

König, Philipp; Bernoth, Kerstin

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The Eurosystem's Agreement on Net Financial Assets (ANFA): Covert Monetary Financing or Legitimate Portfolio Management?

By Philipp König and Kerstin Bernoth

As well as implementing the common monetary policy, the national central banks (NCBs) which, together with the European Central Bank (ECB) form the Eurosystem, are also responsible for performing a range of national tasks. Among other things, these include the management of their financial assets portfolios. To ensure that this function does not interfere with the implementation of the single monetary policy, the Agreement on Net Financial Assets (ANFA) limits the total net amount of financial assets (NFA) the NCBs are permitted to hold. National central bank purchases of government bonds under ANFA have led to public accusations that this was tantamount to covert monetary financing of fiscal deficits through the "printing press" by the national central banks. The present report first explains the Agreement on Net Financial Assets and shows the volume of securities purchased by the different NCBs under ANFA. Based on this, it examines the extent to which the accusation of monetary financing may be justified. Although there have been indications of certain national banks increasing the government bond holdings on their balance sheets in recent years, this does not provide sufficient evidence of monetary financing. However, the public debate on ANFA clearly highlights the Eurosystem's lack of transparency, particularly that of the NCBs. To ensure that confidence in European monetary policy is not undermined and both transparency and communication are improved, more detailed information on the development of NCBs' balance sheets must be published more regularly.

When the European monetary union was created, it required to unite NCBs, which had previously performed diverse national tasks and used different monetary policy instruments, to a common system of central banks. It was decided to create a decentralized system where the euro area's national central banks were integrated into what is known as the Eurosystem.¹ In this arrangement, the Governing Council of the European Central Bank (ECB), comprising the governors of the NCBs, holds the responsibility for taking decisions on the common monetary policy of the currency union binding for all member states. However, the actual implementation of the single monetary policy, such as lending to commercial banks, is decentralized and conducted by the NCBs of the relevant countries.

When the common currency was first introduced, it would have been politically unfeasible to merge the NCBs of the individual European countries into a single central bank. Instead of entrusting a central authority with handling monetary policy operations across the euro area, the best option appeared to be to allocate a country's national central bank, which had the necessary expertise as the point of contact for commercial banks in their country. In addition to their monetary policy functions, the NCBs also performed other tasks, such as banking supervision, which did not automatically disappear with the introduction of the common currency.²

The Eurosystem's statutes (Statute of the European System of Central Banks and of the European Central Bank) continue to explicitly stipulate that the NCBs may perform national tasks independently, provided their ac-

¹ The Delors Report, the minutes of the meetings of the Committee of Governors, and the position papers of various interested parties all frequently refer to a "federal" or "federative" structure, see, *inter alia*, C. van den Berg, *The Making of the Statute of the European System of Central Banks*, doctoral thesis (University of Amsterdam, 2004), 321. However, the term "decentralized" seems to be more suitable in this context, see H. Hahn and U. Härde, *Währungsrecht* (Munich: C.H. Beck, 2010).

² On this see H. Scheller, *The European Central Bank – History, Role and Functions* (Frankfurt am Main: European Central Bank, 2004).

tions do not interfere with the single monetary policy. To ensure that particularly the portfolio management conducted by the NCBs is compatible with the implementation of the single monetary policy, an agreement (ANFA) was concluded between the national central banks and the ECB, limiting the net financial assets on the balance sheets of the NCBs. This Agreement stipulates a ceiling for the net total of balance sheet items which are not directly related to the single monetary policy, for example, gold and foreign currency reserves.

Up until the beginning of this year, ANFA was a confidential document. During a public debate on the subject, central banks were accused of possibly contravening the monetary financing prohibition with the asset purchases they had conducted under ANFA. Following this debate, at the beginning of February 2016, the Agreement was made public.³

National central banks permitted to perform independent tasks

The primary task of the NCBs is to implement monetary policy with the common objective of maintaining price stability in the euro area. Additionally, according to Article 14.4 of the Statute of the European System of Central Bank and of the European Central Bank, the national central banks are still permitted to perform national functions on their own responsibility and liability, provided that these do not interfere with the single monetary policy. These national tasks include supervising financial institutions in the relevant country, safeguarding financial stability, providing emergency liquidity assistance, or compiling statistics, data, and economic analyses.

