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60

Pressure mounts on ECB to act

By Ralph Atkins in Frankfurt

Germany, supposedly the model of European stability, fails to attract enough buyers for its bonds. The eurozone heads into a recession, possibly severe. Talk about a break-up of Europe's monetary union intensifies. How much longer will it be before the European Central Bank acts?

The Frankfurt-based ECB saw pressure intensifying on Wednesday for it to step-up its response to the escalating crisis. Weak demand in a German debt auction may have had technical explanations, but hinted at rising investor aversion towards anything to do with the eurozone.

Meanwhile, weak eurozone purchasing managers' indices for November and an unexpectedly sharp 6.4 per cent drop in industrial new orders reported for September, pointed to a possibly precipitous fall in eurozone economic activity in the last few months of the year, which would intensify further strains on banks.

"Nothing short of an open-ended commitment by the ECB to support troubled sovereigns will stem the panic now," said Sony Kapoor, head of Re-Define, the economic think-tank.

Echoing calls from Spanish and Italian counterparts, Didier Reynders, Belgium's finance minister, told Reuters he was convinced that the ECB "should be a more important player than today". His comments suggested political support coalescing around the position long taken France: that the ECB should act, in effect, as a "lender of last resort" to governments.

At least some on the ECB's 23-strong governing council would agree the bank could be more aggressive. Still, François Baroin, France's finance minister, on Wednesday saw two big obstacles to such as step: "European treaties do not allow it and Germany ... does not want it."

Angela Merkel, German chancellor, and the country's Bundesbank remain fiercely opposed to the ECB riding to the rescue of governments with its government bond purchasing programme – which has already cost €195bn since May last year. Germans fear setting the wrong incentives for politicians, and creating inflation by, in effect, printing money.

German opinion is a crucial factor for the ECB. "Ultimately the euro is still a relatively new currency – and is not just there to support Spain and Italy. It has to suit northern Europe as well to survive," said Julian Callow, European economist at Barclays Capital.

Ultimately, the ECB council, which prides itself on its political independence, could simply ignore Berlin. Jens Weidmann, Bundesbank president, has only one vote: the same as all other council members. His allies may not command a majority.

Moreover, EU treaties need not limit ECB bond buying. The basis for its action so far is that financial market intervention was needed to ensure ECB interest rate decisions were "transmitted" to the real economy.

There is a ban, frequently cited by the Bundesbank, on "monetary financing" – central bank funding of governments – which prevents the ECB buying bonds directly from governments. But ECB lawyers could argue that a public pledge to limit, via intervention in open markets, the "spread" between interest rates on German and other eurozone bonds was entirely compatible with the ECB's inflation-fighting mandate.

The risk, however, is of the ECB's credibility being questioned if it lacks German support for its actions.

In September, Switzerland's central bank took the radical step of announcing it would buy foreign currency in unlimited quantities to combat the overvaluation of the Swiss franc. But its move enjoyed broad public and political backing.

If the ECB set explicit targets for eurozone interest rate spreads, any whiff of internal German opposition could cast doubt on its commitment and encourage speculative market attacks. As a result the ECB could end up spending huge sums defending the targets.

So far during the eurozone crisis, observes Gilles Moec, European economist at Deutsche Bank, the ECB has stepped up its actions only in response to measures taken by politicians. German opposition could be assuaged, he suggests, if the country felt progress were being make in tackling structural flaws that led to the crisis erupting in the first place. That could include concrete steps towards strengthening eurozone governance.

Last week, Mario Draghi, ECB president, urged eurozone leaders to make fully operational the EU's new rescue fund, the European Financial Stability Facility – originally launched 18 months ago. "It takes something to happen on the political side to prompt a massive reaction by the ECB," Mr Moec said.