think you still have a big margin for carrying on with these two diverging policies?

Secondly, my understanding of the asset quality review and this comprehensive stress test is that the banks will be kept in uncertainty until the last moment, until the results are revealed, and only then will they know how much capital they will need for recapitalisation. There is a risk that if all the banks – and I do not know how many have told you that they will face such a challenge – need to raise capital more or less at the same time, this could cause huge congestion in the equity markets. The banks might have problems recapitalising in a relatively short time span and at reasonable cost. Can this challenge be addressed somehow?

Could you also say something more about shadow banking because I think the macro-prudential rules are pushing a lot of financial activity into the shadow banking sector? How serious is this question for you? Do you have any mapping of the shadow banking sector? Perhaps you could make just a short comment on this.

1-025

Mario Draghi, *President of the European Central Bank***. –** In most situations, monetary policy and macro-prudential tools are not in conflict. They should actually reinforce each other. When monetary policy pursues price stability this helps financial stability and the pursuing of financial stability in turn helps price stability as an objective, as we are seeing today. One of the effects of the crisis was in the end to bring price stability into question too. The two are actually strengthening each other.

So basically we have to make sure that we have a working operational framework in place where the two aspects – monetary policy and macro-prudential policy, and I would add micro-prudential policy as well – will integrate each with the other and there is a flow of information which goes between these different parts of the monetary policy decision-making.

I ought to say that the ECB has actually done a lot of work on precisely this point and has established the Financial Stability Committee which will look at macro-prudential policies. But it will meet also in SSM composition. So with the representatives of the supervisory bodies it has to integrate the micro, the macro and the monetary policy decisions.

On recapitalisation: well, I do not know what will happen once the asset quality review of the comprehensive assessments results is known. However a very encouraging fact has been taking place – since we announced the asset quality review I would say, so that is almost seven or eight months now. Banks have really approached capital markets and raised a significant amount of capital already from the markets. So that is encouraging. Having said that, I frankly cannot anticipate what the results will be or what the recapitalisation needs will be following the results.

But the banks will have six to nine months' time to comply and raise capital depending on whether the assessment of recapitalisation needs is based on the asset quality assessment, the asset quality review assessment, or on the stress test scenario. So there is a certain amount of time to do this.

The last question concerned shadow banking. I do not have the numbers here; the shadow banking system is very significant in the euro area and there is no doubt that many activities are moving now from the regulated to the non-regulated sector, so in this sense we certainly welcome very much the work the Commission is doing on this. It is not easy, as you can imagine, because even to redesign the parameters of shadow banking, to include all those institutions which are providing credit in one way or another – so you restrict to only credit provision – and to have a regulation similar to what we have for the banking system is not an easy task but I understand the Commission is actually doing very good work on this.

1-026

Peter Simon (S&D). – Mr President, if I may, I too should like to say something about the structural reforms to which you have referred several times, starting with your speech in London on 9 July. I would be interested to know how compatible you see your ideas as being with the proposals which the Commission made in 2012 under the title 'Convergence and Competitiveness Instrument', or alternatively how different they are. On that occasion you suggested that Member States should enter into contractual agreements with the Commission on implementing reforms, in order to make recommendations more binding, particularly in the context of the European Semester. How do you see your ideas in relation to these ideas which the Commission put forward at that time?

My second question concerning structural reforms is this: you have made it clear that, for you, structural reforms are the be-all and end-all, as opposed to a higher tolerance threshold for indebtedness. Is not the concern in our discussion far rather that, although we all agree that at the end of the day both a lower rate of new borrowing and lower total borrowing by states will be needed, the issue is one of timing: how are we to get there? Do you not think that many structural reforms – if we consider the timing aspect – might make it seem worthwhile to exercise a certain degree of flexibility here in order to be able to achieve our common goal at all? We are not acting in a vacuum here: we are acting in

a political forum where decisions taken in the Member States need to have the support of the majority of the people.

