ECB signals more austerity amid mounting economic divisions in Europe

Alex Lantier
23 September 2016

Speaking yesterday in Frankfurt, European Central Bank (ECB) chief Mario Draghi signaled that the ECB would continue with austerity and massive handouts to the banks. Despite the deepening slump in Europe and internationally, he proposed no change in the financial aristocracy's irrational, economically destructive policies.

A day before, the US Federal Reserve and the Bank of Japan (BoJ) said they would continue similar policies of ultralow interest rates and so-called "quantitative easing" (QE). Under QE programs, the Fed, the BoJ, and the ECB printed trillions of dollars worth of their respective currencies. This money was handed to the banks, which bought up stocks, government bonds, and corporate debt, inflating the value of assets held by the super-rich and the top 10 percent of society, while masses of workers were plundered with austerity and social cuts.

Draghi's announcement testifies to the perplexity and panic gripping the ruling class, faced with crises for which it has no solution. Before Draghi spoke, some expected that he would shift policies widely seen as having failed to revive Europe's economy, and that face growing media criticism.

"The euro zone should have reached economic 'escape velocity' by now after a potent brew of stimulus starting last year," wrote columnist Ambrose Evans-Pritchard in Britain's *Daily Telegraph*, citing cheaper oil, a lower euro, and the printing of €80 billion per month in ECB QE programs.

Despite this injection of financial steroids into the heart of Europe's financial system, however, the continent's economy is still flat lining, nearly a decade after the 2008 crash. The euro zone is growing at 0.3 percent per quarter, with France and Italy stagnant. Purchasing power is so low in Italy that prices for many consumer items are falling, threatening to trigger full-blown deflation.

Deutsche Bank chief economist David Folkerts-Landau attacked the ECB for undermining the euro currency: "Central bankers can lose the plot. When they do, their mistakes can be catastrophic. After seven years of ever-looser monetary policy, there is increasing evidence that following the current dogma risks the long-term stability of the euro zone."

At yesterday's European Systemic Risk Board (ERSB) meeting, Draghi responded with a blanket defense of low, even negative interest rates. That the ECB has had to resort to such policies testifies to the breakdown of the basic financial mechanism of capitalist production: the ability to invest capital, generate a profit, and from this profit pay a positive rate of interest to the original investor on his capital. Private banks have criticized the policy, moreover, for decimating their profits by keeping them from lending at high interest rates.

"A number of reasons have been mooted as the causes of this low profitability, including low interest rates," Draghi said. "Long-term real interest rates have been falling in the major advanced economies for two decades. Technological change, demographics, income inequality and safe asset scarcity are just a few of the factors exerting downward pressure on long-term real rates."

This appraisal of Europe's problems constitutes a devastating self-indictment by financial officials. Rising inequality—that is, the impoverishment of the masses and the enrichment of a small layer at the top—like collapsing demographics, amid broad cuts to living standards and family benefits, are due to reactionary EU austerity policies. These have thrown tens of millions of workers out of work since 2008 and imposed deep wage cuts in country after country.

While the ECB pours cash into the financial markets, the underlying real economy is so depressed by austerity, with corporations and governments facing recurring debt crises, that Draghi admits bankers still cannot find “safe” financial assets to buy. The ECB increased its balance sheet from €1 trillion in 2005 to over €2.5 trillion in 2015, buying up various forms of debt. However, Draghi’s remarks show that it was just inflating other, even larger bubbles involving risky assets.

Nonetheless, Draghi stayed the course with the current policies, calling to boost bank profits by restructuring the financial industry to cut the number of large firms. “Overcapacity in some national banking sectors, and the ensuing intensity of competition, exacerbates this squeeze on margins,” he said, also calling for regulating “shadow banking” operations like hedge and money market funds.

He said that in this depressed environment, financial institutions should pay smaller rates of return to depositors: “banks will need to review their business models to bolster profitability. Other financial institutions also face challenges to their business models in this environment. In particular, institutions providing longer-term return guarantees—notably guaranteed-return life insurers—face a future of weak profitability unless they adapt their business models to a changing world.”

What is emerging is the failure of the capitalist system and of the European political establishment. None of the problems that led to the 2008 economic crisis have been resolved; indeed a decade of intense austerity has worsened them. Even as a new crisis builds, the ruling elite has nothing to propose except more attacks on the working class, and intensifying competition.

After the British vote to exit the EU underscored intractable international tensions building up inside Europe, moreover, the debate over Draghi’s policies is stoking conflicts that threaten to blow apart the euro currency and the EU.

German officials vocally criticized ECB policy, demanding higher interest rates to boost German bank profits. French, Italian, and other weaker southern European economies profited from Draghi’s looser monetary policies, however, and still support them—praising them cynically as pro-growth policies at an Athens summit this month to which German officials were pointedly not invited.

In April, after the IMF warned of the weakness of EU banks like Deutsche Bank and Crédit Suisse, German Finance Minister Wolfgang Schäuble denounced the ECB for damaging Germany’s economy. He said ultralow rates created a “gaping hole” in investors’ and pensioners’ finances. “It is indisputable that the policy of low interest rates is causing extraordinary problems for the banks and the whole financial sector in Germany,” he said. “That also applies for retirement provisions.”

Among the major powers and banks, the knives are out. As the Italian state and banks face financial collapse, with bad loans totaling €360 billion or 17 percent of total Italian bank assets, German officials are suing the ECB to cut off financing to indebted euro zone countries.

Yesterday, conservative German politicians spoke to the *Financial Times* to denounce QE policies. Peter Gauweiler said it “already violates rules on the prohibition of monetary financing [of euro zone governments] by the ECB,” adding that further loosening of QE rules would be “clearly incompatible with European law.”

While Germany’s Constitutional Court has not yet decided to hear his suit, Hans-Olaf Henkel of Germany’s Alfa party said, “If the ECB would blatantly and openly finance states such as Italy, it would provide us with additional ammunition in our court case… This the Court cannot ignore.”

Other officials retaliated, demanding that Germany cut its trade surplus and stimulate Europe’s economy by importing more goods from the rest of Europe. Speaking to *L ’ Opinion* on Wednesday, Belgian ECB board member Peter Praet said: “Germany’s enormous current account surplus, at almost 9 percent of Gross Domestic Product, is an anomaly. German growth is too dependent on external demand. Germany has the budgetary resources to develop its internal demand.”