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Marketing Material

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ECB BOND PURCHASES NOT ENDANGERED BY GERMAN JUDGEMENT

In a nutshell

- Germany's Constitutional Court criticizes the ECB for exceeding its powers, but sees no monetization of government debt by the ECB.
- The ruling is likely to change little in the short-term monetary policy of the Eurozone.
- We expect no opposition from the Bundesbank, and further expansionary monetary policy.

The European Central Bank (ECB) exceeded its powers in the government-bond purchase program and the European Court of Justice (ECJ) in its approval of this behavior did not argue in a comprehensible manner. We are displeased but allow the program to carry on, provided it is better explained.

This is a slightly simplified summary of the ruling of the German Federal Constitutional Court (Bundesverfassungsgericht, BVerfG) regarding bond purchases in the Eurozone. In surprisingly direct words, the German court accuses the ECB of having exceeded its mandate and of not having sufficiently examined the proportionality of its monetary policy in the years 2015 to 2018. It also accuses the ECJ of exceeding its competences and leaving out essential facts in its ruling ("completely ignoring all economic policy effects") and the Federal Government of not having taken action against the purchase program.

The choice of words used by the constitutional judges is certainly surprising and is likely to cause further waves in the complex interplay of national and European courts within Europe. However, we do not see any immediate impact on the ECB's bond purchases.

One reason for this is that the ruling relates to the Public Sector Purchase Program (PSPP) launched in March 2015 and not the current Pandemic Emergency Purchase Program (PEPP). However, the bridge from PSPP to PEPP might be built quickly by new plaintiffs and courts. After all, the capital key and issuer limits of 33% are no longer mandatory in the PEPP. The second reason, which is more important in our opinion, is that the German court concludes that the problem could essentially be solved if the ECB were to explain the proportionality of its actions in more detail.

Given the ECB's access to a large economic analysis department and eloquent experts, we have no doubt that it will be able to provide this proof in the near future.

In general, the German court stated that there was no violation of the ban on monetary-budget financing, since the bond-purchase program was tied to numerous conditions and would not constitute direct state financing.

What has changed? The German court considers it the duty of the German Bundestag and the Federal Government to press for a proportionality test by the ECB, especially for the reinvestment phase from January 1, 2019 to November 2019. Furthermore, the ECB should explain within three months in a comprehensible manner that the means it uses to achieve its monetary-policy objectives are not disproportionate and that all associated economic and financial-policy effects have been sufficiently taken into account. Otherwise the Bundesbank (German central bank) will no longer be allowed to participate in the bond-purchase program. However, despite the Bundesbank's known reservations about the bond-purchase program, we assume it will not contradict the decision of the ECB.

The German court also demands that government-bond holdings should be reduced in the long term, but did not specify a time frame.

We don't see in any of the points an obstacle that would prevent the ECB from sticking to its current course: its monetary policy will not change in the short term. On the other hand, it was already the declared aim of the new ECB President, Christine Lagarde, that the side effects of her policy would be examined more closely and communicated. She is well aware that she would have to reckon with growing resistance from the northern Eurozone countries if she too follows the unconditional "whatever it takes" policy of her predecessor. We believe the ECB should therefore be able to live with this judgement without much difficulty, especially as the German Federal Constitutional Court has, perhaps deliberately, remained vague enough on many points to spare the ECB from any loss of face and to allow it sufficient room to maneuver.

GLOSSARY

The **asset purchase programme (APP)** refers to purchases of marketable debt instruments by the ECB.

The **Bundesbank** is the central bank of Germany.

The **European Central Bank (ECB)** is the central bank for the Eurozone.

European Court of Justice (ECJ) the highest court in the European Union in matters of European Union law.

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

The **German Bundestag** is the national parliament of the Federal Republic of Germany. It is the lower house of the two legislative chambers, the German Bundesrat being the upper house.

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

The ECB's **Pandemic Emergency Purchase Programme (PEPP)** is a non-standard monetary-policy measure initiated in March 2020 to counter the serious risks to the monetary-policy transmission mechanism and the outlook for the Eurozone posed by the coronavirus outbreak.

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