Keynote Speech – Malta Maritime Summit 2022

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Challenges for the euro area economy and its stakeholders

Distinguished guests

I am very pleased to open the fourth day of the Malta Maritime Summit and I would like to thank the organisers for inviting me. Special thanks go to John Gauci Maistre for his unflinching energy and work in this sector he loves so much.

I wish I could deliver this speech in person, but due to binding commitments as member of the ECB's governing council I am unable to attend.

In my brief intervention today, I shall touch upon three issues: first, the challenges that the euro area is facing and how monetary policy is responding to them; second, the role of regulation in enhancing the resilience of the banking sector and thus in supporting lending; and lastly, I will touch upon two areas of important reforms: the transition to net zero and digitalization.

Monetary policy in the face of supply-side disruptions

A year ago, the euro area economy was recovering strongly from the pandemic recession. After the sharp collapse in economic growth in 2020, from the second quarter of 2021 GDP grew at a robust pace. This performance has been the result of several distinct factors: the unprecedented degree of coordination at the global and European level that led to the rapid roll-out of vaccines; the resilience of the banking and productive sectors in withstanding a once-in-a-lifetime shock and considerable policy assistance, both from the monetary policy side and from the fiscal side, that supported incomes and put in place the conditions for growth to resume as soon as pandemic restrictions were lifted.

As soon as the health-related restrictions on economic activity were raised, the demand side of the economy picked up much faster than the supply side could keep up with. Hence the logistic problems we witnessed in most sectors especially in transportation.

In a market economy, these imbalances are expressed via the price mechanism: in the twelve months from December 2020 to December 2021, the annual rate of consumer price inflation (HICP) accelerated from -0.3% to 5%. This trend that has continued since, reinforced by the energy price shock, and pushing euro area inflation to 9.1% in August of this year.

For central bankers, pinning the source of the imbalances is key to tailor an effective response. An increase in prices that is due to excessive demand should normally result in a tightening of monetary policy. A supply shock, however, leads to an increase in prices and a fall in output, with conventional monetary policy tools ill adapted to address them. With the nature of inflation being different from the one experienced in the States, the ECB waited till inflation showed that it began to spill over from energy to food and then across the board.

The outbreak of the war in late February and the sanctions rightfully imposed by the West, together with the retaliatory measures in response shook the euro area economy again. The high European dependency on Russian gas let to a massive spike in energy prices that is still feeding through the real economy. In March, the ECB thus began ending net asset purchases and then in July it started a rate hiking cycle that is still ongoing. As of today, policy rates have been raised by 125 basis points.

Witnessing an erosion in purchasing power, households and firms are expected to seek higher wages and prices., thus embedding inflationary expectations permanently into the fabric of the euro area economy.

It is not the ECB's wish to weaken the economy as a means to lower inflation. But it is conscious that this weakening could lead to a short though unwanted recession.

Regulation and supervision enhanced banks' resilience

One of the *lessons learnt* from the pandemic downturn is that, while cumbersome for the interested parties, additional regulation and supervision which was put in place by the Central Banks world-wide in the aftermath of the Financial Crisis of 2007-8 paid off.

In that occasion, it became evident that new prudential requirements on capital and liquidity buffers were needed to enhance the resilience of the banking sector. This allowed the implementation of financial measures put in place to provide liquidity to affected firms without harming the stability of the banking sector.

Sound banks 'balance sheets translate into support to the real economy.

Benefitting from robust capital buffers and pre-crisis improvements in asset quality, banks deployed their balance sheet capacity to fill in for the sudden collapse of corporate cash flows in the early phase of the pandemic. Banks also benefited from favourable funding conditions, which have been supported by the market stabilisation role of ECB asset purchase programmes APP and PEPPs and by its credit operations, chiefly among which its targeted long-term loans (TLTROs).

Looking ahead, the ECB is also gearing up to enhance banks ’resilience towards climate change, which the ECB’s Banking Supervision listed amongst its strategic priorities for the next two years.

Over the course of the past year, euro area banks have been stress-tested against climate events. The results of this far-reaching exercise reveal that climate risks are relevant for the large majority of banks directly supervised by the ECB, as they generate income from activities related to greenhouse gas-emitting industries.

How banks will adjust to climate change will have significant repercussions on the corporate sector because banks will play a critical role in supporting the private sector’s transition to net zero emissions.

Harnessing the potential of digitalisation

The last topic I would like to mention is the ongoing effort by the ECB to harness the potential of digitalisation. The ECB Governing Council has made the decision to push for the creation of the so-called *digital euro*. A complement to cash, not a substitute for it, the digital euro will guarantee citizens ’ access to public money in the digital economy, while preserving the stabilising role of the central bank in the payment systems.

While the ECB is decisively moving in this direction, the adoption of new technologies carries with it challenges and risks. Cyber-security ranks among the primary concerns of regulators when it comes to the digital ecosystem and the ECB, together with European and national agencies, is working to strengthen the cyber-resilience of banks, financial institutions and financial market infrastructures. Our aim is to foster private sector innovation while protecting consumers from questionable or downright illegal activities.

Let me conclude.

The euro area has been hit by two large shocks in a narrow interval – the pandemic and the war in Ukraine – that triggered imbalances in the form of high inflation.

The ECB is determined to bring prices in line with its mandate over the medium term because low and stable inflation is best conductive to real economic growth. The ECB is committed to act to ensure that inflation comes back down to its medium-term target of 2%.

While price stability remains the chief responsibility of central banks in the euro area, the ECB is also supporting the transition away from fossil fuels and towards the digital economy. Regulation and supervision remain important tools to support private actors in such far-reaching developments.

In this respect, the contribution of the private sector is key. Regulators need to establish a dialogue with stakeholders like yourselves, in order to seek a balance in the decision-making process which will ensure continued prosperity we have experienced so far. I hope that this conference will develop this much needed dialogue.