A number of NCBs also act as fiscal agents for their national governments which means that they conduct financial transactions, assist with the issuance of government bonds, or, as the government's "principal bank", process their government's payment flows.⁴

Finally, in connection with ANFA, the management of foreign currency and gold reserves is of particular importance. For the purpose of portfolio management and in order to maximize profits for their owners,⁵ in addition

to gold and currency reserves, the NCBs also hold a variety of other securities, including euro-denominated bonds and, to a limited extent, also shares. There are, however, substantial differences between the NFA portfolios of the euro area's national central banks. The various investment strategies here, in part, reflect different preferences and owner structures but, to a certain degree, also have historical reasons. For example, in the Central Bank Gold Agreement, which has been in place since 1999, various European central banks agreed to limit and coordinate any gold sales to keep market turbulences to a minimum. Central banks such as the *Deutsche Bundesbank* or *De Nederlandsche Bank*, which already held considerable gold reserves before the introduction of the euro, therefore, still hold major gold reserves. In contrast, countries such as Ireland, Italy, Spain, or Portugal which had linked their domestic currencies to the Deutsche Mark (DM) under the European Monetary System held substantial DM assets which were then converted to euros when the common currency was introduced. Consequently, the portfolio of euro-denominated securities on the balance sheets of these central banks was relatively high.

ANFA prevents interference with single monetary policy

To achieve its objective of safeguarding price stability, the European Central Bank uses variations in its policy interest rates. To ensure an effective interest rate policy, the Eurosystem operates under a structural liquidity deficit.^{6,7} In this case, the banking sector depends on regular liquidity-providing operations by the Eurosystem to meet its (aggregate) liquidity needs.⁸

If, as part of their national tasks, NCBs purchase or sell financial assets, this can impede the implementation of the single monetary policy. Financial asset purchases increase the amount of central bank money in circulation. This, in turn, automatically reduces the li-

work since 1999," in *The Concrete Euro*, P. Mercier and F. Papadia, eds. (Oxford University Press: Oxford, 2010), 253.

⁶ Alternatively, the European Central Bank could also manage interest rates under a structural liquidity surplus. In this case, the ECB would have to absorb liquidity by issuing fixed-term deposits. This would be a technically more complex and costly process for the ECB.

⁷ Here, the term liquidity is used synonymously with central bank money.

⁸ The liquidity requirement is based on: the minimum reserves that a bank must hold, on average, over a set period of time (minimum reserve period) in their reserve account at the NCB; the bank's desired surplus reserves, i.e., assets that are held as a buffer against unexpected shocks; "autonomous liquidity factors," which comprise factors affecting liquidity that are not managed as part of monetary policy; and finally, assets bought in the course of NFA purchases. The technical details of the Eurosystem's implementation framework can be found in ECB, *The Implementation of Monetary Policy in the Euro Area - General Documentation on Eurosystem Monetary Policy Instruments and Procedures* (February 2011), <https://www.ecb.europa.eu/ecb/legal/pdf/gendoc201102en.pdf>.

³ ANFA has been made available by the ECB: https://www.ecb.europa.eu/ecb/legal/pdf/en_anfa_agreement_19nov2014_f_sign.pdf

⁴ Hahn and Härde (2010) state that the term "fiscal agent" is not defined under EU law. The functions that may be performed in this context can be derived from Council Regulation (EC) 3603/93 of 13 December 1993, esp. Article 5 and Article 7.

