
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

Webinar by Bob Lyddon - April 2021

Housekeeping

- This webinar is intended to last 35 minutes:
 - 20 minute presentation
 - 15 minutes for questions and discussion
- Please could you mute your microphones during the presentation
- I will not be able to see the Chat Box while presenting...but please feel free to exchange comments amongst yourselves
- The intention is to give a tour of the paper now issued through Bruges Group
- The full paper is available on the Bruges Group website – www.brugesgroup.com
- It is also available on my website – www.lyddonconsulting.com
- ...along with this Powerpoint and:
 - Article version
 - Bullet point version

Executive Summary

- The Pandemic Emergency Purchase Programme (the PEPP) represents a definitive undermining of the Eurozone as a free financial market
- It is the epitome of the failure of the euro, which promised free, deep and liquid capital markets
- Eurozone financial mechanisms own and control as collateral at least half of all bond supply, and possibly more
- Yields are near zero, liquidity is diminishing, and safety is debased
- The fundamental equation of a free financial market has been demolished: that any assets admitted for trading in it should offer a transparent mix of Safety, Liquidity and Yield
- Safety has been compromised in particular by the ECB's credit quality relaxation measures
- To cap it all the ECB has awarded itself a mandate for the PEPP that laughs in the face of the safeguards in the pre-existing Public Sector Purchase Programme from which the German Constitutional Court (the BVerfG) took comfort

PEPP characteristics

Permitted size

- Initial ceiling of €750 billion on 24/3/20
- Increased to €1.35 trillion on 4/6/20
- Increased again to €1.85 trillion on 10/12/20

Actual size

- €75 billion a month
- €700 billion on 30/11/20
- €718 billion on 11/12/20
- €932 billion on 26/3/21
- €918 billion of headroom

Assets

- Can buy all asset types permitted under pre-existing Asset Purchase Programmes
- Public sector bonds can be bought in the primary market and not just in the secondary market

PEPP characteristics

Safety

- Based on public credit ratings but compromised by EU control of rating agencies
- Can buy and hold bonds of Speculative Grade down to BB
- Can buy bonds backed by banks' "credit claims" without their having a public rating

Liquidity

- The PEPP, like other ECB programmes, is a Buy-and-hold operation
- Large blocks of stock do not trade
- Private and speculative investors no longer participate in the market
- There is one major buyer – the Eurosystem

Yield

- Low or even negative
- Kept there by Eurosystem intervention
- Who else would buy the paper?
- Who else could the Eurosystem sell it to?
- Spares Member States billions in debt interest

Make-up of the PEPP portfolio

- This was the make-up of the PEPP portfolio in November 2020
- Very heavy concentration on public sector securities
- In millions of euros

Issuer type	Amount
Asset-backed securities	0
Covered bonds	3,123
Corporate bonds	20,760
Commercial paper	24,306
Supranationals (A)	41,991
Public sector securities of member states (B)	609,819
Total of public sector securities (A+B)	651,810
Total PEPP	699,999
Public sector securities as percentage of total PEPP	93%
Public sector securities of member states as percentage of total PEPP	87%

Direct monetary financing of Member States

- By our calculations the PEPP has directly purchased – as a minimum – the following percentages of the new, primary market bond issues floated by the following Member States in 2020:

Country	Percentage of new bond issues bought by the PEPP
Spain	64%
Portugal	50%
Italy	47%

Concentration of control

- By our calculations the Eurosystem owned half of all bonds in Euro as of early December 2020, and it could have been more (in millions of euros):

