Lyddon
CONSULTING SERVICES LTD

07939 132341
enquiries@lyddonconsulting.com
www.lyddonconsulting.com

The ECB's Pandemic Emergency Purchase Programme – the undermining of the Eurozone as a free financial market, the epitome of the failure of the Euro project, and a coup d'état by the European Central Bank

By Bob Lyddon

This new study, issued through The Bruges Group, dissects a main response of the European Central Bank to the pandemic: another programme of bond buying, taking up hundreds of billions of euros of Eurozone member state government bonds into the ECB's Pandemic Emergency Purchase Programme, the "PEPP".

The PEPP bought the majority of new debt issued in 2020 by the likes of Spain, Italy and Portugal.

This has concentrated 50% of Eurozone public sector debt into the hands of Eurozone financial mechanisms. The proportion could be much higher if the original balances held on accounts in the TARGET2 payment system were revealed.

ECB operations have driven bonds yields down to around 0%, saving Eurozone public sector borrowers billions of euros in interest payments. The ECB has driven both speculators and private investors out of the market: activity is concentrated between Eurozone financial mechanisms and investment banks.

Statistics on trading in bonds and related derivatives show a marked decline in liquidity.
The ECB's operations have eliminated yield and diminished liquidity: the investments should then at least be safe.

The investor will be disappointed in this area as well. 25,000+ bond issues appear on the ECB's list of collateral eligible for payment and market operations, but by no means all class as "central bank money" – an asset that is free of credit risk. Considerable numbers of these bonds are rated by the public credit rating agencies at the lower end of Investment Grade. Indeed the PEPP is permitted to hold bonds that have fallen down into Speculative Grade, and to buy new bonds of issuers who are rated Speculative Grade as long as the issuer was rated Investment Grade in April 2020.

Through its interventions and distortions the ECB has compromised and undermined a fundamental equation of a free financial market: that any instrument admitted for trading in it should offer a transparent blend of Safety, Yield and Liquidity, benchmarked to independent standards.

The euro was supposed to usher in broad and liquid capital markets based on these principles. The PEPP is the epitome of the holing of this promise below the waterline.

A group of German academics and lawyers took a case to the German Constitutional Court in 2020 to attempt to rein in the ECB's pre-existing programme which invested in public sector securities – the Public Sector Purchase Programme or PSPP. They obtained an equivocal judgement in which the court placed reliance on certain safeguards built into the PSPP which meant that the ECB could be seen as acting within its powers.

The ECB has written its mandate for the PEPP to bypass these safeguards and to make itself inviolate to challenge: the PEPP mandate permits the ECB to adapt the ways and means as it sees fit.

The ECB has made sure that the German Constitutional Court cannot challenge it again, and has put itself beyond democratic controls from either the Member State level or other organs of the EU. The ECB has, through the PEPP, carried out a coup d'état.

Whilst the ECB has undermined one of the promises of the euro (broad and liquid capital markets), it has morphed itself into a type of market actor that ironically fulfils another promise of the euro but not in the intended way: the ECB has become a pan-European commercial bank. Through the PEPP and other programmes the ECB is buying – and accepting as collateral - all manner of asset classes that expose it to credit risk on corporate and retail customers right across the Eurozone, but without its having its own credit department to assess the credit risk. Instead it relies on public credit ratings and banks' self-assessment of the risks the banks transfers to the ECB. The self-assessment mechanism is known as Internal Ratings-Based or "IRB", and it is the common methodology used by banks in Greece, Italy, Cyprus, Spain, Portugal and Ireland to assess credit risk – the methodology that has resulted in such high levels of bad debts.

The ECB has not only undermined the Eurozone financial market through the PEPP: it has fundamentally undermined itself.

This begs the question as to what sort of Brexit deal should be agreed for financial services. There is intense lobbying for the kind of porous arrangements that pertained while the UK was an EU member. The key term bandied about is "equivalence", but there can be no equivalence between a free market, and a controlled and debased one. If the two are connected and porously, the state interference, self-interest and subsidy that underpin the controlled market will infect and undermine the free one.

About the author: Bob Lyddon is an experienced management consultant both privately and with PwC, with a specialization in banking and payments. He has published numerous papers about the financial mechanisms of the EU, through the Bruges Group, Politeia and Global Britain.