⁵ There is no uniform legislation regulating the ownership of the national central banks. Consequently, the *Banca d'Italia* and the Bank of Greece are joint stock corporations, for example, while the *Deutsche Bundesbank* is, in accordance with Section 2 of the *Deutsche Bundesbank Act* (BBankG), a federal corporation under public law whose share capital belongs to the German government. See F. Papadia and T. Valimäki, "Functioning of the Eurosystem Frame-

Box

Calculation of annual NFA ceilings¹

In a first step, based on the level of the minimum liquidity deficit fixed by the Governing Council of the ECB, the ceiling for all NFA purchases in the euro area is allocated to the national central banks in accordance with the Eurosystem's capital key. What is known as a historical waiver ensures that the NFA entitlement of the individual central banks determined in this first step does not fall below a fixed level linked to their historical starting position. Since not all national central banks wish to make use of their entitlement, the unused leeway is redistributed to those NCBs wishing to make purchases over and above their entitlement.

This redistribution is carried out in a second step in which the final individual ceilings are fixed. The procedure weighs up the interests of the NCBs that give up their unused leeway against those of the NCBs that receive it. Distribution of NFA leeway is based on an annual calibration of the size of the portfolios. Central banks that have received additional leeway in a given year could be forced to liquidate financial assets again if other

NCBs reclaim their leeway in the following year. The Agreement prevents this from occurring since NCBs that have passed their unused leeway to others cannot recover this all at once. In order to reduce the risk, however, of these central banks exceeding their individual leeway as a result of unforeseen developments on their balance sheets, the NFA ceilings contain a safety buffer so as to avert circumvention of ANFA.

NFA leeway is distributed in line with the Eurosystem's capital key. At the same time, the following points are taken into account:

- (i) the total sum of all purchases must not exceed the ceiling established for the entire Eurosystem, and to ensure that the predetermined structural liquidity deficit is maintained.
- (ii) national central banks that have passed on unused leeway in the current year are either allocated the previous year's leeway plus any increases in their entitlements (determined in the first step of the process) and in the aforementioned buffer or, if this sum exceeds the new entitlement, then the new entitlement is allocated.
- (iii) all other national central banks are allocated at least their entitlement, but this may not exceed their preferred leeway.

¹ Only the main points of the procedure are outlined below. For further technical details, see Annex II of the Agreement on Net Financial Assets (ANFA): https://www.ecb.europa.eu/ecb/legal/pdf/en_anfa_agreement_19nov2014_f_sign.pdf

quidity needs of the euro area's banking sector and decreases the structural liquidity deficit, possibly hampering an effective implementation of the common interest rate policy.⁹

To prevent interference with the implementation of the single monetary policy, the NCBs and the ECB concluded the Agreement on Net Financial Assets (ANFA) which stipulates a ceiling for the national central banks' net financial assets. NFAs comprise the net total of NCB balance sheet items which are not directly related to implementing the single monetary policy (such as main and longer-term refinancing operations and also structural

operations) and/or are not affected by payment transactions (banknotes in circulation and TARGET 2 balances) or minimum reserve requirements.

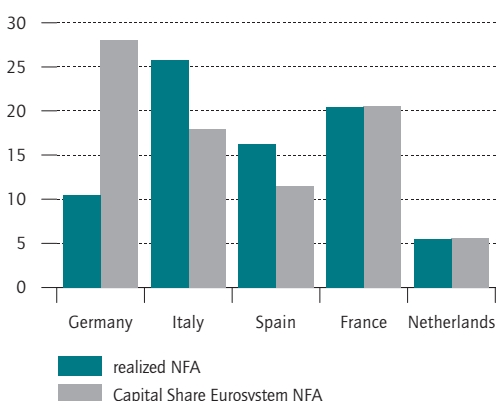
Every year a new net financial asset ceiling is set for each NCB which involves the Governing Council of the ECB first deciding how high the minimum liquidity deficit for the whole euro area for the coming year should be. The new ceiling for the NFA position on the consolidated Eurosystem balance sheet is then calculated on this basis. Subsequently, using a two-step procedure, the individual NCB's purchasing leeway is set, taking into account the desired NFA purchases of the individual NCBs (see box). The allocation of ANFA purchases to the NCBs is essentially guided by the Eurosystem's capital key which means that, theoretically, the *Deutsche Bundesbank* could, due to its higher capital share, show a higher absolute NFA position than *De Nederlandsche Bank*, for example. In practice, however, because of the different national tasks and objectives of the individual NCBs there are considerable deviations from this proportional allocation (see Figure 1).

