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ECOMENTARYô

Money Politics or the Politics of Money?

Three events appear to have combined that may yet force the ECB to alter its interest rate policy on Thursday August 30th. We think they will move, finally!

(1) A major policy statement by the ECB that gives it latitude to ignore one of its own, chosen indicators of ease or tightness, the reference value of M3 growth.

(2) a story leaked to Italian news sources, purportedly from the forthcoming World Economic Review of the IMF (scheduled for release just before the IMF annual meeting in Washington on September 18 that urges the ECB to move. **"It was right to cut interest rates in May, and there is scope for more cuts once there is clear evidence of a fall in inflation or if more signs emerge of growth weakening."**

(3) the growing body of evidence that world economic growth has been substantially undermined (the Italian press reports the IMF's projection has been cut to 2.8 from 3.4%,made in April**). Included in that assessment is a markdown of eurozone growth to 2% from 2.4%**

The **FT** story on August 28 2001 said, "The European Central Bank on Tuesday played down a sharp acceleration in eurozone money supply growth in July - raising hopes that the strong rise will not stand in the way of a near-term interest rate cut" The story was clearly based on the policy document **The Monetary Policy of the ECB,** released yesterday by the ECB. In its key, third chapter, entitled, "The ECB's monetary policy strategy," one can find the ECB's analytical justification for removing themselves from their policy box. : **'The reference value [M3] is not a monetary target.'**(p.47). Therein lies the latitude the ECB needed to gain in order to come to terms finally with the 'risks' presented by Pillar II (real factors). The box created by the ECB's Pillar I concerns has gotten too small. The recent M3 growth rate was 6.3%, which even if adjusted by the ECB's own analysis by some .6%, would bring the M3% growth rate well in excess of previously stated ECB reference value (say 4.5%). The ECB gave itself a way out of a seemingly, self-imposed limit, by stating at one point, **"…the ECB does not rely solely on deviations of M3 growth from the reference value."** (p.49). The door is now open to a reduction of its key interest rate on Thursday.

At the same time, by releasing this document two days prior to the Thursday Governing Council Meeting, the ECB can seemingly avoid the charge it has made a 'political' decision and veered away from its previously announced fascination with M3 growth. Ultimately, however, it is confirmation that Central Banks are in the last analysis not totally free of the Politics of Money.

On August 23, we looked at the ECB's dilemma. We focused on the "box" that the ECB's consistent focus on the M3% growth reference value had created for policy maneuver, and we concluded that if the M3 number was very high, we could judge a decision to cut anyway as a 'political decision.'

"Suppose they cut anyway? If the ECB does cut at its August 30th meeting, we will be looking for their estimates of M3 growth to decide if the decision was political or economic. If it has slowed considerably, the ECB can point to the favorable price index movements that are now coursing through the member states and justify its second move since the May cut. If they can't find a justification by significantly lowered M3 growth, the ECB has made a political decision." (Ecomentary MAS 082301).

Yesterday, the ECB cleverly rearranged the dimensions of the box, confirming the politics trumps economics, once again!

Prior to the last ECB meeting, they had released their July Monthly Report with an editorial that seemingly gave scope to a reduction in rates yet they did not move. This time, they have created an analytical basis for a move and the economic data world wide suggest that the ECB has finally joined the other Central Banks. The risks of global recession have become too large, even for the ECB.

The press conference on August 30th should sparkle indeed. We will all hear and listen, Dr. Duisenberg.