I should like to draw an analogy with something that you said earlier: you said that in individual cases it may be necessary to partially surrender sovereignty in order to maintain sovereignty. Do you not think, conversely, here too, that in individual cases strict, precise rules need to be supplemented by an element of flexibility in order to be able to maintain strict, precise rules overall?

1-027
Mario Draghi, *President of the European Central Bank***.** **–** Let me just make a few comments addressing the specific points you raised: the reflections and thoughts about how to design or redesign the governance of the structural reform process at the Union level or at a euro area level could well fit into one of the frameworks that the Commission has presented and put forward. For example, the country-specific recommendations would be a starting point to move along this path, and I think that would be one possibility. But in a sense, the ECB wants to stop for a moment before telling other people what to do because, as someone reminded me before, we must be extremely careful about what we say, and about whether or not we are stepping outside of our mandate. There is a clear need for structural reforms, but with regard to how to design this governance process, the ECB is there to advise but is certainly not the primary actor at all.

As regards the time needed for structural reforms, there is a common view that structural reforms are slow in yielding fruit, that it takes time for structural reforms to yield benefits. In fact, the experience we have from the crisis, in the countries that have actually undertaken these structural reforms, was that it was not that slow. Especially in the labour market, we saw improvements in a much shorter time span then people had thought. The same thing will certainly happen with the completion of the single market. If we move into fields like education or the reform of the judiciary, there the reforms will probably be slower to yield fruit, but this is only true for certain reforms and is not true for others.

On the point concerning the need for flexibility to accompany stricter rules, I am very cautious about entering into this area because it is one of political judgment, so it is not my area. I would tend to say the opposite. I would say that if there is a rule then it has to be complied with, and if it contains some flexibility, as the present rules indeed do, then that flexibility should be well defined and very carefully implemented. I am not sure I understand – though this is perhaps because of my lack of political skills – the chemistry whereby flexibility is essential for making a rule credible.

1-028
Bernard Monot (NI). – Mr President, as a euro-realist, I think in the light of the social and economic results that the debate is no longer so much about how to save the euro as the single currency but whether it should not be turned into a common currency instead.

Thus I believe that there is a need for reflection on the development of the ECB's remit in support of jobs and economic growth, within the framework of a genuine constructive dialogue. At the same time, I also note that the ECB is no longer really carrying out a monetary policy because its deposit facility rates are now negative.

So, in line with your present remit, I have two main questions today. Firstly, do you not think that the European Systemic Risk Committee, which is responsible for macro-prudential policy, should bring together the Member States rather than the central banks? Next, do you not think that banking supervision should be placed under the aegis of the European Banking Authority and not the ECB, as was suggested in the European Court of Auditors' report published on 2 July?

1-029
Mario Draghi, *President of the European Central Bank* **–** On the Systemic Risk Board (SRB), you know that there is a review of experience with the SRB under way, and the European Central Bank has been asked to produce an opinion about the SRB, which it will do before September or October. Anyway, we are looking at the SRB experience, which we tend to judge as a success although, of course, we – and me in particular – are biased observers. The Commission is currently driving this process of review of the SRB.

As to whether the board should include representatives of the Member States or the central banks: first of all, it does not have the central banks only, it has the central banks and the supervisors. Now, I am not sure that in most countries the state – and I take it you mean the Finance Ministry – actually has direct competence for supervision, so, for the management of macro-prudential risks at least, I think that the combination of central banks, supervisors and market authorities is plenty for the scope of activities of the SRB. However, as I said, the whole process is under review, and I believe the report will come out before the end of next year. In any case, it is in the hands of the Commission.

The other point you made was about whether bank supervision should be moved from the ECB to the European Banking Authority or another institution. This is a question that has been raised several times since the creation of the Single Supervisory Mechanism. My sense is that we are creating a new institution, and I do not think it would be good to say to the people who are working for this purpose: 'Look, in one year's time you will be elsewhere.' We currently have the objective of creating this institution. It is a highly complex effort. More than 500 people are going to be hired in Frankfurt. About 500 people have already been hired. There are 6 000 people now involved, including supervisors, accountants and consulting firms throughout the euro area, inspecting the banks on the comprehensive assessment list. So it is a gigantic effort and I do not think it is the right time to speculate about where this institution might be in the long term.