⁹ If, for example, an NCB purchases a bond to the value of 100 euros, then the bank enters this asset under the relevant heading on the assets side of its balance sheet. The purchasing price of 100 euros is credited to the reserve account of the seller's bank on the liabilities side of the ECB balance sheet. The NCB's balance sheet is extended by 100 euros. The banking sector now has additional central bank money to the value of 100 euros and its liquidity requirement and the structural liquidity deficit in the euro area falls by this sum. Only if the additional 100 euros of central bank money reach circulation in the form of banknotes does the ECB purchase have no impact on the liquidity deficit.

Figure 1

Realized NFA of selected national central banks and their share in total realized Eurosystem NFA according to the capital key

Euro billion averages over 2002-2014



Source: ECB (Statistical Data Warehouse), National Central Banks, own calculations

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Realized NFA positions often do not coincide with the national central banks' share in total Eurosystem NFA (when allocated according to the capital key).

Figure 2

Simplified consolidated balance sheet of the Eurosystem

Assets	Liabilities
Refinancing operations	Banknotes in circulation
monetary policy portfolios	Minimum Reserve
Net Financial Assets	Deposit Facility Excess Reserves

Source: Own presentation.

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Positions that inject liquidity into the banking sector are shown on the asset side of the Eurosystem's balance sheet. Except for excess reserves, which are the balancing item, the liability side shows positions that absorb liquidity from the banking sector.

Consolidated Eurosystem NFA position virtually constant

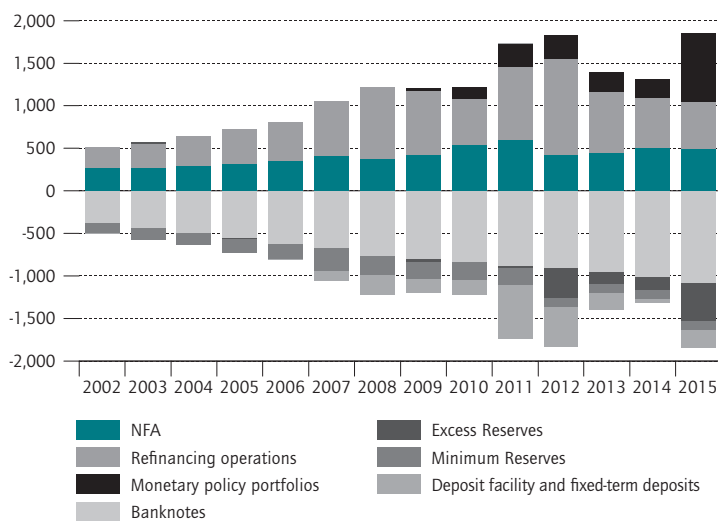
The asset side of the consolidated Eurosystem balance sheet shows items that provide the banking sector with liquidity, while the positions on the liability side (with the exception of excess reserves) absorb liquidity from the banking sector. The NFA position is netted on the asset side of the consolidated Eurosystem balance sheet. The asset side can therefore be split into the NFA position and items relating to monetary policy operations (refinancing credit, and monetary policy portfolios). The liability side includes banknotes in circulation,¹⁰ the minimum reserve requirements of the commercial banks, and other liabilities from monetary policy operations (surplus reserves, deposit facility, and fixed-term deposits) (see Figure 2).

Since the introduction of the euro, the volume of banknotes in circulation, in particular, has grown considerably (see Figure 3). From 2002 to 2015, this amount rose by around 190 percent to over 1,080 billion euros which, in turn, led to a considerable increase in the banking sector's liquidity needs. The NFA position, in contrast, only increased by slightly over 80 percent to just under 500 billion euros, while the remaining share of the increased liquidity needs was primarily covered by additional refinancing operations. However, monetary policy portfolios such as the large-scale asset purchase programs have

Figure 3

Development of Eurosystem's consolidated balance sheet

Euro billion



Source: ECB (Weekly Financial Statement, values at year end), own calculations.

