

## From ECB: To Karlsruhe with love

The minutes of the June meeting have “Karlsruhe” written all over it. But it looks as if the ECB has found an elegant way to end the controversy with the German constitutional court



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The latest minutes of the European Central Bank meeting on 4 June does not only provide the rationale for the increase of the pandemic emergency purchase programme (PEPP) but is also the ECB's answer to the German constitutional court's ruling on quantitative easing.

In recent days, the ECB's chief economist Philip Lane had already given extensive explanations and arguments of and for the ECB's measures since the start of the Covid-19 crisis and the latest minutes echo the same sentiment.

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Low growth and disinflationary pressures were the main drivers of the June decision to increase the size of the PEPP. With regards to the economic situation, the ECB staff projections expect the eurozone economy to return to its late-2019 level towards the end of 2022. The ECB expects the inflation outlook to be disinflationary, as the inflation forecast of 1.3% in 2022 is clearly well below

the central bank's target.

Interestingly, Lane added a new element to the ECB's official narrative: the role of the ECB's monetary policy measures as a backstop against adverse tail risks.

In his comments this week, Lane pointed out that “by averting a meltdown of financial markets, providing a liquidity backstop, curbing the excessive valuation of risk and preventing the most adverse macro-financial feedback loops that could trigger a credit crunch, our monetary policy package reduces the magnitude of risks around the central tendency of the economic outlook.”

## Karlsruhe, this is for you

The ruling of the German constitutional court on the ECB's first QE programme had not only caused uncertainty in financial markets but also created uncertainty about the right reaction. Should the ECB address the concerns put forward by a national court?

Today's minutes are clearly an attempt to address the concerns, without explicitly saying so. During the press conference after the June meeting, ECB president Christine Lagarde put more emphasis than usual on low inflation, deflationary risks and the need to act in accordance with the ECB's mandate. Today's minutes, as well as Lane's earlier remarks, have now addressed the issue of lacking proportionality analysis.

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In his speeches, Philip Lane had already presented some kind of proportionality analysis, showing several model calculations of the expected impact from the monetary policy measures taken since March. According to Lane, the measures taken would increase inflation by some 0.4 percentage points in 2021 and 2022 and GDP growth by between 0.3 and 0.6 percentage points each year from 2020 to 2022. Don't forget that the ECB staff projections only took into account the March measures but not the announced increase in PEPP in June.

Today's minutes have three explicit references to proportionality. Interestingly not only referring to the current PEPP but also to the 2015 decision to start asset purchases.

Phrases like “purchases of government bonds under the PEPP and the APP were an effective tool for delivering on the Treaty-assigned price stability objective” or “the PEPP and the APP were proportionate measures under the current conditions for pursuing the price stability objective, with sufficient safeguards having been built into the design of these programmes to limit potential adverse side effects, including risks of fiscal dominance, and to address the monetary financing prohibition” clearly have ‘Karlsruhe written all over them.

In our view, demonstrating proportionality of unconventional monetary policy measures will always be difficult.

At least at the moment of the first decision-taking as it is in the nature of an unconventional measure that the situation triggering such a first decision is so unprecedented that no fully-fledged proportionality analysis will be possible. In the end, monetary policy is also almost as much of an art as science. However, in the current situation, the most important goal was to bring an end to the controversy between Karlsruhe, Berlin and Frankfurt.

It looks as if the ECB found an elegant way to come to a smooth end. Next week, when the German parliament discusses the ruling and the possible next steps, chances are high that some kind of face-saving workaround will be found.

The minutes send two messages: the ECB stands ready to do more if needed and it is also trying to put the conflict with the German constitutional court to bed.

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