The Increasing Number of Euro Fools

By Antonio Fatas , INSEAD Professor of Economics

Central banks don’t determine all interest rates.

Mario Draghi, the president of the European Central Bank (ECB) was surprisingly strong in his defence of ECB policies in a recent interview with **Der Spiegel**. Faced with criticism in Germany, I applaud his honesty and clarity when he responds that all German fears about increasing inflation in the Euro area have turned out to be wrong.

“The fears felt by some sectors of the public in Germany have not been confirmed. What haven’t we been accused of? When we offered European banks additional liquidity two years ago, it was said there would be a high rate of inflation. Nothing has happened. When I made my comment in London, there was talk of a violation of the Central Bank’s mandate. But we had made clear from the beginning that we are moving within our mandate. Each time it was said, ‘for goodness’ sake, this Italian is ruining Germany’. There was this perverse angst that things were turning bad, but the opposite has happened: inflation is low and uncertainty reduced," he said.

Of course, the journalist is not convinced and continues asking questions about the potential damage that ECB policies are inflicting on Germany. He follows with a set of questions on how the low interest rate policy of the ECB is hurting savers in Germany, claiming that the ECB has pushed interest rates for investments down so far that they are no longer enough to compensate for inflation. “In other words, only fools save,” the journalist contends.

This suggestion reflects a poor level of understanding of some basic economic principles. The statement "only fools save" can only be consistent with the data if the number of fools has increased dramatically in recent years. Interest rates are low because saving is high (and investment is low). Not the other way around.

Der Spiegel also claims that savers are paying the price for rescuing the euro.

Actually, savers are paying the price of fear and a long-lasting crisis. Both have reduced spending and, as a result, the equilibrium (real) interest rate. And more so in countries that are perceived as safe (as in the case of Germany).

Draghi is good at responding to both of these questions but I find his tone less aggressive than when he answers the questions on inflation. Maybe central bankers need to be more explicit about their (limited) influence on interest rates. The (wrong) perception among many is that interest rates, both nominal and real, for all maturities and risk profiles are determined by central bank policies.

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About the author(s)

Antonio Fatas is a Professor of Economics at INSEAD. He is also a Research Fellow at the Centre for Economic and Policy Research in London and has worked as an external consultant for the International Monetary Fund, the OECD and the World Bank.