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## On the May ECB Rate Decision

Thursday, May 3, 2012

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### Mario Draghi gives a supply-side economics lesson to euro area leaders.

As expected (see ["S&P Sp BBB = ECB SMP?"](#) April 27, 2012) the ECB [made no change to interest rates](#) at today's monetary policy meeting in Barcelona. Further, there were no announcements of any new liquidity tools, or any extension of current tools.

- In his [statement at the press conference](#) following the rate decision, ECB President Mario Draghi gave no hint to future rate changes, saying "Inflation rates are likely to stay above 2% in 2012. However, over the policy-relevant horizon, we expect price developments to remain in line with price stability." He added during the press conference that a rate change was not even discussed today.

It may have been a non-event in terms of monetary policy, but not growth policy -- an area in which the ECB is now positioning itself as a powerful influencer. Draghi concluded his prepared statement with the warning that "several governments need to be more ambitious" in implementing their growth reforms. And in his remarks at the press conference he spoke at length about the progress of structural reforms among euro area governments, and what those reforms should be.

- Jobs have to be created. Draghi asked "who creates jobs?" then answered his own question saying "the private sector creates jobs."
- Governments need to facilitate entrepreneurial activities. The start-up of new firms for job creation is crucial.
- Competition needs to be enhanced, and wage and employment adjustment capacity of firms needs to increase to foster innovation and promote job creation.
- These reforms are particularly important for countries that have lost cost competitiveness and need to stimulate productivity and improve trade performance.
- Governments should not engage in fiscal retrenchment by cutting capital expenditure and raising taxes, instead they should cut current expenditure.

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#### Update to strategic view

**ECB, EUROPE MACRO:**  
The ECB left interest rates unchanged for the fifth meeting in a row, and show no signs of moving in the near future. No increase in liquidity operations or bond buying either. President Mario Draghi used the press conference following the decision to strongly advocate the supply-side philosophy that the euro area needs to implement to return to growth.

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- Draghi refused to name any single any country that "needed to be more ambitions," even under questioning from journalists.

Draghi also used the press conference to call for a ten-year plan for the euro area, and to establish a framework for countries to give up some of their fiscal sovereignty -- yes, he literally used that expression -- to a central fiscal agency. Basically, he is calling for full monetary and fiscal union of the euro area.

Draghi's policy prescription is very much a supply-side one, and such policies are already beginning to be implemented in Europe's periphery (see "[Europe's Supply-Side Revolution](#)" February 17, 2012).

It is significant that the ECB, this most independent and powerful of euro area institutions, has such a supply-side bias. It gives an intellectual and theoretical framework for euro area politicians to follow, one that will allow growth to return and unemployment to fall.

And, as Draghi himself said, euro area politicians are, on average, smart enough.

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### Bottom line

The ECB left interest rates unchanged for the fifth meeting in a row, and show no signs of moving in the near future. No increase in liquidity operations or bond buying either. President Mario Draghi used the press conference following the decision to strongly advocate the supply-side philosophy that the euro area needs to implement to return to growth. ▶

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