Despite the Brexit: The Anglo-German dialogue goes on

Markus C. Kerber replies to *Martin Wolf's* comment
In a letter to the editor of the Financial Times

Those challenging the ECB's rescue measures are not mad

I have the privilege to read the Financial Times regularly with great intellectual pleasure, although your continuous praise of the ECB's policy sometimes suggests a soupçon of systematic bias. Martin Wolf's article "Why the European Central Bank can save the Eurozone" (April 21) crosses a Rubicon.
Mr Wolf requests unlimited powers for an institution which possesses by definition only limited powers. His request coincides with a period of sustained legal controversy over the ECB's non-standard monetary policy measures since 2012. Contrary to what Mr Wolf asserts, neither the European Court of Justice nor the German Constitutional Court has given 100 per cent clearance to unconventional ECB policy. In all cases the courts have laid down conditions. After the Outright Monetary Transaction rulings in 2015 and 2016 we are waiting for the German constitutional court's legal clarification for the Public Sector Purchase Programme on May 5. The ECB's new Pandemic Emergency Purchase Programme cannot claim to defend "price stability' but clearly aims to save the Eurozone by sponsoring bond issues by Italy, France and Spain. These measures are out of bounds, or at least highly debatable.
Mr Wolf claims that Germany would be "mad" not to consent to the ECB's emergency policy "to help every Eurozone member manage this crisis". It is neither polite nor rational to postulate that German opponents of the ECB's policy and even a whole country would be mad if it abandons the euro. Since the Lisbon treaty in 2008 a group of moderate, pro-European sceptics including many renowned academics and entrepreneurs have legally challenged successive rescue measures.
As their attorney I am well placed to tell you that this widening opposition is far from being mad. We believe the euro experiment should be brought to a smooth end, instead of waiting for a collapse that would bring far-reaching collateral damage for European integration.
Mr Wolf is welcome to visit Berlin to investigate the rationality of our opposition to ECB policy. As a convinced anglophile I wholeheartedly support open debates rather than prejudiced assertions.
Prof Markus C Kerber
Berlin, Germany

Why the European Central Bank can save the eurozone
It has near-unlimited firepower and is the only EU institution willing and able to act

Martin Wolf Financial Times April 21st 2020
Will the Eurozone survive Covid-19? If it does, it will be for the same two reasons it survived the financial crisis: fear of a ruinous break-up and action by the one institution able to do so on the scale needed. In July 2012, Mario Draghi told an audience in London: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."
The ECB is saying this now. It should be enough. The pandemic is creating an enormous common shock. But it has asymmetric results. Among larger member countries, the brunt of the disease has fallen on Italy and Spain, although France has been catching up. According to the IMF, the Eurozone's gross domestic product will shrink by 7.5 per cent this year; Germany's GDP will fall 7 per cent, but Italy's by 9.1 per cent.
Its Fiscal Monitor forecasts the Eurozone fiscal deficit at 7.5 per cent, Germany's at 5.5 per cent and Italy's at 8.3 per cent. Alas, even this looks optimistic. The "baseline" projection of the IMF's World Economic Outlook assumes that shutdowns will end in the second quarter of 2020. But it is quite likely that they will not, or that they will need to be repeated.
In the baseline scenario, the GDP of high-income countries shrinks by 2 per cent between 2019 and 2021. In the worst alternative — a lengthier shutdown now, followed by another in 2021 — GDP would be almost 10 per cent lower in 2021 than in 2019. Yet, even on its baseline view, the IMF

forecasts Italy's gross public debt at 156 per cent of GDP this year, up from 135 per cent last year. Debt is set to become mountainous for several Eurozone members in the years ahead.
This realisation has raised what is euphemistically called "redenomination risk" — fears of defaults, financial crises and finally even exits from the Eurozone. So spreads between the yield on Italian debt and the GDP-weighted Eurozone average began to rise, helped along by an unfortunate remark of its president, Christine Lagarde, that it was not the ECB's role to "close the spread".
With its €750bn Pandemic Emergency Purchase Programme, launched on March 18, the ECB undid the harm. Isabel Schnabel, German member of the board, has laid out its rationale. The ECB, she explained, has two overarching objectives, "to restore the orderly functioning of euro area financial markets" and to ensure that "our accommodative monetary policy continued to be transmitted to all parts of the single currency area" (my emphasis). Redenomination risk imperils both objectives. This gives the ECB a potentially unlimited obligation to intervene.
Moreover, since the biggest challenge has been the "heterogeneity" of conditions across the Eurozone, the ECB needs to act "flexibly across time, asset classes and jurisdictions", as the PEPP now permits. The ECB has duly brought Greece back into its fold. The PEPP itself is limited in time and scale. But its stated objectives mean that the ECB has to do even more if needed. In essence, the ECB is committed to acting as if it were the national central bank of every member. Since it issues the world's second-most-accepted reserve currency, it has the capacity to do so.
Technically, in a disinflationary or deflationary situation, such as today's, a central bank has unlimited firepower. It can buy anything, at any price it wants, subject to just three constraints: first, it might overdo intervention, so triggering flight from the currency and inflation; second, it might exceed its legal powers; finally, it might destroy the political consensus that created it.
The inflation constraint is hardly binding today. At some point, however, the ECB might want to reverse its interventions and so sell the bonds it holds. This could create problems for the most indebted governments. On the legalities, the German constitutional court and the European Court of Justice have found in favour of the ECB, so far. The ECJ surely always will, provided the ECB is careful. The German court might rule against the ECB. That would at once create a political crisis. Germany has a credible exit option. But a return to the D-Mark would create a huge economic and political shock.
Germans would be mad to exercise their option, however much they may hate the ECB's actions. In brief, the ECB has to do whatever it takes to help every Eurozone member manage this crisis. So what about the parallel discussions of the role of the European Stability Mechanism, "corona bonds" or some similar alternatives? The ESM seems irrelevant. Its firepower is far too small. So it matters only to the extent that it might trigger the ECB's Outright Monetary Transactions programme, invented in 2012. But, given the subsequent development of ECB asset purchases, the OMT is no longer relevant. Moreover, the ESM's conditionality — if not now, then later, when rollovers come due — makes its loans anathema. These would also be divisive, when solidarity is required.
Politically, a common financial instrument ("corona bonds") is attractive to some, but anathema to others. It will not happen. Yet such an instrument provides the obvious exit for the ECB when it wishes to sell the bonds it is about to acquire. Otherwise, there could be difficulties with the debt mountains in future. Yet, provided interest rates stay low and the ECB supportive, it may be surprising how much debt is sustainable. It is debt's costs, not its levels, that determines sustainability.
The collapse of the eurozone would be a catastrophe. The ECB is the one institution able and willing to act. Governments should back it. They also need to consider how to clean up the debt when all is over. Now is a time for action: "whatever it takes", once again.