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The additional liquidity needs due to the increase in banknotes in circulation was largely covered through an increase in refinancing operations and outright monetary operations.

¹⁰ An increase in banknote circulation (outside the banking sector) withdraws liquidity from the banking sector since, to issue the notes, banks must convert central bank money from their reserve accounts into cash. The higher the volume of banknotes in circulation, the higher the banking sector's aggregate liquidity requirement.

also contributed to an increase in the banking sector's liquidity position since the financial crisis.

Figure 4 illustrates the Eurosystem's NFA position relative to the sum of banknotes in circulation and minimum reserve requirements. The resulting normalized value shows the share of liquidity in the euro area provided by the NFA positions. From 2002 to 2015, the average figure was around 45 percent. At the peak of the financial crisis, however, it increased to just over 50 percent and subsequently declined again. Therefore, the overall contribution made by the NFA positions to liquidity supply has not increased since 2002 but has remained largely constant; only the composition of the NFA has changed.

If the Eurosystem's NFA position is broken down into its component parts, it is clear that gold and foreign currency reserves continue to make up the lion's share of NFAs on the asset side (see Figure 5). However, this share has followed a downward trend for some time—in favor of securities such as money market instruments and bonds, including government bonds.¹¹ The liability side of the NFA position primarily comprises other liabilities including the NCBs' capital, risk provisions, and also gains from asset revaluations.

Diverging trends in development of national NFA positions

The NFA positions of the individual central banks within the Eurosystem have developed quite differently in terms of both volume and composition (see Figure 6).¹² The NFA position of *Deutsche Bundesbank* on the asset side, for example, primarily comprises gold and foreign currency reserves. Compared with Germany's capital share in the Eurosystem, the NFA position is very low and was even negative for a short period. The NFA position of *De Nederlandsche Bank* has remained relatively constant over time and also comprises a high share of gold and foreign currency reserves.

However, the assets side of the NFA positions of the other NCBs studied here are now primarily made up of euro-denominated securities. The Spanish NFA position in particular has experienced considerable growth since 2004: the *Banco de España* initially significantly expanded its euro-denominated securities but then more recently increasingly focused on building up its foreign cur-

¹¹ The "General Government Debt" position comprises government bonds already on the NCBs' books before the currency union came into existence.

¹² Our selection is limited to the five NCBs with the largest capital share in the Eurosystem, i.e., the *Bundesbank*, *Banque de France*, *Banca d'Italia*, *Banco de España*, *De Nederlandsche Bank*, and also the Central Bank of Ireland. There have been suspicions of the latter violating ANFA for some time now.

Figure 4

Development of total Eurosystem NFA

In percent of banknotes in circulation and reserve requirements



Source: ECB (Weekly Financial Statement, values at year end), own calculations

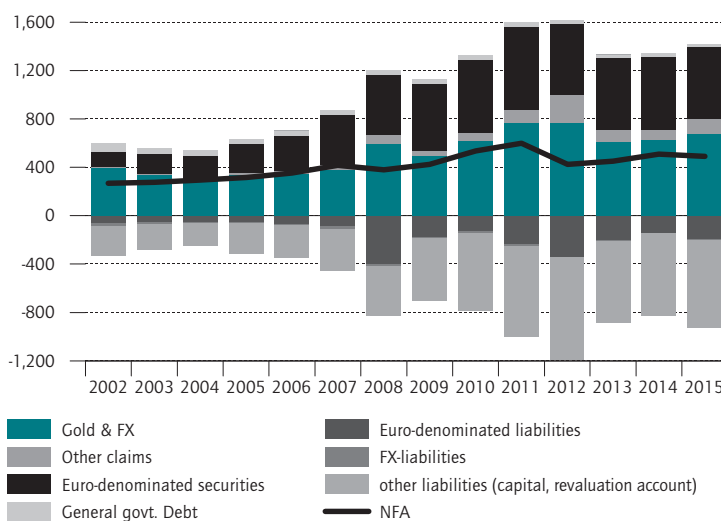
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The NFA-position (in percent of minimum reserves and banknotes in circulation) fluctuates around a mean of 45 percent.

