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# Reading the ECB's Inaction



By Antonio Fatas , INSEAD Professor of Economics

## **The Euro area does not have deflation today, but the risk could increase if policy inaction persists.**

Mario Draghi, president of the European Central Bank (ECB), showed great skill in handling the questions at last week's [press conference](#). When pressed about why the ECB is not doing more in the presence of low inflation and possibly deflationary pressures he answered that they are are doing enough and that there is no deflation in the Euro area but simply a period of "low inflation from a protracted period of time". Technically he is right, inflation is low but remains positive and expectations of inflation do not point in the direction of immediate deflation.

But what remains unclear is the message he is giving about future actions. How low should inflation be and for how many months before the ECB considers it necessary to have more expansionary monetary policy? And why is the ECB ignoring the second pillar of its strategy (the money supply) when the numbers show growth rates that are clearly below target? [I am not a fan of the monetary pillar but it is always fascinating to see how the ECB feels compelled to report M3 growth numbers and then ignores them.]

Draghi gives two reasons to justify his inaction. One is the usual statement that there are risks on both sides:

"Both upside and downside risks to the outlook for price developments remain limited, and they continue to be broadly balanced over the medium term."

This sentence reminds me of the language used by the Bank of Japan to defend their inaction during the many years with deflation. Here is a quote from the minutes of the Bank of Japan monetary policy meeting in April 2010:

"Regarding risks to prices, some members said that attention should continue to be paid to a possible decline in medium-to-long term inflation expectations. One member expressed the view that attention should also be paid to the upside risk that a surge in commodity prices due to an overheating of emerging and commodity-exporting economies could lead to a higher-than-expected rate of change in Japan's CPI."

How could it be that in 2010 in Japan, after more than 20 years of struggling with deflation and in the middle of a global crisis, the perception of risks looked balanced and that some had the fear of overheating? And even if risk look balanced, what about erring once on the other side of this balance?

The second reason Draghi gives is that the situation is very complex and that they need to wait for more data in March. Maybe this was a way of saying that action is coming, but it is confusing and it remains unclear why uncertainty should lead to inaction.

Draghi is right, the Euro area does not have deflation today, but if the risks to price developments are perceived as balanced by the ECB, and uncertainty is another excuse for inaction it looks as if the ECB is doing its best to ensure that the Euro area remains close enough to deflation (not to 2%) and Draghi can be sure that he will get the exact same questions in future press conferences.

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