The Economist

The European Central Bank's deterrent

Bench press

The legitimacy of the doctrine that calmed panicky markets is challenged

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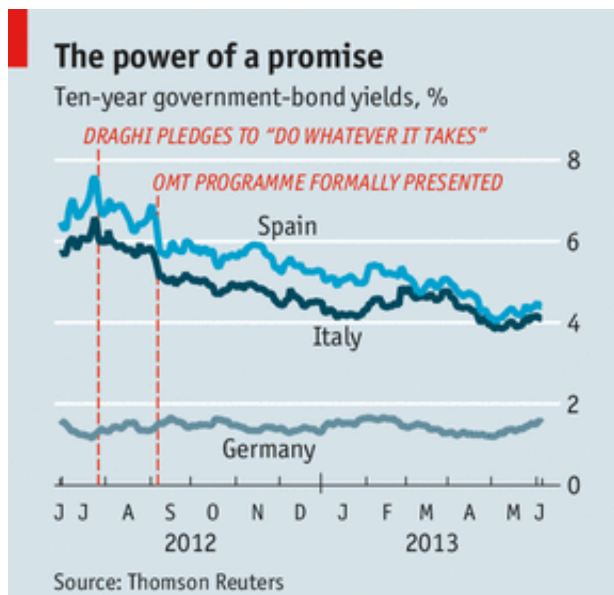
THE falls in global bond markets in May also reversed a long rally in southern European debt. Yields on ten-year Spanish government bonds rose by 30 basis points over the month. There may be worse to come. Investors remain nervous about how soon America's central bank will slow its bond-buying programme. Adding to the worries, Germany's constitutional court will hold public hearings on June 11th and 12th about the legality of policies undertaken by the European Central Bank (ECB), above all the initiative that stemmed the rout in peripheral euro-area debt last summer.



That policy, called "Outright Monetary Transactions" (OMT), gave flesh to the "whatever it takes" pledge to save the euro made by Mario Draghi, the ECB's boss, in July 2012. What made OMT so potent was that for the first time the ECB committed itself to making unlimited bond purchases (in secondary markets). That had not been the case with its previous bond-buying, which it had done sporadically since the euro crisis first erupted in 2010.

The threat of unlimited purchases tamed speculators who had been betting on a break-up of the euro (see chart). Indeed OMT has been so successful a deterrent that it has not yet been put to the test. But now the doctrine is being examined by judges rather than investors.

The German court is considering ECB policies, including OMT, together with a case on Germany's participation in the euro area's rescue fund (which it sanctioned in a preliminary ruling last September). The judges will tread carefully: OMT is expected to survive unscathed when they reach their verdict later this year. But the hearings will nonetheless expose a deep rift at the heart of the ECB.

That rift is embodied in the two Germans on the ECB's 23-strong council: Jörg Asmussen, an ECB board member, who backs the policy, and Jens Weidmann, president of the Bundesbank, who opposes it. Mr Asmussen will argue that the ECB is acting squarely within its legal mandate. But it is Mr Weidmann who is likely to grab attention at the hearings, not just because he heads the biggest of the 17 national central banks that implement ECB decisions but also because the Bundesbank remains revered within Germany. His views will have a particular resonance ahead of the federal election on September 22nd.

A leaked document has already disclosed how deeply the Bundesbank dislikes OMT. The submission, which was requested by the court, contests the whole rationale for the policy. Mr Draghi had argued it was vital to eliminate the "reversibility risk" that had caused bond yields to soar in southern Europe on fears that the euro area might break up. But the Bundesbank argues that it is not the job of a central bank to keep a currency union together, since that is a prerogative of the member states and their citizens. The emergence of reversibility risk in bond yields therefore does not justify unlimited purchases.

Another airing of such fundamental doubts raises the question whether OMT would prove to be so formidable a weapon if it ever actually had to be used, not just threatened. The ECB's commitment to make unlimited purchases is already restricted to bonds of up to three years' remaining maturity. The policy is also tied to countries accepting tough conditions imposed by the euro area's rescue fund. But it is the unrelenting opposition of the Bundesbank that may prove most unsettling, by shaking investor confidence in just how unlimited bond purchases might turn out to be in practice.

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