Figure 5

Development of NFA components

Euro billion



Source: ECB (Weekly Financial Statement, values at year end), own calculations.

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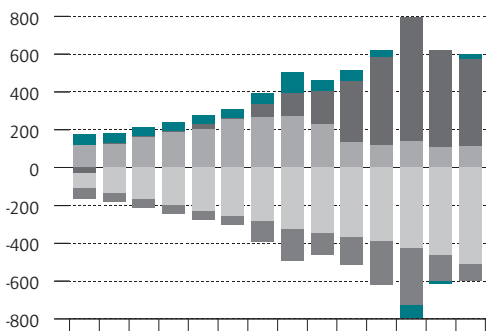
The share of gold and foreign reserves declined in recent years while the share of euro-denominated securities rose.

Figure 6

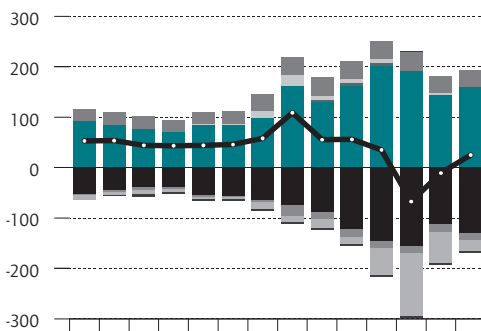
Balance sheets and NFA positions of selected Eurosystem central banks

Euro billion

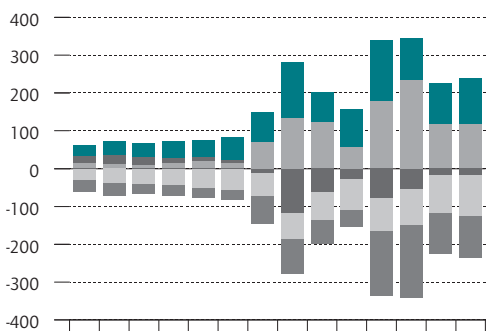
Bundesbank: Balance Sheet Development



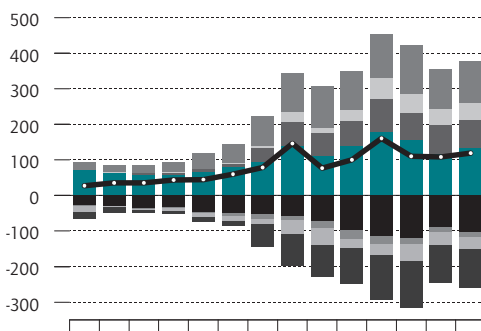
Bundesbank: NFA-Position



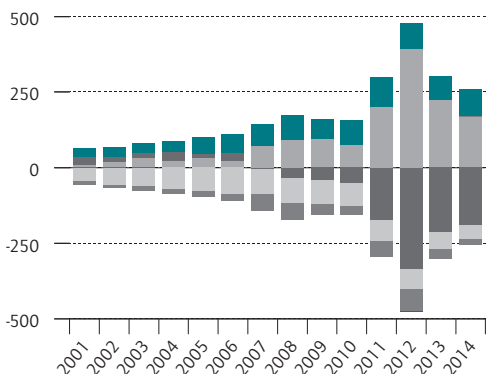
Banque de France: Balance Sheet Development