Total nominal value of Eurosystem eligible collateral	15,800,000
Collateral lodged in the Eurosystem	2,600,000
TARGET2 net-net balance (end October)	323,700
TARGET2 creditors - balance (end October)	1,546,200
TARGET2 debtors - balance (end October)	1,222,500
PEPP portfolio	718,000
Pre-existing APP/Corporate Sector	243,000
Pre-existing APP/Public Sector	2,309,000
Pre-existing APP/Asset-Backed	29,000
Pre-existing APP/Third Covered Bonds	286,000
Total pre-existing APP portfolio	2,868,000
APP + PEPP	3,586,000
APP + PEPP + Collateral	6,186,000
APP + PEPP + Collateral + TARGET net-net balance	6,509,700
APP + PEPP + Collateral + TARGET debtors balance	7,732,200
Relationship of indicator to total value of Eurosystem eligible collateral:	
APP + PEPP	23%
APP + PEPP + Collateral	39%
APP + PEPP + Collateral + TARGET net-net balance	41%
APP + PEPP + Collateral + TARGET debtors balance	49%

Note: does not include bonds owned by other parts of the global 'concert party':

- EU supranationals (ESM, EIB, EIF...)
- Public entities at EU Member State level
- Non-EU supranationals (World Bank, IADB, IBRD...)
- Non-EU public entities (Federal Reserve, Bank of England...)

Invisible TARGET2 gross balances

- We included the TARGET2 debtors balance of €1.2 trillion at the end of October 2020 in our €7.7 trillion figure for the total of bonds owned or controlled by the Eurosystem
- It is a reasonable assumption that at least this €1.2 trillion has to be collateralized with eligible bonds

TARGET Balances

1. TARGET balances of participating NCBs

1.1 Historical data

(EUR billions, outstanding amounts at end of period)