Finally, on the same point, any change of location would appear to require a Treaty change so, from the point of view of legal practicality too, it may be difficult.

1-030
Alain Lamassoure (PPE). – Mr President, I have two questions.

First, to put things extremely simply, after the financial crisis triggered by the collapse of Lehman Brothers, states – through the taxpayers or public debt – took on the private debt of certain financial operators and investors, particularly mortgage investors. Do we not have a situation today in which sovereign debt has reached such a level that it has a crowding-out effect on existing or future corporate debt? That is my first question.

Second question: we can see that public and private investment is at a very low level. You told us just now that leverage was fairly low and that therefore in general there is no risk today of excessive private sector debt. Nevertheless, there are countries, sectors and companies that have reached their borrowing limits and which can thus invest only if they receive a capital injection. Do you have the feeling that these injections will happen automatically on the financial markets that are taking over from the traditional lending channels or are new mechanisms on another scale necessary?

1-031
Mario Draghi, *President of the European Central Bank* **–** Let me say exactly what I meant when I expressed myself on leverage. First, sovereign debt has been going up, not down. Private sector debt – households, non-financial sector and financial sector – with respect to GDP, has been going down. However, it has been going down with respect to 2009/2010, but it is still higher than it was in 2007.

We have to be careful about which measures we use on that because this is usually true if we use debt relative to GDP. But if we were to use debt relative to assets or book values or other measures we would get different conclusions. The key point, however, is that leverage for the private sector, where it was relevant to what I was saying before, has not been going up. I was referring to the combination of leverage with low price of risk and low volatility. The two of them could be a signal that bubbles are being created if they go together – an increasing level of leverage for the private sector and very low levels of volatility and risk premium – and we do not have that now if we look at 2010.

However, as you said, the situation remains fragile because the levels of debt are higher than they were in 2007 when they were, as we know, already very high because this was just before the crisis. Part of the reason why the recovery is proceeding so weakly is also due to the fact that companies and the private sector – I have to be very careful because this is not true for all countries, the situation is actually highly different and fragmented across countries – but in some countries the level of private investment is, as you said, very low because households and private sector companies are still deleveraging.

But there is one other reason why investment is so low in spite of the fact that confidence on the markets has returned, if we compare the present situation with what it was in July 2012. The reason is that investments are not being made because the return on investments is too low. It is low because the prospects for aggregate demand are weak, and because the companies' pricing power has not returned yet.

Now one of the reasons, and here again, is that there is not enough competition, there is not enough private sector interest in investment. I am not saying that there is only one universal truth and that is that the structural reforms have to be undertaken, but I think that a substantial part of the explanation has to do with this.

1-032
Renato Soru (S&D). – President Draghi, in one of your replies you said that one of our challenges for the near future is to ensure that the monetary union goes back to being an area of widespread prosperity and job creation.

In your report, however, you pointed out how this is not happening. New jobs are scarce, more or less all over Europe, and I come from an area in which the situation is far worse: not only can not the slightest growth be detected, but the level of employment is even continuing to fall. And among the various countries of this euro area, employment level differentials continue to grow, rather than to converge.

Tonight you mentioned that one of the threats the euro is facing and will continue to face in the near future is this growing unemployment. It is becoming a threat that is perhaps even greater than that of financial instability, the instability of the labour market. What you have explained to us is all very important – the TLTROs that are to be introduced next autumn and all the monetary policies that have been mentioned, which aim to increase employment levels. You, however, reminded us today – and you had already made an interesting speech about this in London – that perhaps we should start thinking of some kind of European governance of structural reforms in order to help increase the level of flexibility that individual countries can have.

My question is this: could we not perhaps begin to consider that we might need a kind of European governance of the level of unemployment, so that all together we can frame timely policies that could provide solutions in individual countries, so that this threat to the euro of rising unemployment can gradually be averted? An agency, a sort of common government, as you called it, which could develop a number of measures, and not just the simpler structural reforms we can imagine, but structural reforms even in education or in reforms of jurisdiction, even though they take longer.

