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Unhappy with Easy Money: Germany and the ECB's Monetary Policy

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The expansive monetary policy of the European Central Bank (ECB) is controversial in Germany where it is perceived as a threat to the interests of savers and banks and an attempt to undermine the austerity approach to public finances in the euro area. The arguments formulated in Germany will not, however, persuade the ECB to change course: the easy money policy will continue. This raises the chances of euro area growth, which is also important for the Polish economy because it is highly dependent (e.g., exports) on single-currency markets.

During its September meeting, the ECB Council decided to further ease its monetary policy. The deposit rate was reduced to -0.50% (previously -0.40%) to encourage banks to take on bolder lending and discourage them from “parking” capital in the central bank. In addition, the ECB decided to restart the government bond-purchase programme, thanks to which €20 billion per month will land in the market. Expansive monetary policy is to be continued until inflation increases close to 2% (currently just 1%).

The ECB's decisions echoed in Germany. Theoretically, they should be welcomed because the German economy is almost in recession. The easy money policy also allows the state to borrow without interest and helps exporters because of the weakening euro. There also should be optimism spreading among consumers who enjoy access to the cheapest credit ever. However, the president of the ECB, Mario Draghi, heard harsh criticism in Germany for his recent decisions.

Criticism of the ECB. The most frequently formulated complaint concerns the deterioration of savers' situations. Conservative in financial matters, Germans usually hold their money in bank accounts, which in the face of the post-crisis monetary policy meant a radical reduction in interest income. Currently, it can even mean losses if banks start shifting the cost of negative ECB deposit rates to savers, for example, in the form of additional account fees. The problem of “saving penalties” has become political. In the public debate, ideas are circulating to deduct losses resulting from negative interest rates from tax burdens, examine their compliance with the constitution, or even prohibit them by a special law.

Critics of the ECB's policy also say that it is very damaging to German banks. Under low-interest conditions, they hardly make a profit and are additionally obliged to pay even €2.3 billion annually for capital held in ECB accounts. Representatives of the sector warn that further loosening of monetary policy may trigger a wave of bankruptcies, especially among smaller banks. Insurance companies and funds offering, for example, retirement programs may also be in trouble: at current rates, they are hardly able to meet the profit promises made to customers.

Germans also doubt the effectiveness of the ECB's action. They argue, for example, that making very cheap money even cheaper does not constitute a qualitative change in the economy but boosts speculative bubbles in real estate or stock markets. Another problem is the phenomenon of so-called zombie companies whose very existence is made possible by zero-cost lending. The debt and structurally weak

economies of the eurozone operate in a similar pattern: the ECB money has allowed the necessary reforms and adjustments to be postponed. In Germany, there are also fears that Draghi's decisions pushing the euro towards devaluation will exacerbate the trade conflict with the U.S. President Trump considers them a form of aggressive support by the ECB of EU companies, thus he may return to the idea of imposing higher duties on European products, in particular German cars.

Weaknesses of German Criticism. The allegations made against the ECB policy are not without flaws. For example, low or even negative interest rates on bank deposits result not only from decisions made in Frankfurt but also from the high saving rate in Germany and an oversupply of capital. It is mainly due to companies that are reluctant to invest despite profits and a government that has been achieving billions in budget surpluses for years and is also reluctant to invest. The attack on the ECB, therefore, seems to be an attempt to divert attention from economic policy, whose natural consequence is a low market interest rate.

Blaming the ECB for the bad situation of banks also should be treated with caution. The sector's problems with profitability are largely due to its fragmentation (almost 1,600 entities) and too slow response to the digital revolution in finance. Their business model, which—unlike in the U.S.—depends less on commissions for services, and more on interest, is also quite outdated. The structural flaws of the German sector can be demonstrated by direct comparison with other European competitors: in 2018, it generated a profit of €9.6 billion while the French generated €30.5 billion, and the Italian—usually associated with a deep crisis—€11.6 billion. In addition, a closer look at recent ECB decisions shows that it has taken into account the need to alleviate the situation with the German banks by making part of excess liquidity holdings exempt from the negative deposit facility rate. As a result, the sector in Germany, as calculated by BdB, an association of banks, will save €0.5 billion a year and improve its position relative to, for example, its Italian competitors, who do not have such huge capital resources and do not enjoy the advantage.

However, the most difficult to defend is the combined critique of the ECB's expansive policy and an affirmation of restrictive fiscal policy. If the bank initiated a return to higher interest rates under the current conditions, the effect would probably be the collapse of the euro area economy and a massive debt crisis. The risk would be much lower if the stimulation of economic growth was taken over by the fiscal policy of countries that have space to increase spending, like Germany. This argument does not raise major disputes among German economists, but it hardly breaks into German politics. Presented in September, the government's draft budget assumes maintaining a balanced budget until 2023 (the so-called "black zero").

Conclusions and Perspectives. The ECB's decisions suggest that the eurozone will have a long period of very low interest rates. This may mean a growing dispute between Germany and the bank, whose management will be taken over soon by Christine Lagarde. The new president believes that the end of expansive monetary policy will be possible only when the fiscal policy of eurozone countries is loosened or when the economic situation clearly improves.

In this dispute, Germany has strong opponents among the Member States. The ECB's stance will be mainly defended by the indebted Southern European countries and France: low rates allow for debt restructuring (the yield on popular 10-year Italian bonds fell to 0.9%) and sustain growth. Germany's arguments also are facing increasing criticism from expert circles. Defending fiscal circumspection in an economic downturn and at the same time criticizing loose monetary policy is considered simply inconsistent.

The new president of the ECB may put even more pressure on Germany by announcing further experiments in monetary policy: direct financial transfers from the bank to the citizens or to public budgets ("helicopter money"). Their introduction is rather unlikely due to legal barriers, but just considering them would be a political problem for Germany, in effect creating a polarisation of positions in the eurozone on the principles of macroeconomic policy. That is why the likelihood of German concessions in the form of a gradual shift to the more fiscal spending side is on the rise. The first step in this direction may be the climate package prepared by the government, which envisages €54 billion in the coming four years for accelerating the energy transformation in Germany.

From the Polish point of view, the prospect of long-term low interest rates in the euro area is favourable, although not without some risks. The situation certainly increases the chances of maintaining economic growth in the eurozone, which accounts for more than half of Polish exports (57.4% in the first quarter of 2019). In addition, thanks to the ECB's policy, the National Bank of Poland has more space to maintain low interest rates in Poland too. The state budget can also enjoy lower costs of debt issuance in the environment of easy money. However, a side effect may be a decrease in the attractiveness of saving in Poland, an increase in the risk associated with speculative bubbles, such as in the real estate market, as well as inflationary pressure in the economy.