

## **Transcript of conversation between Didier Borowski, head of global views at Amundi, and David Marsh, OMFIF chairman, 20 May 2020**

The German constitutional court verdict on 5 May on the Bundesbank's participation in the European Central Bank's public sector purchase programme has important short- and long-term implications. Didier Borowski, head of global views at Amundi, the French asset management firm, previously worked as senior economist and strategist at Société Générale Asset Management and at the French Treasury. He was associate professor at the Université Sorbonne Paris Nord.

### **Timing a surprise, not the contents**

**David Marsh:** Did you expect this court judgment?

**Didier Borowski:** We were surprised by poor timing. I was not that surprised by the contents. We know that the German court was very reluctant to authorise the Bundesbank to participate in the programme. The timing was surprising given that we are in the middle of the biggest recession probably ever seen in Europe. There are risks for the flexibility of the ECB programme.

**DM:** And the bigger picture?

**DB:** At the global level, particularly in Europe, we are seeing central banks with a quasi-fiscal role since they are printing money to buy private assets and government bonds without any clear legal legitimacy to do that. So, from a legal standpoint, the ruling has some merits, bringing the debate to the political space, where it should be. We have a very complex interaction between fiscal and monetary policy, and parliaments and governments have words to say here.

**DM:** Will the court judgment have any operational significance for how the ECB conducts either the public sector purchase programme or the new emergency pandemic emergency purchase programme during the next three months?

**DB:** In the short term, no. According to the European court of justice, the PSPP is in line with European law. The ECB will want at least in the short term to assure that it continues to operate as if there was no constraint. If you look ahead, and seeing the debate in Germany, it may lose some flexibility in its purchase programme. In the short run, until the next monetary policy meeting [on 4 June], we would expect the ECB in its government bond purchases to continue to deviate quite substantially from the capital keys.

### **Still €500bn left in ECB's PEPP**

**DM:** What has happened up to now?

**DB:** Since March, the ECB has deviated quite substantially from the capital key. On the basis of the most recent data, the two countries that were targeted were Italy and France. And my guess is that the ECB may have to continue in this direction. The PSPP is clearly under review from the German court. The PEPP is not, it's a new programme, totalling €750bn. The ECB is free in theory to continue to operate and to deviate quite substantially from the capital key. And there is a consensus in the euro area that, under exceptional crisis circumstances and for a short period, until the end of 2020, the ECB can operate without respecting the proportionality rule. We don't know yet the PEPP breakdown between purchased private and public assets. We will know that in early June.

**DM:** How much PEPP capacity is left?

**DB:** We estimate around €500bn at the end of May. If the ECB continues to buy assets at the same pace, it would have ammunition only until the end of September. That's why it's highly likely that in June the ECB will announce a new programme [or increase the PEPP] probably by €400bn-€500bn.

### **Bundesbank in difficult position**

**DM:** What does that mean for the Bundesbank? They are a German institution under the jurisdiction of the constitutional court. But the ECB can say that Jens Weidmann, the Bundesbank president, on the governing council, is a European citizen, subject to European laws and constraints. Doesn't this bring the Bundesbank into a nearly insoluble conflict?

**DB:** It could indeed. I think the German court is aware of that. The best case scenario is that, after the ECB produces a [proportionality] report, the German says the Bundesbank is in line with German law. If that's not the case – if the German court continues to say the action is ultra vires and that the Bundesbank needs to stop its participation in the ECB programme – that would put the Bundesbank in a very difficult situation. In theory, it may even refuse to obey the German court, which would create a precedent and a lot of political noise in Germany.

**DM:** What can the Bundesbank do?

**DB:** The Bundesbank has a duty to advise the federal government on monetary policy issues. It's highly likely that before the ECB [proportionality] report, we will see a report from the Bundesbank on the PSPP and proportionality rules – and this should be aligned with what ECB has constantly been saying over the past months.

**DM:** Where will this lead?

**DB:** Ultimately, I believe that the German court is more open-minded on European integration than is often said. The German government and the Bundestag have own words to say. And the German court will listen very carefully to this, after the Bundesbank has given them advice. We may see a lot of volatility and political tensions in Germany during the summer, but eventually I believe that we can imagine a situation where all institutions save face and close the debate in an orderly manner.

### **Cutting through Gordian knot**

**DM:** The German court says the proportionality report should be done by the ECB. The ECB executive board seems to be practising 'benign neglect', saying it takes note of the German verdict but it's not actually heeding it. It is hoping that the Bundesbank, the German government, and the parliament will resolve the issue by themselves. The ECB is very averse to writing any kind of report or decision. How can you cut through this Gordian knot and respect the judgment while upholding ECB independence?

**DB:** The ECB does not need to say precisely what they will do by the end of August. From a symbolic standpoint, they need to show a kind of benign neglect. They need to emphasise that the ECB operates under European law and that the ECB does not answer to a national court. They need to show independence.

