

European Central Bank to continue bond-buying program

Nick Beams
27 October 2017

In what was described as its most important meeting of the year, the European Central Bank (ECB) yesterday decided to extend its program of bond purchasing until at least next September, with no date set for when it might come to a conclusion.

German representatives, together with others on the governing council, favour setting a definite time for the ending of the quantitative easing policy initiated in 2015. But, as ECB president Mario Draghi made clear a number of times during his press conference yesterday, there was a “large majority” in favour of keeping the program “open-ended.”

As a result of the meeting in Frankfurt, the rate of bond purchases will continue at €60 billion per month until the end of this year and then be reduced to €30 billion a month from January.

The ECB also will maintain its policy of ultra-low interest rates, with no indication of when they might be increased. The main rate was left at zero, with the ECB deposit facility set at minus 0.4 percent. Draghi’s opening statement to the media conference repeated the phrase used in the past that interest rates would remain at present levels “for an extended period of time, and well past the horizon of our net asset purchases.”

One of the most significant features of the media presentation was Draghi’s emphasis on the ECB decision to reinvest in bonds that are maturing, on top of any additional purchases. Draghi recalled that back in December 2015, when he said the central bank would undertake this measure, there was little reaction. “Now, since then we have bought a lot of bonds,” he continued.

The ECB’s stockpile of bonds has grown to €2.1 trillion, meaning that the ECB has become the key pillar of European financial markets. Draghi said the reinvestment program “is going to be massive.”

While no details were provided—the amount will depend on what assets are maturing in any given month—ECB vice president Vitor Constâncio said “we are talking about many billions per month, on average” and the stock was “also important for the transmission of monetary policy.”

The official rationale for the ECB policy is to secure a lift in inflation close to, but below, the target rate of 2 percent. Draghi claimed the policy was working. Eurozone growth was on the rise and the output gap—the difference between potential and actual growth—was closing, with more than 7 million jobs created over the past four years.

Despite the improvement in official unemployment data, this is having little impact on wages and inflation rates, largely because many new jobs are part-time or casual, paying relatively low rates.

This trend will continue. Draghi insisted, as he has repeatedly at press conferences, that “structural reforms”—the code phrase for attacking working conditions and job security and therefore wages—must be “substantially stepped up” in all euro area countries.

Draghi has said the threat of deflation has been pushed back, but the ECB estimates for inflation show no persistent rise. Inflation is expected to be 1.5 percent this year, before falling to 1.2 percent in 2018 and rising to 1.5 percent the following year.

The outcome of the governing council meeting was another win for Draghi’s faction, which favours a “prudent” and “persistent” return to what are considered more “normal” policies. There was broad “consensus” on the outlook for an improved position in the eurozone economy.

The *Financial Times* noted a “surprisingly muted” reaction from Germany, where economists, bankers and government representatives have criticised the low-

interest rate regime, saying it is distorting financial markets and adversely impacting on savings. The newspaper noted that Berlin has “recently scaled back its criticism of Mr Draghi amid hopes that the head of Germany’s Bundesbank Jen Weidmann could succeed him in 2019.”

While presenting a positive picture for the eurozone, Draghi said downside risks remained, related to global factors, that is, political turbulence, and developments in foreign exchange markets.

On the issue of political turbulence, one questioner at the press conference noted that the Catalan government had sent emails to the ECB and a letter to Draghi warning that political turmoil in Spain could have an impact on financial stability there and in the entire eurozone.

Draghi said it would be “premature” to conclude there was a risk to financial stability. It was necessary to “see what’s going to happen,” but the ECB was studying the situation “with attention, great attention.”

One of the issues in foreign exchange markets and the financial system more broadly is the divergence between the policies of the ECB and the US Federal Reserve, which has started to raise interest rates, with a further increase expected before the end of the year.

There is also a contradiction in the ECB’s policies. On the one hand, any increase in eurozone economic growth tends to lift the value of the euro in international markets. On the other hand, a rising euro tends to push down inflation and keep it below the target rate of close to but below 2 percent.

The picture presented by Draghi, both in his presentation and his answers to questions, was one of measured calm—suggesting that the ECB was proceeding with persistence, patience and prudence.

But if one steps back from the immediate situation, a very different picture emerges—one of a complete transformation in the operation of European and global financial markets. Nearly a decade on from the eruption of the 2008 global financial crisis, the program of “accommodation” for financial markets continues, with no sign of when it might end.

Moreover, in a historically unprecedented situation, the world’s central banks, particularly the ECB, no longer function as external forces acting on financial markets to stabilise them. Rather, they are central players in their day-to-day operations. With the

eruption of another financial crisis, they will not be on the outside but in the very eye of the storm.



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