	ECB	BE	DE	EE	IE	GR	ES	FR	IT	CY	LV	LT	LU	MT	NL	AT	PT	SI	SK	FI	U4 ¹⁾
2009	4.0	-42.5	177.7	-	-53.5	-49.0	-41.1	-62.0	54.8	-7.1	-	-	52.5	-0.8	15.4	-19.6	-23.4	-3.3	-14.5	9.5	3.2
2010	-22.4	-13.9	325.6	-	-145.2	-87.1	-50.9	-28.3	3.4	-6.4	-	-	67.9	-1.2	40.5	-27.5	-59.9	-2.1	-13.3	19.7	1.1
2011	42.2	-52.9	463.1	0.6	-120.4	-104.8	-175.0	-77.4	-191.4	-7.9	-	-	109.4	-0.4	152.8	-34.6	-60.9	-2.7	-13.6	66.0	7.9
2012	-2.2	-38.2	655.7	1.7	-79.3	-98.4	-337.3	-54.8	-255.1	-7.5	-	-	108.2	-0.2	120.8	-39.9	-66.0	-4.4	0.9	70.6	27.4
2013	-6.7	-15.5	510.2	1.8	-55.1	-51.1	-213.7	-16.2	-229.1	-6.8	-	-	103.7	-0.7	46.1	-39.2	-59.6	-1.0	2.7	22.2	8.0
2014	-23.6	-12.4	460.8	3.2	-22.7	-49.3	-189.9	-17.0	-208.9	-2.5	-0.8	-	105.1	-1.9	19.4	-30.1	-54.6	2.4	2.2	19.7	0.9
2015	-83.8	-7.7	584.2	2.8	-3.0	-94.4	-254.1	-29.2	-248.9	2.4	-1.3	0.2	147.6	-0.9	54.7	-29.2	-61.7	0.2	0.5	20.1	1.5
2016	-159.7	-18.6	754.3	0.9	-1.0	-72.3	-328.1	-13.8	-356.6	5.9	-5.3	-3.6	187.4	1.0	87.0	-31.2	-71.6	-1.2	-5.1	22.0	9.5
2017	-222.8	-36.1	906.9	0.9	1.9	-59.4	-373.7	30.0	-439.0	7.4	-6.3	-4.0	192.1	4.3	71.0	-45.9	-61.2	-1.4	9.0	40.4	6.1
2018	-246.5	-52.9	966.2	0.8	14.3	-28.6	-401.9	-2.3	-482.0	7.8	-6.2	-5.8	213.0	4.5	92.6	-45.6	-82.8	1.2	9.7	39.8	4.6
2019	-236.1	-63.7	895.2	0.6	35.4	-25.7	-392.4	28.5	-439.4	8.5	-3.8	-0.9	192.4	5.6	46.4	-46.6	-77.0	3.4	9.3	57.1	3.3
2019 Q3	-244.0	-39.9	915.3	0.8	28.0	-23.2	-383.5	-36.7	-468.0	8.2	-3.6	-1.8	215.9	5.4	75.6	-52.5	-80.6	0.9	10.8	69.7	3.0
Q4	-236.1	-63.7	895.2	0.6	35.4	-25.7	-392.4	28.5	-439.4	8.5	-3.8	-0.9	192.4	5.6	46.4	-46.6	-77.0	3.4	9.3	57.1	3.3
2020 Q1	-143.6	-52.8	935.1	0.2	36.6	-37.0	-407.4	-109.4	-491.6	7.7	-3.4	-0.1	225.1	5.7	62.8	-37.5	-73.8	4.5	12.6	63.4	2.9
Q2	-259.9	-63.1	995.1	-0.3	51.0	-66.3	-462.4	48.3	-536.7	7.3	-4.0	3.8	234.7	6.1	69.7	-36.7	-62.7	7.5	13.7	72.4	2.6
2020 July	-289.4	-50.91,019.2	-0.5	51.3	-70.0	-460.6	34.4	-522.2	8.3	-4.3	5.5	232.8	5.7	65.2	-33.2	-83.0	6.9	11.1	70.2	3.2	
Aug	-297.1	-42.81,056.2	-0.5	50.2	-71.7	-458.5	11.3	-522.9	8.8	-4.5	5.7	228.9	5.9	54.6	-43.3	-80.4	7.3	10.1	78.6	3.9	
Sep	-310.7	-64.31,115.2	-0.6	52.3	-73.3	-464.7	19.9	-546.3	8.8	-4.4	5.8	229.3	6.0	69.5	-48.4	-81.7	6.5	10.3	66.7	4.3	
Oct	-323.7	-48.21,047.3	-0.9	45.4	-73.6	-457.2	61.8	-519.6	8.2	-4.4	7.1	235.1	5.6	55.4	-36.7	-81.9	6.9	9.2	61.1	3.1	
Nov	-330.7	-32.21,060.3	-1.2	48.0	-75.2	-480.4	40.4	-494.9	8.5	-4.5	8.0	242.2	5.5	42.3	-35.5	-83.3	7.3	9.8	62.1	3.6	
Dec	-341.5	-65.91,136.0	-1.0	46.1	-80.3	-500.0	58.3	-516.0	8.4	-4.8	5.8	259.3	6.1	38.4	-37.4	-80.2	6.8	7.7	49.5	4.7	

- But €1.2 trillion is already a netted figure
- We do not know the original, gross balances on the 600 current accounts run by the TARGET2 participants with one another
- A higher amount than the €1.2 trillion of net debtors that we are shown might be collateralised with eligible bonds
- The netting is legally spurious anyway and of short duration – it lasts for the 45 minutes at most of the TARGET2 end-of-day, and is then reversed...
- ...and the ECB reports are only for one business day per month

Circumvention of safeguards quoted by BVG

Summary of the conditions of the PEPP that confound the BVG's verdict about the PSPP

Here is a summary of the conditions of the PEPP that conflict with the comfort and safeguards that the BVG observed in the PSPP:

PEPP condition	Which BVG point is countered
Absence of limitation to activity to the secondary market	Prohibition of direct monetary financing of member states
Tenuous linkage of the PEPP to price stability	Democratic control over the ECB and the PEPP
ECB Capital Keys need only act as a guideline for the make-up of the PEPP portfolio	"Purchases are carried out in the accordance with the ECB's capital key"
There are no Purchase Limits in the PEPP	"The purchase limit of 33% per International Securities Identification Number (ISIN) is observed"
ECB is granted an unfettered right to amend Decision 2020/440 if they feel that its text might hinder their actions	Democratic control over the ECB and the PEPP
The PEPP can buy Republic of Greece bonds	"Issuer has a minimum credit quality assessment that provides access to the bond markets"
The PEPP can buy non-financial commercial paper with the lowest short-term public credit ratings	"Issuer has a minimum credit quality assessment that provides access to the bond markets"
Credit assessment can be based on banks' IRB methodologies as an alternative to public credit ratings	"Issuer has a minimum credit quality assessment that provides access to the bond markets"
Securities do not have to be sold when their public ratings fall below "Investment Grade" (see following section)	"Issuer has a minimum credit quality assessment that provides access to the bond markets"
Debt securities based on "Credit claims" would now be eligible (see following section)	"Issuer has a minimum credit quality assessment that provides access to the bond markets"
"Credit claims" can include loans with lower credit quality, loans to types of debtors not accepted in the ECB's general framework, and foreign-currency loans. COVID-19 emergency loans, guaranteed by a public entity, are also eligible (see following section)	"Issuer has a minimum credit quality assessment that provides access to the bond markets"

- The PEPP can:
 1. Buy primary market bonds
 2. Buy whole new issues
 3. Buy and hold Speculative Grade bonds down to BB
 4. Buy Republic of Greece bonds
 5. Ignore the ECB Capital Keys as a rule for the make-up of the PEPP portfolio
 6. Have its mandate altered by the ECB without reference to the EU organs

False prospectuses of Eurozone public issuers

Eurostat figures for EU public sector debt take no account of Member State guarantee liabilities towards the EU/EIB/ESM

Credit rating agencies have lost their independence thanks to EU regulation

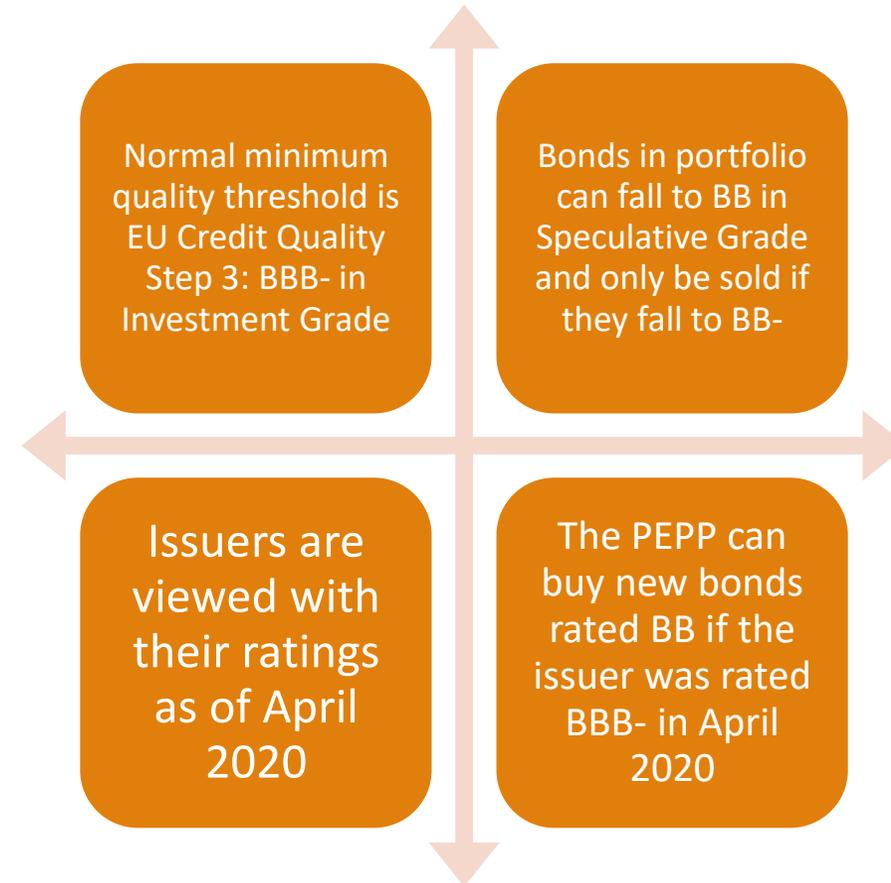
Prospectuses for Eurozone public issuers understate the credit risk being taken by the investor – by as many as four credit rating notches (one for each factor)