In other words, unemployment in some parts of Europe is a dramatic issue – I would use that word even if it's a little '*emotional'*, as you said earlier on. What do you

think can be done, in addition to monetary policies, to address this problem?

1-033
Mario Draghi, *President of the European Central Bank* **–** Well, it is not an easy question. Let me first say that in the past few months we have observed tentative improvement on the labour markets: at least a stabilisation of unemployment and in some cases slight improvement.

It is also true that the level of unemployment remains unacceptably high, and that this could become an existential threat if it is not coped with. By and large, the European Central Bank has done a lot to cope with this problem. Our objective is price stability, and of course price stability is also affected by weakness of demand and by the level of unemployment. However, it is affected, too, by many other factors of a global nature and factors that have to do with the relative price adjustment of certain countries in the euro area, so we have to look at price stability, and the ECB has done a great deal in that respect. We keep on saying that our monetary policy will remain accommodative, and we have to wait, because the effects of monetary policy are not instantaneous. We have to wait for these effects to work through to the economy and finally reach the decision makers.

The common design that I had mentioned, bringing the structural reform areas under a sort of euro-area common governance, would certainly improve the labour market situation everywhere. And you rightly mentioned education. Now, we should ask ourselves a question. All countries have been hit by the crisis, but in some of them unemployment went up much more than in others. Within the ones where unemployment went up a lot, however, only a few saw youth unemployment going up a lot. How was that? There are at least two answers, which I think we will discuss further on other occasions.

One concerns the presence of certain highly distortionary labour market legislation in some countries, which made youth employment much more difficult and costly and variable and flexible than in other places. In other words, the weight of flexibility was only on the young segment, with complete rigidity for people already in the labour market.

The second answer has to do with education: with the fact that, basically, many young people do not have the skills that the labour market requires them to have in order to get hired. It is not coincidental that the countries with the highest figures for youth unemployment are also the countries that rank almost last in the OECD rankings for education.

1-034
Gunnar Hökmark (PPE). – I would like to raise two issues. The first is more of a pedagogical issue: I wonder why it does not come through in the public debate that the real austerity you are faced with is when you have overspend and cannot pay your debts or when interest rates are skyrocketing, not when you have consolidated and can finance your spending. I wonder why the ECB does not communicate this more strongly because I think this is part of the crucial discussion about how to proceed in the future.

My second reflection concerns the risks you are talking about regarding sustained low inflation. I think we can all share the perspectives on these risks. We have seen it in some economies as well. But, in order to interpret the situation or assess it, do you not need to relate it to what sort of growth you want and you need, whether it is to be demand-driven growth or supply side-driven growth? Some economists point out that one of the reasons for low inflation is of course the digitalisation of the economy, which generates a huge increase in productivity. We can really see that in these sectors you have growth, but it is driven by the supply side and by structural reforms.

I say this because you are, quite rightly, underlining the need for structural reforms. But is the crunch not that the more successful you are with structural reforms, the more supply side stimuli you get and the more productivity is increased? You will see then that you will not have these necessary increases in prices because of rising demand. It is traditional logic that you spend and stimulate demand and then you get inflation, but that was in some ways part of the problem that we were facing, namely that we did spend too much and it did not help in the long run.

1-035
Mario Draghi, *President of the European Central Bank***.** **–** I will address the second question first. As you can imagine, we have asked ourselves many times what the reasons are for this low inflation and why this low inflation has lasted so long. The list of reasons is actually quite broad and they all interact. The first reason is that the contribution of oil and food prices to inflation has largely disappeared. If we take the inflation level in late 2011 or early 2012 – if I am not mistaken – and we compare it with today's level, we can say that two-thirds of the lower inflation figures we get today depend on oil, energy and food prices falling from that time to now.

This, however, is a story that unfolds in different ways over that period of time. The contribution of energy basically disappears in the first year of the period I mentioned and after that it was compounded by the exchange rate appreciation. So we should not count these things twice just because we measure energy prices in euros. But basically the two of them interacted so as to keep the inflation level as low as it is today.

