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No Cheers for the Bundesbank

German policies are hurting…Germans.

BY MELVYN KRAUSS

One reason the Bundesbank is popular with ordinary Germans is that it is seen to pursue a more national than European agenda.

But the German central bank on occasion can shoot itself in the foot. Policies intended to promote strictly German interests wind up damaging them.

The Bundesbank's successful campaign of until recently stalling ECB quantitative easing is a case in point. Instead of pressuring structural and fiscal reforms in eurozone reform laggards such as Italy and France—something the German public clearly approves of—the quantitative easing stalling strategy has damaged some of Germany's finest export companies and financial firms.

Export companies have been hurt because the Bundesbank only belatedly anticipated that while the ECB sat on its hands, the Bank of Japan would adopt an aggressive quantitative easing program of its own, aimed at lowering the yen in world currency markets.

The disparity between Japan and Europe on quantitative easing has led to a sharp appreciation of the euro relative to the yen—putting German jobs and profits at risk, especially in export industries that directly compete with Japanese firms in world markets such as automobiles, heavy capital equipment, high-tech goods, chemicals, and so on.

German export firms such as Siemens, Bosch, Villeroy and Boch—and even the less price-sensitive luxury car makers such as Mercedes Benz and BMW—were caught in the crossfire between Japanese monetary aggression on the one hand and the Bundesbank's quantitative easing intransigence on the other.

Another German industry hard hit by Bundesbank stalling on quantitative easing was German insurance companies and pension funds.

The central bank's effective stalling allowed the eurozone's disinflationary process to proceed to the point where yields on German bunds have reached record lows.

This strangled the insurance companies, which have fixed rate legal obligations to savers they must respect, and pension funds, which have fixed obligations to pensioners.

Things reached the point where only a major operation—which has to include ECB purchase of sovereign bonds to be effective at this late date—was capable of doing the job.

To some extent, German financial firms got what they deserve. They fought quantitative easing tooth and nail—and continued to do so even when eurozone inflation was negative.

Michael Heise, chief economist of Allianz SE in Munich, argued against quantitative easing in a *Wall Street Journal* article on the grounds that "ultralow interest rates discourage savings for retirement and slow down the growth of existing pension assets."

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He failed to see that the reason Europe has such low rates now is because it didn't take care of business before. Bundesbank stalling on quantitative easing allowed the disinflationary process to proceed unabated when it should have been cut short. Take the right medicine and the pain goes away.

The insurance companies still don't understand that quantitative easing will raise the yields on bunds, not lower them further. When the markets see the ECB finally is doing something effective against deflation, periphery debt in particular becomes more attractive because of the squeeze deflation puts on debtors. Private investors should respond to quantitative easing by buying the periphery and selling bunds.

Behind the Bundesbank's refusal to take the right medicine was its nationalistic obsession that German taxpayers not be stuck with the bill for ECB holdings of sovereign debt gone sour. Allianz, BMW, and many other German firms are paying a heavy price for this.

The irony is that these companies would have been better served by a European than purely national perspective at the German central bank.

Bundesbank chief Jens Weidmann should have surprised people at the ECB's January meeting and voted in favor of quantitative easing—if only to protect legitimate German interests. He didn't. ◆

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