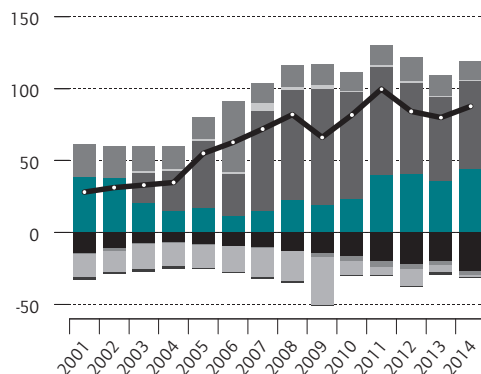
Banque de France: NFA-Position



Banco de España: Balance Sheet Development



Banco de España: NFA-Position



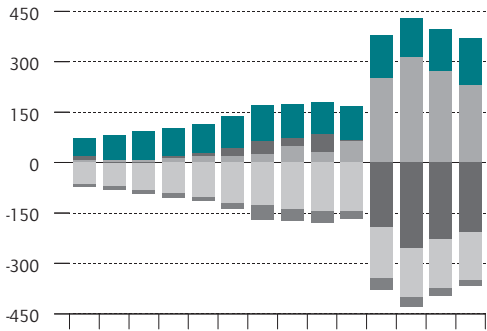
- monetary policy operations
- Target 2 position
- Banknotes in circulation
- Liabilities from monetary policy operations (reserve accounts, time deposits and deposit facility)
- Net financial assets

- Gold and foreign currency
- Securities
- other claims in euro
- other assets
- capital, reserves, revaluation accounts and provisions for risk
- liabilities denominated in foreign currency
- liabilities denominated in euro
- other liabilities
- Net financial assets

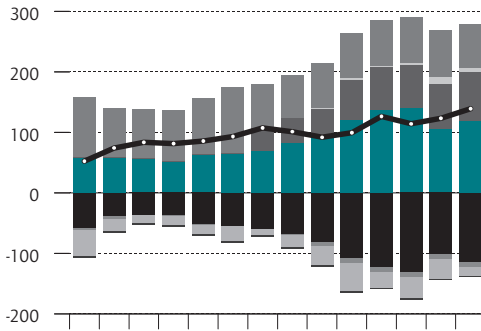
Source: National central banks (annual reports), own calculations.

The developments of national central banks' balance sheet was quite heterogeneous. By and large, net financial asset positions are driven by gold and foreign reserves as well as euro-denominated securities.

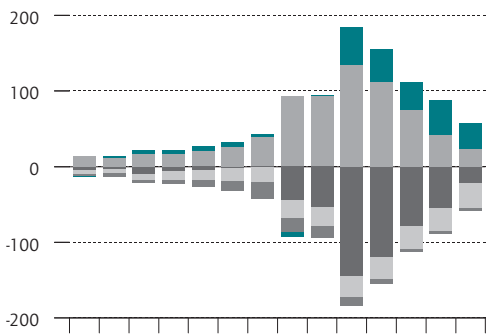
Banca d'Italia: Balance Sheet Development



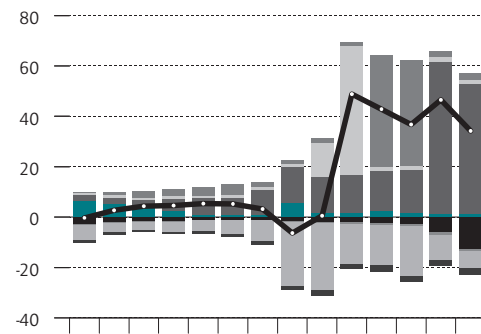
Banca d'Italia: NFA-Position



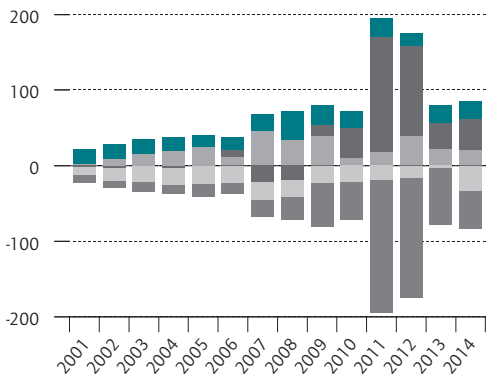
Central Bank of Ireland: Balance Sheet Development