The other reason has to do with the euro area itself. There was no question that several countries, especially the stress countries, had to go through a relative price adjustment and this is exactly what happened in the countries under the programme – all of them – so there was a massive relative price adjustment, and this contributed to lowering the average inflation figure. But

we would be foolish if we were to ignore the fact that inflation figures are also low because of the high level of unemployment over a long period of time.

However, there is a difference between the first two factors and the third. The key point here is that a relative price adjustment, if it occurs once and for all, is not a problem because it lowers inflation and then that is that. The same thing applies to other global factors. But what keeps inflation low is also the weakness of demand. So we have to distinguish between factors which work once and for all, and factors that are continuously depressing the inflation rate. And that is where the risk that we watch very carefully could come from.

The reason why a longer period of too-low inflation is bad is that it threatens the stability of our medium-term inflation expectations. In other words, people look at inflation and say 'Well, it will go up in 2015' and then they discover that it is not going up. And then they say 'It will go up in 2016' and then they find out that it is not going up. At that point their inflation expectations start moving.

We have not seen that yet. We saw that inflation expectations in the medium to long term remain firmly anchored, so in this sense the situation is different from Japan. But should we say that the whole reason for low inflation is extraordinary changes in productivity? It is hard to say, because this would have to do with the relative price adjustment that has taken place in some parts of the euro area. These are certainly present but there are also other countries with hyperactivity where the inflation rate is and remains low. So, I think it is a combination. That is why the reality is complex.

Your first point was more a suggestion than a question, and we shall certainly take that on board.

1-036

Costas Mavrides (S&D). – I will be very specific, Mr Draghi. Two questions. First, let us talk a little bit about the safety of the deposit system in countries such as Cyprus, for example. Do you think that guaranteeing deposits will help in stabilising the deposit system and guaranteeing deposits by the European Central Bank, even for a small amount? If not, I think that the systemic risk will always be there and it is a matter of luck whether or not some banks will get into trouble again as happened a year and a half ago.

Another very specific question: how have non-performing loans been determined over the last year? Is this done the same way throughout the European Union and throughout the euro area, or not? This is a very specific question. As I understand it, it is not, so what is the reasoning?

1-037

Mario Draghi, *President of the European Central Bank***.** – I will answer the second question first. You are right: it was not, and now it is, because we have one single supervisor. Part of the effort and the benefit of having one supervisor in the euro area is exactly this. To have the same standard everywhere.

So far, until now, it was national supervisors who decided – within certain rules by the way, it was not completely arbitrary and the EBA did lay down some standards. But there was a certain range of views on what constitutes an NPL. Now that is over.

On the first point, the ECB cannot guarantee deposits in the Eurosystem. That is not within its mandate. Now if banks are not able to survive without this guarantee then there is something very wrong and the banking system should be fixed. Let me say that Cyprus has made enormous progress in fixing many of the problems of its banking system and many of the problems with economic policy and in the budgetary area. So I am not as pessimistic as you seem to be on the future stability of the Cypriot banking system.

A lot has been done. Restrictions on intrabank domestic payments have been lifted and at some time in the future restrictions on foreign payments will also be lifted as the situation continues to progress.

1-038

Othmar Karas (PPE). – Mr President, I should like to put three questions to you. On the one hand, enough speakers have now talked about the individual points: it is always the same problems that are being raised. But do you not believe that weak demand in the private sector is also closely associated with the low interest rates? And what can we do – apart from the structural reforms that you have mentioned, which of course are rather public than private – to increase demand? What do you see as the main problems in the structure beyond the eurozone, and where do you perceive the main investment potential on the basis of your experience?

Although I realise that it is not part of your mandate, you have touched upon the idea of sharing governance. Do you believe that it is possible to do so and to complete economic and monetary union under the terms of the existing Treaties? Or do we need a reform of the Treaties for the purpose? And what responsibility will the ECB take for persuading public opinion of the need for such a reform of the Treaties?

