Divisions grow over European Central Bank policy

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Mario Draghi, the president of the European Central Bank, has responded sharply to German politicians who have criticised the bank's negative interest rate regime as being responsible for the rise of the right-wing populist party Alternative for Germany (AfD).

The attacks on the ECB, which have come from several quarters of the German political establishment, were set off by remarks from finance minister Wolfgang Schäuble in which he said Draghi could claim at least 50 percent responsibility for the AfD's strong support because of ECB policies that are hitting German pensioners and savers.

At a press conference on Wednesday, following a meeting of the ECB's governing council, which made no change on interest rates and asset purchases, at least half the questions focused on German criticisms of the ECB's interest rate regime.

Draghi insisted the ECB was independent, that it did not take orders from politicians and that any challenges to the central bank's independence would risk delaying investment as well as lowering business and consumer confidence.

"We have a mandate to pursue price stability for the whole of the euro zone, not only for Germany. This mandate is established by the Treaty, by European law. We obey the law, not the politicians, because we are independent, as stated by the law. And by the way, this applies to all countries, to all politicians in the euro zone," he said in response to a question about how he answered to his German critics.

Draghi's response to another question on how "guilty" he felt about the rise of the AfD, pointed to the growing national divisions within the euro zone. Would a non-Italian president run different policies, he asked rhetorically. Yes, he would, but then added that his predecessor Jean-Claude Trichet, a Frenchman, had given an interview two days before in which he had said: "I would have done the same things that Mario did."

Asked whether he was aware that German citizens were worried about their pension schemes because they are receiving little or no yields, Draghi said the ECB was monitoring these developments very closely. He said it was necessary to resist the temptation to blame low interest rates as the cause of everything that had gone wrong.

Low interest rates were a symptom of low growth and inflation; economic problems were not a consequence of monetary policy, and for a return to higher interest rates there had to be higher growth and higher inflation. But there is little sign of that as indicated by the economic data provided in Draghi's opening remarks to the press conference.

He reported that in the final three months of 2015, on a quarter by quarter basis, real growth in euro area GDP was just 0.3 percent, having been dampened by "relatively weak export demand"—an indication of the deepening stagnation of the world economy as a whole. He expected first quarter growth for 2016 to be around the same level. Draghi said risks remained "tilted to the downside" and were being impacted by subdued growth prospects in emerging markets as well as dampened by "ongoing balance sheet adjustments"—a reference to the constrictions on lending because of the continued high levels of bad loans held by banks in a number of countries, particularly in Italy. Draghi repeated his call for the pace of "structural reforms"—attacks on employment conditions—to be stepped up.

The official rationale for the negative interest rate regime and the purchases of financial assets by the ECB at the rate of €80 billion a month is that these

measures are needed to return inflation rates to a level close to, but below, 2 percent. However, inflation remains persistently low.

Inflation in the euro zone area was zero in March, compared with -0.2 percent in February, and Draghi warned that inflation rates could again turn negative in coming months. However, he claimed that they would pick up in the second half of the year and rise further in the next two years, supported by the bank's monetary policy measures and an expected economic recovery. These forecasts will be taken with a large grain of salt as the ECB has been continuously predicting such improvement only to find that the stagnation continues.

On the specific attack on him made by Schäuble, Draghi said he had held a "quiet" and "very friendly" discussion with the German finance minister at the recent spring meeting of the International Monetary Fund, where Schäuble had said that "he didn't mean what he said, or he didn't say what he meant."

The conflict may have been papered over for now but it will continue to fester because it is not a result of differences between two individuals but is rooted in the political economy of German capitalism.

As a recent comment by the *Financial Times* columnist Wolfgang Münchau noted, while it may seem irrational for the German finance minister to question the independence of the ECB, there was a "powerful" reason why this was happening.

The ECB policy is seen as an attack on "Germany's economic model," which is "heavily dependent on the country's peculiar banking system." If banks and insurance companies get into trouble, "the model could collapse."

The dispute was not about monetary policy philosophy but about money "pure and simple." The Sparkassen group, consisting of more than 430 banks, as well as local savings and small mutual banks – dependent on positive interest rates—were "losing tons of it" as a result of the negative interest rate regime.

Many German companies, he noted, are dependent on their local bank to provide them with easy credit under conditions were corporate bond markets were underdeveloped, as is the market for venture capital. Changes to the banking system had been blocked by political pressure because the management boards of the Sparkassen "power base for local politicians."

If low interest rates persisted for many years, this could threaten the "very existence of many savings banks." According to Münchau this might be a "good thing" because it would force an overdue restructuring of the country's banking system but there would be resistance leading to a "balance of terror," with the ECB fearing a German backlash against its policies and the Germans trying to sit through it.

As he noted, this is not the way a "healthy monetary union" is supposed to work and the Schäuble intervention was a "reminder" that the "collective spirit that was so strongly present in the first years of the euro zone" had gone and this constituted "the biggest danger to the long-term viability of Europe's monetary union."