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## ECB to buy bonds despite ruling of the German Constitutional Court

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The European Central Bank (ECB) intends to buy bonds despite the recent ruling of the German Constitutional Court. Early last week, the Federal Constitutional Court in Karlsruhe ruled that the ECB's billion-euro bond purchase programmes partly violated the constitution, and in doing so, opposed a ruling by the European Court of Justice (ECJ) that deemed the bond purchases legal in December 2018.

The ECB central bankers have so far been unperturbed by the ruling. As an independent institution, the ECB is accountable to the European Parliament and driven by its mandate, said ECB President Christine Lagarde on Thursday at a conference held by the news agency Bloomberg.

"We will continue to do whatever is necessary to fulfil this mandate," she said. ECB Vice-President Luis de Guindos said, "We remain more determined than ever to ensure supportive financial conditions across all sectors and countries to allow this unprecedented shock to be absorbed."

### ECB has already invested EUR 2.6tn in securities purchases since 2015

Between 2015 and 2018, the ECB had invested around EUR 2.6tn euros in government bonds and other securities – most of it through its Public Sector Purchase Programme (PSPP), to which the judgment refers. In November 2019 the purchases were relaunched, initially comprising a comparatively small amount of EUR 20bn per month.

With the bond purchases, the ECB wants to prevent possible deflation after its interest rate cuts had not had sufficient effect. In technical jargon this is called quantitative easing (QE).

Central banks normally try to achieve monetary policy goals, such as monetary stability or economic growth, by controlling their key interest rates. After the financial crisis, however, many central banks lowered their key rates to virtually zero, exhausting this measure. In this case, central banks can fall back on unconventional measures such as "helicopter money" or even bond purchases.

Other central banks already chose this path before the ECB, the pioneer being the Japanese central bank, which launched a bond purchase program in 2001 to combat deflation in the country. In 2008, the US Federal Reserve announced a massive bond purchase program to fight the financial crisis, after having already lowered its key interest rate to zero.

Since 2009, the British central bank has also been buying bonds.

Under these programs, the central banks buy up private or public securities, such as government bonds, from the commercial banks. These purchases increase the banks' monetary base and liquidity, while at the same time lowering the interest rate level in the bond market.

This is intended to boost credit demand, investment activity and private consumption, but also to combat too-low inflation. Through its purchasing program, the ECB is also trying to achieve its inflation target of approximately two per cent; however, it is currently far from achieving this: consumer price inflation in the euro zone recently lay at 0.4 per cent, and in view of the coronavirus crisis the ECB is preparing for a further decline.

### Purchases aren't forbidden state financing, but not conducting review is unconstitutional, Court rules

Critics of bond purchase programmes often argue that this could be a covert form of government financing. In 2017, the German Constitutional Court had already inquired of the European Court of Justice (ECJ) whether the ECB's bond purchases constituted a prohibited form of public financing.

In its much-publicized ruling, however, the ECJ had declared the purchases to be lawful. The constitutional law experts in Karlsruhe have also "acquitted" the ECB in their recent ruling on this point. However, it is in violation of the constitution that the ECB did not review the proportionality of its measures.

It should also have examined the economic consequences for savers, shareholders and property prices, the ruling states.

The Governing Council of the ECB must now demonstrate that the purchase programme is proportionate within three months, as otherwise, the Deutsche Bundesbank is prohibited from participating in the programme after a transitional period of no more than three months. The Bundesbank is the ECB's largest shareholder, owning a share of more than 26 per cent, and its purchase volume is correspondingly large.

As a consequence of the ruling, the Deutsche Bundestag should by law request information on ECB activities from the Bundesbank, states a proposal in a confidential legal analysis by the Bundestag made available to Reuters.

The paper states that the Bundestag should examine the proportionality of the ECB's bond purchases and continuously be informed about the purchase programme. In addition, the proportionality of the purchase programmes must be reviewed at regular intervals.

The Bundestag's lawyers for European affairs do not expect the ruling to have a major impact on the PSPP bond purchase programme to which it refers. Analysts also expect that the ECB will prove the proportionality and continue the PSPP bond purchases.

### Purchase limits could affect pandemic emergency programme

If the judgement were to refer to the EUR 750bn pandemic emergency purchase program (PEPP) of the ECB launched this year, this could exacerbate the matter: According to the ruling, the ban on public financing only applies if the ECB's share in a government bond does not exceed 33 per cent and the ECB distributes its purchases among the individual countries according to the share of local central banks in the ECB's capital.

However, it is precisely these purchase limits and allocation keys that are handled flexibly under the new PEPP bond purchase program, which is bound to tie the ECB's hands to a certain degree and limit its scope for action.

The ECB could now point out that the pandemic programme is not covered by the ruling, or it could also comply with the limits and key values in this regard as well. In any case, analysts expect the ECB to firmly adhere to its PEPP crisis programme.

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