Eurostat figures do not capture all public sector debts such as those of water, power and transport utilities, or InvestEU projects

Eurozone public sector credit ratings take no account of there being no genuine Euro sovereign issuer

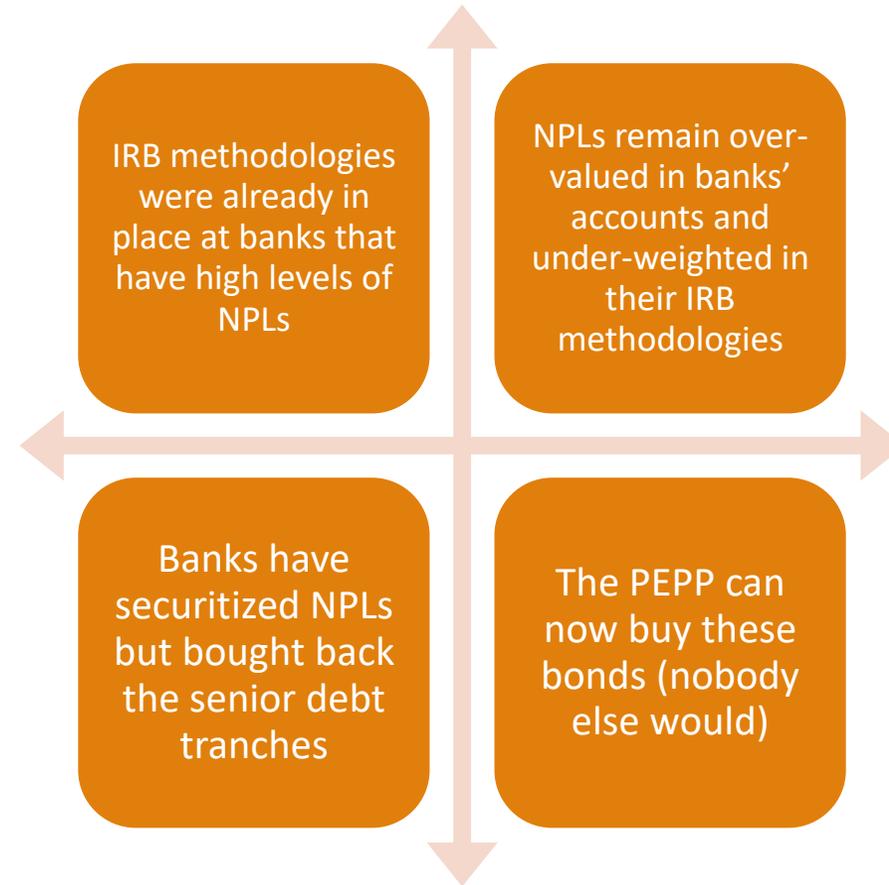
PEPP compromises credit quality standards

- The normal Credit Quality standards for Eurosystem operations have been relaxed for the PEPP
- From Credit Quality Step 3 (BBB-) to Credit Quality Step 5 (BB)
- Bonds do not have to be sold if they are downgraded to below Investment Grade
- It also means that the PEPP can continue to buy the bonds of Italy, Spain etc. even if they are downgraded to below Investment Grade

