European Central Bank still failing to meet inflation objective

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The European Central Bank (ECB) left its monetary policies basically unchanged following a meeting of the governing council in Tallinn, Estonia, on Thursday, except for a small change in wording indicating that it would not reduce interest rates any further.

In its forward guidance statement, the ECB omitted a reference in earlier statements about cutting interest rates to lower levels if warranted. The change was made in response to data showing that the euro zone experienced an uptick in growth in the recent period.

Explaining the change, ECB president Mario Draghi said deflation—the risk of falling prices—had "gone away."

However, Draghi did not hold out any prospect for price levels to rise on a sustained basis to the ECB's target of below, but close to, 2 percent in the near future. The latest data show inflation in the euro zone running at 1.4 percent in May, after 1.9 percent in April and 1.5 percent in March.

At the press conference following the meeting, Draghi said the ECB expected interest rates to remain at their present levels for an extended period and well past the horizon of net asset purchases.

While there was a "stronger momentum" for growth in the euro area and the economy was expanding at a "somewhat faster pace than previously expected," this expansion had yet to translate into "stronger inflation dynamics."

Draghi continued: "Therefore, a very substantial degree of monetary accommodation is still needed for underlying inflation pressures to build up and support headline inflation in the medium term."

In addition to keeping the ECB base interest rate at minus 0.4 percent, the governing council maintained its financial asset purchases—mainly government bonds but some corporate bonds as well—at the present level of €60 billion a month at least to the end of the year and possibly beyond. By the end of 2017, the ECB will have some €2 trillion on its books.

In view of the higher growth rate in the euro area and the opposition from Germany to the asset-purchasing program, questions were raised at the press conference about whether the ECB was set to announce a "tapering" of its asset purchases, possibly at its September meeting. But Draghi said it was not discussed.

While the official explanation is that inflation has not yet reached the target of 2 percent, the more fundamental reason is the fear that a lift in interest rates would impact on countries, such as Italy, that have significant debt problems. This could cause turmoil in the European financial system, which increasingly depends on the flow of cheap money from the central bank.

In the lead-up to the Tallinn meeting, Draghi said there were risks in a premature tightening of monetary conditions.

Some of those risks were underscored in the days before the ECB meeting. The Spanish bank Banco Popular was taken over by its rival Banco Santander for a symbolic payment of €1 after it ran through €3.6 billion in the first two days of this week.

The burn-through of emergency funding provided to the bank was the result of the first major run on a large-scale euro zone bank. After the Banco Popular failed to find a buyer, a steady trickle of customers turned into a flood, creating a liquidity crisis.

The bank, which did not require a bailout in the immediate aftermath of the global financial crisis of 2008–2009, was weighed down by €37 billion of property loans, many toxic. It was forced to tell authorities on Tuesday it could not open its doors the next day without an intervention.

Questions were raised at Draghi’s press conference about the takeover operation, conducted by the euro area bank resolution authority, the Single Resolution Board. But the questions were deflected on the grounds that it was not within the province of the ECB and could not be dealt with for legal reasons.

While the specifics of the takeover, and the losses imposed on shareholders and junior bondholders, were not discussed, the overall direction of ECB monetary policy has clear implications for the viability of other euro zone banks.

Numbers of banks in Portugal and Italy face funding problems and that list would be extended were there to be significant tightening of overall monetary policy.

One of the most significant parts of the press conference came during an explanation by Draghi in response to a question about whether there was any prospect of the ECB reaching its inflation target.

Draghi said there was a “flat and low profile for underlying inflation.” This is despite the official data showing a reduction of unemployment levels and an upturn in economic growth.

“That has mostly to do with subdued nominal wage growth,” Draghi said, indicating that the main reason for this was “structural changes” in the economy.

“All this recovery is happening with very strong creation of new jobs, so there is definitely a very significant increase in labour force, labour participation. At the same time we have evidence that many … of these new jobs are so-called ‘low-quality’ jobs, where we’re talking about temporary employment, we’re talking about part-time employment.”

This phenomenon is so prevalent that the ECB is seeking to develop new measures of the “concept of unemployment,” broader than that provided by the official rate.

One of the recurring themes of Draghi’s press conferences over the years has been his emphasis on the need for “structural reforms.” While claiming that such reforms were “good for growth,” he said those that made labour markets “more flexible do tend to produce a lower growth in nominal wages.”

However, in the long-established tradition of capitalist politicians and policy-makers, he promised “jam tomorrow”—calling for patience and claiming that, in the end, the “structural reforms” effects would “fade away” and “job quality will improve.”

In fact, the stagnation and outright lowering of wages, through the creation of part-time and casual employment under conditions of increasing exploitation, is not a temporary affliction. It is the “new normal” in all the major capitalist economies, such as the US, Britain, Europe and Australia. It might be called the Amazonisation of the workforce.