ECB offers reassurance to anxious financial markets

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The European Central Bank has sought to assure jittery financial markets that the flow of cheap money, which has been so crucial to their activities, is not going to be withdrawn rapidly.

The bank's governing council, meeting yesterday in Frankfurt, Germany, decided to keep interest rates at their ultra-low, and in some cases negative, levels. It gave no indication of when its €60 billion per month bond-purchasing program might be ended or tapered.

The assurances that the cheap money supply would continue were underscored both in the prepared statement by ECB president Mario Draghi and his response to questions at the press conference after the meeting.

The ECB meeting assumed critical importance for financial markets following a speech by Draghi at an ECB forum in Sintra, Portugal, on June 27 in which he said reflation had replaced the risk of deflation.

This was taken to mean that the ECB was preparing to throttle back on its quantitative easing (QE) program. This led to a rise in bond market yields and an increase in the value of the euro on currency exchanges. Investors anticipated monetary tightening by the ECB and a possible repeat of the 2013 "taper tantrum" when the US Federal Reserve indicated it would pull back on QE.

In his prepared statement, Draghi pointed to an "ongoing expansion" of the euro-zone economy and expressed confidence this would gradually lead to levels of inflation in line with the ECB's goal of around 2 percent. But he emphasised that the uptick in growth was "yet to translate into stronger inflation dynamics."

The rationale for the ECB's present policy is that it must continue until inflation nears the central bank's target. The latest figures showed prices rises for June at just 1.3 percent, down from the 1.4 percent recorded in May. Draghi said measures of underlying inflation remained at "subdued levels."

Then came a crucial passage:

"Therefore, a very substantial degree of monetary accommodation is still needed for underlying inflation pressures to gradually build up and support headline inflation developments in the medium term. If the outlook becomes less favourable, or financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, we stand ready to increase our asset purchase program in terms of size and/or duration."

The last sentence has appeared regularly in past statements. Its removal would be regarded as a signal that the ECB was ready to move toward tightening its monetary policy.

The questions directed to Draghi at his press conference focused on the significance of his remarks at Sintra, as well as the underlying causes for the failure of inflation, despite the injection of billions of euros into the financial system, to even begin to approach the 2 percent target rate.

One questioner pointed to the contrast between Draghi's comments at Sintra, where he indicated that the weakness in inflation would be temporary, and his statement, following the meeting of the governing council, that he saw no sign of a pickup in the headline rate.

In answers to questions, Draghi insisted he did not comment on market reactions. Yet it was clearly the reaction of the markets to his comments last month that framed the wording of the latest statement. The ECB fears that indications of monetary tightening could spark a difficult to control sell-off. Such is the dependence of bond markets on central bank support—it

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is the largest trader in this area.

The calculations of both the ECB and the US Federal Reserve have been thrown awry by the breakdown of the so-called Philips curve, which claims to establish a relationship between economic growth, unemployment, wages and inflation. According to this model, as growth begins to revive and unemployment falls, wages should start to increase, leading to a rise in inflation. This is not taking place, either in Europe or the US, where inflation remains persistently below the 2 percent level.

The reason is that the ongoing impact of the global financial crisis of 2008 has shattered the relationships on which this model was based. As Draghi was forced to acknowledge, while the official level of unemployment has fallen, the response of wages was "different from that it was in the past." That is, wages have continued to stagnate or decline in real terms.

The fall in unemployment, both in the US and Europe, is not the outcome of an increase in full-time jobs, but the product of the growth of part-time and casual working.

According to the ECB's own figures, when account is taken of the number of people who would take on more work if they could get it, the real level of unemployment—the "U6" measure—is 18 percent, almost double the official jobless rate of 9.3 percent.

In other words, what Marx termed the "industrial reserve army of labour" is exerting downward pressure on wages, despite economic growth showing an increase.

Draghi had elaborated further on this question at the Sintra forum. There he noted that as a result of the financial crisis the number of underemployed—those who wanted more hours or had temporary jobs—had risen. This had "implications for inflation dynamics, since people might prioritise more hours or job security over higher wages in employment negotiations."

Translating from the language of central bankers, millions of workers, and especially young people, are being forced to accept whatever they can get from employers.

Throughout his term as ECB governor, Draghi has emphasised the importance of "structural reforms"—above all, the ability of employers to scrap national standards for wages and working conditions and impose their own dictates. "Structural reforms that have increased firm-level bargaining may have made wages flexible downwards but not necessarily upwards," he told the Sintra meeting.

Yesterday's ECB meeting was another expression of the class agenda that drives all economic policy—the ongoing provision of billions of euros for the finance houses, financial investors and money market operatives, enabling them to continue their wealth gouging, combined with a never-ending offensive against the working class.

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