EUROPEAN CENTRAL BANK

EUROSYSTEM

COURTESY TRANSLATION

Mario DRAGHI

President

Mr Nuno Melo
Member of the European Parliament
European Parliament
60, rue Wiertz
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Frankfurt am Main, 4 December 2012

L/MD/12/767

Re: Your letter

Dear Mr Melo,

Thank you for your letter passed on to me by Ms Sharon Bowles, Chairwoman of the Committee on Economic and Monetary Affairs, and accompanied by a cover letter dated 23 October 2012.

Regarding your question on the estimates of the fiscal multipliers by the International Monetary Fund (IMF), our staff analysis shows that these results are not directly applicable to euro area countries. While fiscal consolidation has indeed been a drag on short-term growth in the recent past, our analysis does not find compelling evidence to suggest that multipliers have been larger than usual in vulnerable euro area countries. This view is shared by the European Commission's experts (see Box 1.5 in the Commission's autumn 2012 European Economic Forecast published on 7 November 2012).[1]

Fiscal consolidation in vulnerable countries needs to be sizeable in order to restore confidence in fiscal sustainability. In that respect, the current pace of consolidation is appropriate and has even been adjusted in some countries with a financial assistance programme (namely Greece and Portugal).

[1] European Commission, European Economic Forecast, Autumn 2012,
http://ec.europa.eu/economy_finance/eu/forecasts/2012_autumn_forecast_en.htm.

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Regarding your question on the cost of debt for countries receiving financial assistance, the decision rests with the Member States. The EU-IMF lending rate to Portugal has been below 3% and therefore substantially below the rates that some other non-programme euro area countries have to pay for long-term financing at present. The current lending conditions, which are the same for all euro area countries with a financial assistance programme, are a strong signal that euro area countries are ready to support efforts by vulnerable countries to put their public finances on a sustainable path.

As regards the downward revisions of IMF growth forecasts, I do not comment on forecasts produced by other institutions. You may wish to compare these forecasts with the Eurosystem staff macroeconomic projections that will be published on 6 December.

Fiscal consolidation efforts by countries with a financial assistance programme cannot be viewed in isolation, but need to be seen in the context of the overall programme design. One key element, which is indispensable for the success of the adjustment programmes, is that the sustainability of public finances is assured on a permanent basis. This requires fiscal consolidation efforts. At the same time, it is essential that existing macroeconomic imbalances are unwound. Without such adjustment programmes, countries have no prospect of returning to sustainable growth. To aid the unwinding of imbalances and raise the potential growth rate, structural reforms in all sectors of the economy are essential and need to be pursued with strong determination. These two dimensions – ensuring fiscal sustainability and growth-enhancing structural reforms – are a key part of all adjustment programmes.

Regarding your question as to whether the sovereign debt crisis is one reason for capital “flights”, there is evidently a relationship between euro area countries’ distress and funding conditions for banks. Banks in affected countries have struggled with increased funding costs, reduced access to liquidity in the interbank market and a deterioration in asset quality. Investors’ perception of the tail risk of a euro area break-up has led to the fragmentation of financial markets and contributed to the flow of capital out of stressed countries. The Eurosystem, within its mandate of price stability, has offered liquidity to banks through two 3-year longer-term refinancing operations, conducted at the end of last year and the beginning of this year. Moreover, it announced Outright Monetary Transactions on 6 September 2012 for countries that have retained or regained market access, with a view to safeguarding an appropriate monetary policy transmission mechanism and the singleness of the monetary policy.

To reverse capital flows it is essential to restore healthy macroeconomic and financial conditions and regain confidence, by fully implementing necessary fiscal consolidation and structural reforms and by completing the Economic and Monetary Union.

Yours sincerely,

[signed]

Mario Draghi