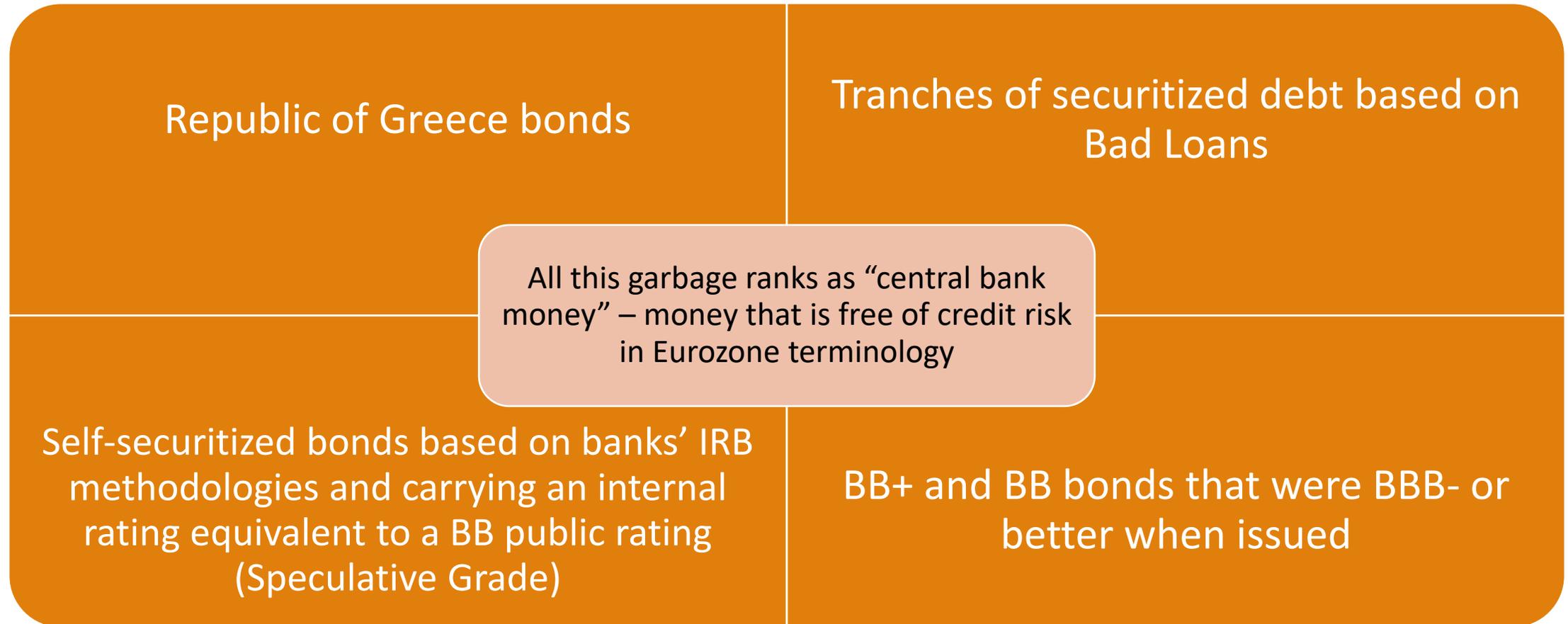


PEPP is exposed to worst excesses of banks

- PEPP can buy self-securitized bonds owned by Eurozone banks, backed by “credit claims”
- The “credit claims” could be any sort of loan and even Non-Performing Loans (NPLs)
- These bonds do not have to have a public credit rating
- Instead an assessment based on a bank’s Internal Ratings-Based (IRB) methodology is good enough if that internal rating is at the level of an acceptable public rating
- “Acceptable” means meeting the relaxed Credit Quality standards



The ECB recycles waste into central bank money



Summary – issues for the UK

- Why should we connect ourselves porously to this controlled and debased financial market?
- Why should we risk the trust of the City of London in the eyes of the rest of the world by having the bonds of these issuers floated and traded in London based on their questionable prospectuses?
- How much stock is already owned by institutions in the UK?
- How much is owned by the Bank of England?
- How much is relied upon as collateral by the Bank of England for loans to banks in the UK?
- This data should be collected and publicized before the UK commits to any post-Brexit financial services deal

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Close of webinar by Bob Lyddon - April 2021