You said earlier – and it is a point that I consider somewhat problematic; I hope that what the interpreter said was actually what you meant – that as from November the ECB will supervise the banks, as part of the banking union. Do you really see the ECB as supervising the banks? Or did we not wish to see independent banking supervision attached to the ECB rather than the ECB conducting it itself? And what is the relationship with the EBA? How do you see things developing?

1-039

Mario Draghi, *President of the European Central Bank***.** – The SSM is rooted within the ECB, so when I say the ECB I really mean that the SSM, the Single Supervisory Mechanism and the Supervisory Board, will be doing the supervision. But since this was done within the present Treaty all the responsibility will be and has to be with the Governing Council of the ECB. In practice, however,

the operational responsibility and the operational activity will be carried out and will be borne by the Supervisory Board and the SSM.

So the two things are separate: there is a strict separation between monetary policy, which is what the Governing Council of the ECB will do, and supervisory policy, which is what the Supervisory Board and the SSM will do.

You also asked specific questions about the process of how the governance of the structural reforms process would work and whether it would be necessary to change the Treaties. I have to say that we are still at such a preliminary stage that it is very difficult to say what changes we will need, but I am convinced that we could go a long way within the existing Treaty. We do not need to make big changes to bring this area of structural reforms within the euro area governance and treat it in a way not very dissimilar to what we have done with the budgetary area.

I did not catch your first question so could you be so kind and repeat it for me.

1-040
Othmar Karas (PPE). – I would be interested to hear your assessment as to the sector in which we can increase demand, and by means of what investment and what structural reforms.

1-041
Mario Draghi, *President of the European Central Bank***. –** The investments have been low and are low in several areas, the first of which concerns infrastructure in some parts of the euro area. In other parts of the euro area investment in education, as was mentioned a moment ago, is very low, as it is in changing the judiciary systems in other parts of the area. Some of these investments are not really very costly, namely if one wants to complete the single market legislation, that is a big investment which is not going to cost much. That is an example. If one wants to improve labour market legislation or regional and industrial competition, these are big investments which probably do not cost very much.

1-042
Luděk Niedermayer (PPE). – First of all let me congratulate you, Mr Draghi, on your courage and sense of responsibility in handling the ECB.

First, let me ask you how you see the pros and cons of current monetary policy at a time when European economies are gradually recovering? On growth it is clear that you are trying to get inflation to the target, despite the fact that it is extremely difficult to find out what is bad low inflation and good low inflation. And secondly, providing that inflation is low, obviously you are trying to support the economy with the low cost of credit.

At the same time, on the risk side, there is asset price inflation – not good for financial stability in the future – and also asset prices, as they are not included generally in the CPI, are increasing inflation in a way that it is not seen in the targeted variable.

Secondly, I guess there is a certain risk arising from the fact that we do not know what the potential is for the economies in the future and if the potential growth is much lower than we anticipate, then a too relaxed monetary policy might not be so appropriate.

What we can see clearly from your statement is that you consider that current monetary policy should be supported by the factors that are mentioned first. I wonder what must happen before we see a change in your perception and more stress on those negatives.

Second question: very simply, in its recent annual report the BIS (Bank for International Settlements) argued for less stress on a relaxed monetary policy and more stress on balance sheet restructuring and structural reform. Here in Parliament I am not excited about this but I can hear a lot of talk saying that probably we need a more relaxed fiscal policy. This is what people mentioning more intelligent fiscal rules probably have in mind. So I wonder what you would consider as an optimal policy mix in the near future from the point of view of monetary policy, fiscal policy and the reforms.

1-043
Mario Draghi, *President of the European Central Bank***. –** Monetary policy stance is, and will remain, accommodative for an extended period of time and, as I think I mentioned before, the Governing Council is also unanimous in using other instruments, also unconventional instruments, if the risk of a protracted period of low inflation were to increase.

