EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

Mario DRAGHI
President

Mr Fabio De Masi
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt, 3 February 2016

L/MD/16/53

Re: Your letter (QZ-178)

Honourable Member of the European Parliament, dear Mr De Masi,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 8 January 2015.

Let me first stress that global monetary policies may diverge for good reason, since every central bank needs to deliver on its domestic mandate and economic circumstances tend to differ across countries/monetary unions.

For emerging markets, stability-oriented policies, as well as a strong regulatory and oversight framework and clear communication of policy intentions, have proved to be the best defence against sudden reversals of global capital flows. In fact, during the episode known as “Taper Tantrum”, when, in summer 2013, members of the Federal Reserve Board started thinking publicly about the prospect of exiting from its unconventional monetary policy stance, more vulnerable emerging markets were affected the most. Likewise, the financial turbulence in emerging market economies now and last year was mostly generated by domestic challenges and, to a lesser extent, by the gradual monetary tightening globally that has been widely expected by financial markets.

At the same time, we have repeatedly emphasised that the exchange rate is not a policy target for the ECB, but that it is important for price stability and for growth in the euro area. Moreover, there is a strong consensus in the international community, expressed notably by the G20 and the G7, to refrain from competitive devaluations and not to target exchange rates for competitive purposes.

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Let me also stress that, by definition, the euro area's current account surplus is reflected in deficits elsewhere in the world. Experience has shown that large current account deficits can be a source of concern if they are funded by short-term and volatile sources of capital. At the same time, current account deficits can also be an important funding source for sustainable growth if institutional arrangements and policies in the host country are conducive to channelling foreign funds into productive uses. It is useful in this context to recall that many policy initiatives in Europe are aimed at stimulating domestic demand and notably investment. Moreover, in the context of the G20, the EU actively supports sustainable global developments and the process of global rebalancing.

Let me also briefly address the issue of the relationship between banking regulation, macroeconomic stability and monetary policy. A healthy banking system is a precondition for financial stability and the smooth transmission of monetary policy, particularly in the euro area, which relies heavily on bank-based financial intermediation. Recent and pending regulatory requirements regarding capital ratios (SREP, pillar 2 requirements and leverage ratios) and loss-absorbing funds (TLAC, MREL) will support the ongoing bank balance sheet repair and foster the resilience of, and confidence in, the euro area banking system. By improving financial stability, the enhanced regulatory framework can contribute to macroeconomic stability, thereby facilitating the implementation and transmission of monetary policy.

In this respect, the extended Asset Purchase Programme (APP) is expected to be beneficial for banks' intermediation capacity. First, the APP mechanically reduces the aggregate liquidity needs of the banking system and, therefore, the collateral required for refinancing operations by exchanging securities for central bank money. There is no evidence of collateral scarcity, as both the amount and composition of collateral posted for monetary policy operations by Eurosystem counterparties has been relatively stable since the APP's inception. Second, the APP can, on balance, have a positive impact on banks' intermediation capacity via its effect on both bank profitability and solvency. As regards bank profitability, the downward pressure of the APP on banks' net interest income is expected to be outweighed by the positive effects associated with capital gains and improved credit quality against the background of the positive impact of the APP on economic activity. This, in turn, also has a positive impact on regulatory capital, thus strengthening the banking system in the euro area.

In conclusion, the best contribution that the ECB can make to avoid becoming a source of financial market volatility itself is to be open and transparent about the policy rationale that determines its decisions. For this reason, the ECB's Governing Council strives to provide the public with an in-depth assessment of the outlook for inflation and the economy, the prevailing risks and how they map into the envisaged evolution of policy measures.

By enhancing markets' understanding of the central bank's assessment of the economic outlook and the corresponding evolution of policy measures, such forward guidance should help to dampen financial market volatility.

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Yours sincerely,

[signed]

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