World’s Biggest Bad Bank

Is there such a thing as a genius loci - the protective spirit of a place that watches over people and whispers words of wisdom into their ears? This ancient Roman belief was certainly not in force during the selection of locations for European agencies and authorities. The Frontex border management agency, for example, is headquartered in Warsaw, Poland, even though the agency’s main area of activity is the Mediterranean region. The agency in charge of cyber security in Europe is located in Heraklion, Crete. Gender equality is monitored in Vilnius, conferences on railway issues take place in the French city of Lille, aviation safety is monitored from Cologne and Budapest promotes innovation.

Bureaucracy creates jobs and these are sought after and fought for with all available means. There are only two places to which this rule does not apply: Parma is known not only for ham, but also as the home of the European Food Safety Authority. And Frankfurt is the capital of European money. The fact that Frankfurt am Main is home to the headquarters of the European Central Bank (ECB) could be regarded as the fulfillment of Helmut Kohl’s promise to the German people, who had long resisted the abolition of their trusty D-mark in favor of the ominous euro. Frankfurt is the place where the champion of Germany’s postwar economic miracle, Ludwig Erhard, called the D-mark into being; and Frankfurt is also the fortress from which the Deutsche Bundesbank defended the value of the Deutsche Mark - often enough in conflict with the West German government, which was then located in Bonn.

It was hoped that this same spirit would preside over the common European currency. Initially, Frankfurt was regarded as the bulwark of monetary security, which had merely transferred its home from the Bundesbank to the institutions of Europe. The ECB has meanwhile built a new twin skyscraper building, which dominates the Frankfurt skyline and looms over the banking district like an icy-gray watchdog monitoring its activities. But the genius loci is nowhere to be found.

Under President Mario Draghi, the European Central Bank has pumped money into the economy, totaling
approximately €2 tn in direct and indirect measures over the past few years. The ECB is buying government and corporate bonds. By indirectly purchasing southern European debt, the ECB has long since become the de facto revenue authority for the region – even though this is expressly prohibited and serves only to undermine the principle of sound fiscal management among the member states. But the Deutsche Bundesbank’s longstanding tradition of strict adherence to regulations and to literal interpretation of the law has long since been Europeanized.

Dangerous mismanagement

Nowadays fiscal regulations and their enforcement respond elastically to the requirements of European policymaking. European politics does not demand monetary stability but rather the promotion of growth achieved through the instrument of monetary policy. The bond-buying program is now so massive that it has come to dominate the bond market. It is no longer the diversity of demand but the ECB and its assets that determine prices and price trends. Due to lack of assets, the ECB is continuing to lower its standards of creditworthiness for bond securities; today the ECB is de facto the world’s biggest „bad bank‟.

Gold, interest rates and prices are the nervous system of the economy. This delicate web controls what we earn, what we save, what we spend our money on, what we invest in – and how much. Any disruption to this system can lead to dangerous mismanagement of risk: „zombie banks“ that should long since have gone bankrupt are still afloat thanks to cheap money. Investments are being made that fail to yield any profit – but investing is cheap, and the interest rate in profitability calculations is effectively zero.

ECB measures continue to pour even more money into this nervous system, flooding it with cash in much the way that a junkie’s brain is flooded with drugs. The aim is to encourage corporations, consumers and politicians to increase their spending. The hope is that this will trigger a frenzy of consumption that will jump start the economy. Those who consume quickest will be rewarded. Anyone who prudently deposits money in a savings account is a fool. Consumption yields a brief rush of pleasure. But profitability is no longer a decisive criterion for investment. Germany’s economy is humming along, fueled by Frankfurt’s cash infusion. New productivity records are being set, exports and wages are rising, profits are robust. The world is envious of Germany and what seems to be its new economic miracle – at least measured against the decidedly modest results achieved elsewhere in Europe. Each additional lowering of interest rates provides a further boost to Germany’s economic competitiveness by making it even easier to finance the production of its already highly competitive export products.

But outside Germany, economies continue to languish; countries that suffer from structural difficulties will not succeed in solving their problems through these means. Indeed, lending has begun to decline across Europe – in the end, sales potential governs investment, and not only cheap financing options. The energizing effect of the easy-credit drug has long since begun to fizzle. In many countries, structural problems that block growth have rendered it impossible to stimulate the economy through artificial means.
Today, it is only national governments that remain happy about this course of events. Or they put up a good pretense, at the very least. If Greece, France and Italy had to start paying interest again, they would soon find themselves pushed over the brink into bankruptcy. German Minister of Finance Wolfgang Schäuble’s balanced German budget is also a result of the zero-rate policy. Without it, Germany’s budget would still be in the red. And now ECB chief Mario Draghi has expanded the quantitative easing program from €60 bn per month to €80 bn per month. Interest rates have sunk from a paltry 0.05 percent to zero. Consumers in debt-laden countries are demanding ever more quantitative easing, just like an addict demanding ever-higher doses of their drug of choice. Now, institutional investors will even have to pay a penalty rate. The drug has been infused with a new and heretofore unknown active ingredient. But side effects are also becoming apparent: anyone who saves is slowly falling victim to expropriation. Union Invest, one of the largest investment companies that bundles small savings accounts, calculates that quantitative easing will cost German households €224 bn in lost interest earnings over five years. People who save money are growing poorer instead of building up their retirement funds. The policy of the ECB is operating like a massive redistribution machine that is fed by German savings accounts, which are then sent to southern Europe. Italy alone is saving at least €54 bn in interest payments – each year.

Quantitative easing

And governments are addicted to these policies, too. Anyone who buys €10,000 worth of German Federal savings notes from Wolfgang Schäuble in hopes of plumping up their retirement account will lose €30 per year. But quantitative easing is set to save Schäuble €88 bn through 2022.

The policies of the ECB are so diametrically opposed to the spirit of a solid currency that the genius loci has become little more than a fig leaf helping to disguise a malevolent spirit. The spirit of the Deutsche Bundesbank has been relegated to history. It is fitting that the Deutsche Börse Group, one of the leading exchange organizations worldwide, is planning to move its headquarters from Frankfurt to London – outside the eurozone, and if the Brexit succeeds, perhaps even outside the economic sphere that draws upon it for financing. Why not move the ECB elsewhere – perhaps to Rome, or even better, to Athens? After all, Greece’s capital does not yet have a European institution to call its own.

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