In this context, credit flows remain weak and very subdued. So, what to do? We have in the last three or four years experienced in most of the euro area, if not in all of it, on average a weaker potential output, but also certainly a large amount of slack, unused capacity. So, it is quite clear that policy actions should go through different channels here. One is to repair the banking system, so as to reactivate the capacity that banks have to lend to the real economy. The second line of action is to do everything necessary to raise potential output and, at the same time, reduce the slack, decrease the unutilised capacity which remains quite high in the whole of the euro area. And the third line of action consists of maintaining fiscal-financial stability throughout, so as to make sure that the confidence that returned after July 2012 will remain. These are the three or four main lines of action, and that is where we should all be working.

We discussed the BIS report extensively in Basel two or three weeks ago. That report argues that monetary policy could be too lax and could actually create bubbles. We have gone through this before. I think it is an argument like any other. In our case, the monetary policy stance is what our current economic situation requires. In other jurisdictions the BIS prescription might well be correct,

but in ours the situation is different. Second, it is also true that volatility is low – very low – and in some segments of the financial markets spreads could be too narrow, in the search for yield, with perhaps a mispricing of risk. That is certainly the case in some jurisdictions more than others, but there the answer is to use macro-prudential tools. Do not change monetary policy if one believes that this is the correct policy to achieve the objectives within the mandate, namely, in our case, the pursuit of price stability.

1-044

Paul Tang (S&D). – Thank you, Mr Draghi, for being here and having this broad elaborate explanation.

The reactions to the intervention in early June were rather sceptical. Maybe you have noticed that: too little, too late, it was often said. That happens more often to the ECB. It seems committed to fighting high inflation but I am not sure that the public and the financial markets are really sure that you are also equally committed to fighting low inflation, so I am looking for a commitment. Do you find 3% inflation as bad as 1%+ inflation? That is one question.

Again looking for commitment: you talk about what governments can do in structural reforms. You say that rather easily. What more can the ECB do to fight low inflation? Do you have the right instruments at this time to fight low inflation? You do consider other instruments, I presume. Will those other instruments include the possibility that the ECB's balance sheet will start to increase again, because you just said that the ECB's balance sheet was decreasing? You said it with some pride but are you as proud when the balance sheet increases when you want to fight low inflation?

1-045

Mario Draghi, *President of the European Central Bank***. –** Let me confirm, the ECB is symmetric in its view. So it reads 3% or more inflation in the same way. Of course, it is a medium-term outlook assessment and this is also how it treats the low, too-low inflation. And there is absolutely no doubt about that.

If you look back at the experience of the ECB in the first 15 years or so of its existence, as my predecessor used to say, it has delivered on price stability better than most central banks in the world, and even better than the central banks that existed before the ECB. So we – I and the Governing Council – are wholly committed to maintaining this record in the future.

Are we going to use other instruments? The answer is yes, if needed. The Governing Council – and I shall repeat it because that is the key sentence – is unanimous in its commitment to use also unconventional instruments if the risks for an excessively long period of too-low inflation were to increase.

With regard to the size of the balance sheet of the ECB, you said I said it with a certain amount of pride. The answer is yes and no. I will tell you why. When we launched the LTROs at the end of 2011, early 2012, there were lots of people saying 'Oh this is horrible, there will be huge risks, there will be huge inflation, there will be loss on the collateral that has been posted, and the size of the balance sheet has gone up so much, it will hang over the euro area economy for a long time'. But none of that has happened and these loans have simply been repaid to such an extent that we are now more or less back to the previous level.

Now this is not necessarily negative. It is also positive because it shows that banks could have actually started lending and borrowing from each other again, which means that the interbank market is starting to function again.

However, given the present and future prospects for price stability we do not want this to become a permanent feature of our monetary policy. That is why we have decided on the TLTROs which will again increase the size of our balance sheet and we prefer to move in an operation targeting the banking system because the banking system accounts for something like 80% of credit intermediation in the euro area. In this sense, the euro area is different from other parts of the world. And that is the logic behind our decision-making.

1-046

Chair. – Thank you, President Draghi, and thank you to all colleagues for your questions. I think it has been a very interesting dialogue. The next monetary dialogue will be held on 22 September 2014. Once again, thank you, President Draghi.

(Applause)