European Central Bank President Mario Draghi signaled the bank has no intention of tightening monetary policy anytime soon with inflation projected to “significantly” undershoot its 2 percent target next year.

While the ECB’s balance sheet may shrink naturally as confidence returns to financial markets and banks repay emergency loans, policy makers are “far” from considering an exit from monetary stimulus, Draghi said at an event in Munich late yesterday. “We foresee for next year an inflation rate which is significantly lower than 2 percent.”

The ECB has cut its benchmark interest rate to a record low of 0.75 percent, extended over 1 trillion euros ($1.3 trillion) in cheap loans to banks and pledged to buy the bonds of debt-strapped nations if they agree to economic reforms. The ECB in December forecast the 17-nation euro economy will contract 0.3 percent this year and inflation will slow to 1.4 percent in 2014. It is due to update the forecasts next week.

While conditions on financial markets are improving, Draghi said the euro-area economy is still “weak” and the ECB’s accommodative policy will help to drive a “gradual recovery” in the course of 2013.

“It is clearly too early to pull the carpet as risks are still to the downside,” said Thomas Costerg, an economist at Standard Chartered Bank in London. At the same time, “we cannot ignore that there seems to be growing underlying accommodation fatigue among central bankers,” he said.

**ECB Warning**

Two ECB Executive Board members yesterday warned about the risks of leaving emergency measures in place for too long.

“The maintenance of our extraordinary measures over a too-long timeframe creates false incentives and leads to moral hazard,” Yves Mersch said in his first speech as an ECB board member in Frankfurt, adding that governments can relieve pressure on the central bank by pursuing structural reforms.

At a separate event, fellow board member Peter Praet said there’s a risk that the ECB’s policies will become less effective the longer they are left in place.
Draghi said there’s a limit to what the ECB can do and it’s up to governments to solve the region’s debt crisis.

“It is important to stress that the ECB’s mandate only extends so far,” Draghi said. “There are clear limits to what monetary policy can and should aim to achieve. We cannot repair unsound budgets. We cannot clean up struggling banks. We cannot solve deep-rooted problems in the structure of Europe’s economies.”

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