**DM:** The ECB has to answer to the questions raised by the German court.

**DB:** They will do that in due course. The question is clearly for the ECB. But the Bundesbank at some point will have to give its opinion. At any time, the German government or the Bundestag can formally ask the Bundesbank for its own advice. So that's a complex game. The German government, the Bundesbank, the German court and the ECB all have to save face. That doesn't mean that the

ECB will not comply with the court ruling, and they will not write, by the end of August, to the German court. They can do both.

### **Medium-term approach to respecting capital key**

**DM:** Ultimately, this is about monetary financing of states. In Europe, it is enshrined in the treaty, there should not be monetary financing, The German court and the ECJ did bring in some stipulations, such as the various limits. You have to get back to the capital key in due course. Do you think that for the PEPP, this could actually be as long as say 30 years?

**DB:** The solution might be to say that, in normal circumstances, you have operate with the proportionality rule, you have to respect the capital key one way or another. But in exceptional circumstances, there is no need to respect the capital key because you need a lot of flexibility.

**DM:** How does that work?

**DB:** It's like the inflation target. You don't need to have inflation at 2% at any point of time. You need to implement monetary policy to achieve your inflation target in the medium term. And so, for the capital key, you need respect the capital key in the medium term.

**DM:** How long, five years, 10 years?

**DB:** Probably less than that – three to five years. The ECB mandate to respect the 2% inflation target. They have not achieved their mandate, because inflation has remained substantially below the ECB target since the great financial crisis. And my point is that the medium term can be longer than that, in exceptional circumstances.

**DM:** But what about proportionality? The court uses very brusque language in claiming that the ECB did not take into account some of the negative effects of its actions? Do you think that's right or wrong?

**DB:** It's wrong because one of the main objectives of a central bank is macrofinancial stability. The first objective of the ECB during this crisis was to avoid the deep fragmentation of sovereign bond markets and credit markets that we had after the 2008 financial crisis. The ECB has avoided the deep market fragmentation that might have taken place without intervention. The ECB has benefited all euro area economies since the start of the crisis.

### **Franco-German plan for recovery fund**

**DM:** We now have a new position with the France-German plan for the European Commission to borrow €500bn from the markets, to be passed on to states that need it, not as loans, but as grants. The constraints brought in on 5 May were probably a factor behind that. Is the plan for the recovery fund going in the right direction? Will it get approval?

**DB:** First, an important point is that it concerns the whole European Union not just the euro area. But yes, it goes in the right direction. When you have the kind of extraordinary exogenous shock as we have now, there is no moral hazard. We need to share risks. The central bank cannot do everything. The ECB, in particular, faces legal constraints. So that's why the verdict increases the pressure on governments to deliver something. On a national basis, all governments have done what they could. The French and German initiative is welcome.

**DM:** Yet it's not a done deal.

**DB:** You have many countries quite reluctant to go in this direction. The initial proposal from France and Germany is to build this recovery fund only with grants, with issuance from the Commission. The amount is substantial, more than 3.5% of EU GDP. But we are not sure that it will be 100% grants, although that is what we need. We also need common debt issuance to share the burden of this crisis for countries like Italy and Spain and others.

### **Advancing through crises – a Hamiltonian moment?**

**DM:** We have a single currency. We don't have a single fiscal power. Does the Franco-German proposal bring us anywhere near the famous Hamiltonian moment?

**DB:** Europe has progressed only through crisis. We are able to cope with this crisis, thanks to the tools that were launched following the European sovereign debt crisis. And to some extent, it was also true for the Federal Reserve, which was able to deal with the great financial crisis because of the changes made to its status in the 1930s.

**DM:** Fiscal or monetary – what should take priority?

**DB:** On the monetary front the toolbox is already there. We have many possibilities regarding ECB action. We will make progress on the fiscal front. The euro area would be in a much more comfortable position if it had a single significant budget to deal with these kind of shocks. And a single financing instrument would make easier a very flexible and a reactive policy mix, as in the US.

### **Progress – but tensions ahead**

**DM:** Is the glass half-empty, or half-full?

**DB:** Gradually, the glass is filling up in the euro area. Thanks to this crisis in Europe, we will make some progress on the fiscal side. It's not the true mutualisation that many economists expect, but it's the first step. European monetary union will, I believe, step by step, become a true monetary union. We will also make advances in capital markets.

**DM:** What would be your best guess of when we will have a political union? Will crises swamp the reform efforts?

**DB:** There is an emergency push to launch a stimulus that will boost growth at the end of the year or in early 2021 when we may go through a soft patch for the economy. So now the debate is on the political front. We need to deal at the same time with the recovery fund, and with pressure from the German constitutional court. The political environment will be quite noisy; fiscal policy is lagging and monetary policy may not be as flexible as we thought. I would expect that governments will ultimately do what is necessary. The ECB will keep its independence and continue operating under the European court. Yet we should not rule out tensions during the summer.

**DM:** Thank you for setting the scene, Didier, in very realistic fashion. Maybe we'll get through to the right solution in the end with goodwill and diplomacy.