European Central Bank meeting downgrades euro zone forecast

By Nick Beams
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Forecasts of euro zone growth rates and inflation provided by the European Central Bank (ECB) at its monthly governing council meeting in Frankfurt yesterday indicate the accelerating downturn in the region's economy.

The ECB predicted that growth in 2015 would be just 1 percent, compared to its forecast of 1.6 percent made only three months ago. Inflation will be 0.7 percent next year, compared to the previous forecast of 1.1 percent, issued in September. Even these figures may turn out to be too high, with risks being characterised as on the "downside."

The annual inflation rate in the euro zone was just 0.3 percent last month and is expected to fall again this month and into 2015 because of a drop in oil prices. The ECB is officially committed to lifting inflation to 2 percent but there is no sign of that target being reached. Falling inflation has a significant impact on the region's economy because it increases the real level of debt and interest payments, despite the reduction in official rates to near zero.

While the euro zone has not entered a recession, it is on the verge of one. According to the latest purchasing managers' index compiled by the data firm Markit, which is a fairly accurate indicator of future trends, economic activity in the euro zone was at its lowest level for a year and a half, with the index falling to 51.1 from 52.1 in October.

The most significant feature of the latest Markit data is that the downturn is concentrated in the so-called core economies, with Germany experiencing its worst result for 17 months and France its lowest level of economic activity for nine months.

The main focus of financial markets was whether the ECB meeting would soon begin a full-scale program of quantitative easing, involving the purchase of government bonds.

At present the ECB only buys asset-based securities and covered bonds, not sovereign debt. This is largely because of opposition from German representatives in the governing council, which again surfaced at yesterday's meeting.

Setting out the central bank's monetary policy, ECB president Mario Draghi said it "intends" to expand its balance sheet by around €1 trillion, back to the level it reached in 2012, rather than that it "expects" to reach this objective. However, even this slight change in wording produced divisions in the governing council, with opposition coming from German officials and possibly others.

In his press conference, Draghi spoke of "major decisions" where there was no unanimity. Firing a shot across the bow of his opponents, who maintain that the purchase of sovereign debt is beyond the powers of the ECB and could be challenged in the courts, Draghi said policymakers were not politicians and had to stick to their mandate of keeping inflation on track. "Not to pursue our mandate would be illegal," he added.

Draghi indicated that all measures were discussed, including the purchase of sovereign debt. But he refused to specify when a decision might be taken, saying only that it would be some time "early" next year, following an assessment of the impact of the recent fall in oil prices. He was at pains to make clear that "early" did not necessarily mean the next meeting of the governing council, scheduled for January 22.

Financial markets are growing somewhat impatient with the ECB's prevarication.

"At some point, they will lose credibility," Mark Zandi, chief economist of Moody's Analytics told the *New York Times*. "They still have time, but time is running out," he said. The euro zone was "flat on its

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back and flirting with recession.” It might avoid outright deflation, but it was “close.”

The newspaper also cited Nicholas Spiro, the managing director of Spiro Sovereign Strategy, who said: “Draghi’s ability to buoy financial markets through his words (and his words alone) is diminishing with each passing day.”

Spiro warned: “The ECB’s inability to take meaningful action to avert the threat of deflation could become the trigger for a much more pronounced deterioration in market sentiment towards the euro zone.”

In other words, unless financial markets get their way and more ultra-cheap cash is pumped into the system, they could provoke a crisis.

The program of quantitative easing has nothing to do with boosting the real economy but is purely directed toward funding speculation on stock exchanges and other financial markets. This was made clear by figures provided in Draghi’s remarks following the meeting.

He said the annual rate of change to loans to non-financial corporations—money that is used in financing real economic activity—was down by 1.6 percent in October, following a decline of 1.8 percent in September.

The divisions among euro zone members, reflected in the disagreements on the ECB governing council, are indicative of increasing tensions globally. The talk of global cooperation and collaboration, which filled the air in the immediate aftermath of the 2008 financial crisis, has well and truly gone by the board amid the downturn in the world economy.

These tensions were exacerbated by last week’s decision of the OPEC oil cartel, led by Saudi Arabia, not to cut production in order to stabilise global oil prices, which have fallen by around 40 percent since June.

The decision threatens a financial crisis in a number of countries, including Nigeria, Algeria, Iran, Venezuela and, most significantly, Russia.

The impact of the deepening economic downturn on global politics was underscored in a speech delivered by Russian President Vladimir Putin on Thursday.

With the rouble now down almost 40 percent against the US dollar since the start of the year, Putin said the government would crack down on speculators and fight attempts by Russia’s enemies to bring it to its knees.

Fearing that the oligarchs upon whom he rests could withdraw their support, Putin’s speech was aimed at mobilising Russian nationalism against efforts by Western powers to undermine the country.

“Hitler with his misanthropic ideas tried to destroy Russia and throw us back to the Urals. Just remember how that ended,” he said. If the Russian annexation of Crimea had not happened, some other excuse would have been found to hold Russia down.

Putin said Western powers intended to “run a Yugoslav scenario in Russia.”

The break-up of Yugoslavia in the 1990s, orchestrated by Germany and the US, was preceded by a financial crisis, created in large part by the actions of the International Monetary Fund.

Putin’s direct linkage of Russia’s worsening economic crisis to the events of World War II is indicative of the interconnection between the gathering world slump and geo-political tensions. Those tensions can only increase as a result of the worsening economic situation in Europe, which was revealed at the ECB meeting.

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