Expert Comment
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Whose Central Bank?

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One of the hardest lessons to be learnt from the **euro-zone crisis** is that, with the single currency, **countries no longer borrow in their own currencies**. Similarly to many developing economies –that borrowed dollars but could only print their national currencies–, the southern European debtor countries have realised that although in theory they have the European Central Bank (ECB), the latter is unwilling to print euros for them to face up to their commitments in the event of problems.

The US Federal Reserve has no objection to buying any sort of asset, including government debt, because there is a banking, fiscal, economic and political union that ensures the proper functioning of the dollar area and provides legitimacy to the outcome of the redistributive conflicts brought about by an expansive monetary policy. In Europe, however, **Germany has imposed a different approach**: the **ECB was to have the sole task of controlling inflation**, and to this end –in addition to being unconcerned with growth– it was deprived of the role of lender of last resort, ie, of the function for which central banks were originally created. And only at times of panic –as in the summer of 2012– has it bent its mandate and concocted a complex technical justification (that the transmission mechanism of monetary policy has broken down due to the doubts about the euro's survival) to explain its readiness to act as a lender of last resort through the **OMT (Outright Monetary Transactions) programme** for purchasing foreign debt in the secondary market.

But Germany's shadow is so long that the ECB had to explain that it would only intervene in return for very tough conditions (which is why neither Spain nor Italy decided to avail themselves of its help), and, furthermore, all Europe is awaiting the German Constitutional Court's ruling as to the OMT programme's compatibility with German law. In summary, Germany decided to share its currency with its European neighbours but failed to internalise the fact that the implication was that the ECB would not be exactly the same as the Bundesbank. And as the euro crisis has placed Germany in a hegemonic position, it appears that, for the time being, **the debtor countries will have to learn to live with a ECB that is their central bank on paper but that in practice is essentially Germany's**.

Recently, a further subject for debate has appeared concerning the ECB's policies which, although less newsworthy than its position on the purchase of public debt in troubled economies, may be even more important for the euro's future: **what to do in view of the fall in the inflation rate**. According to the latest data, average inflation in the euro zone has reached 1.1%, an extremely low level that reflects a situation of virtual deflation in southern Europe and inflation slightly above 1.5% in Germany. Since the ECB has pledged to maintain inflation below but close to 2% in the long term, and the crisis in southern Europe is not yet over (which should foreseeably continue to depress prices), if it were really serving the interests of the euro-zone as a whole it should adopt a more flexible monetary policy (either further lowering interest rates or employing more heterodox methods such as quantitative easing) to prevent the continuing drop in prices and the steady appreciation of the euro. Ultimately, it is just as bad to push inflation too high or too low, and it could even be argued that it is more dangerous for Europe's future for the highly-indebted southern countries to succumb to deflation, because that would imply an increase in the real value of their debt, which would again generate banking and sovereign crises.

The problem is that Germany has registered an average inflation rate of 2% since the Second World War (which is exactly why that is the ECB's long-term target) and is now close to that level. Hence, were the ECB to adopt an expansive monetary policy, German prices would accelerate above 2%, precisely so that the average for the euro-zone as a whole (in which Germany has a weighting is 27%) should adjust to the ECB's target.

From the standpoint of the correction of macroeconomic imbalances in the euro-zone (current account surpluses in the centre and deficits in the periphery) it would be desirable for the ECB to strictly comply with its mandate, that is, to adopt a more expansive policy: this would allow current accounts to be adjusted more symmetrically (with the burden being partly borne by wage cuts in the south and partly by higher prices in Germany), making them more politically sustainable and therefore more viable. However, it remains to be seen if Germany, whose public opinion is firmly against inflation, will accept that now that it has joined the euro its prices can spend several years growing at a rate of over 2%, above its historical average. If it does not accept the fact, the southern European countries should remind Germany that the ECB is their central bank too.