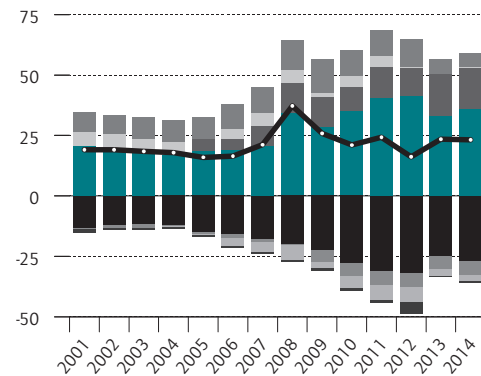
Central Bank of Ireland: NFA-Position



De Nederlandsche Bank: Balance Sheet Development



De Nederlandsche Bank: NFA-Position



- monetary policy operations
- Target 2 position
- Banknotes in circulation
- Liabilities from monetary policy operations (reserve accounts, time deposits and deposit facility)
- Net financial assets

- Gold and foreign currency
- Securities
- other claims in euro
- other assets
- capital, reserves, revaluation accounts and provisions for risk
- liabilities denominated in foreign currency
- liabilities denominated in euro
- other liabilities
- Net financial assets

rency reserves. The development of the Central Bank of Ireland's NFA position is particularly striking as it skyrocketed between 2009 and 2010 when the Irish banking crisis reached its climax. The main reason for this upward movement up until 2013 was the provision of emergency liquidity assistance. Emergency loans were discontinued in 2013 when, in the process of liquidating the Irish Bank Resolution Corporation (IBRC), the Central Bank of Ireland purchased a larger portfolio of government bonds and securities from the IBRC. Although the Irish Central Bank stressed its intention to swiftly sell this portfolio, to date it has only done so to a limited extent.¹³

Are NFA purchases tantamount to prohibited monetary financing?

A key principle of the European currency union is the prohibition of monetary financing stipulated in Article 123 of the Treaty on the Functioning of the European Union (TFEU).¹⁴ It serves, *inter alia*, to ensure strict separation of fiscal and monetary policy and to safeguard the credibility and integrity of the single monetary policy.

Monetary financing occurs when a national central bank in the euro area grants credit to a member state or purchases its debt directly on the primary market, i.e., immediately after the bond has been issued by the government. Further, if an NCB injects capital into an insolvent bank, which should in fact have already been liquidated by other national authorities at the expense of the taxpayer, or provides the said financial institution with under-collateralized emergency loans over a longer period of time, this would probably also constitute a case of monetary financing.

The monetary financing prohibition does not apply to government bond purchases on the secondary market for monetary policy purposes or the use of government bonds as collateral for the central bank's refinancing operations, provided this does not amount to a circumvention of Article 123.¹⁵

¹³ See, *inter alia*, Central Bank of Ireland, *Annual Report 2013* (2014). <https://www.centralbank.ie/publications/Documents/Central%20Bank%20of%20Ireland%20Annual%20Report%202013.pdf>

¹⁴ See, *inter alia*, O. Issing, *The Birth of the Euro* (Cambridge, Cambridge University Press: 2008), 54 ff.

¹⁵ For example, the ECJ stated in its ruling on Outright Monetary Transactions, that "(...) the ECB does not have the authority to purchase government bonds on secondary markets under conditions which would, in practice, mean that its action has an effect equivalent to that of a direct purchase of government bonds (...), thereby undermining the effectiveness of the prohibition in Article 123(1) TFEU." (Judgement of the ECJ of 16 June 2015, Case C-62/14; <http://curia.europa.eu/juris/document/document.jsf?docid=165057&mode=req&pageIndex=1&dir=&occ=first&part=1&text=&doclang=DE&cid=972873>) on preventing a circumvention of the prohibition of monetary financing, see Council Regulation (EC) No 3603/93 of 13 December 1993, Article 7.

One point occasionally made about possible circumvention of the prohibition is that secondary market purchases can deprive governments of market discipline as a result of their effect on bond prices and the associated improvement in refinancing conditions. In this case, the impact of secondary market purchases may be equal to that of primary market purchases and, consequently, could constitute a violation of Article 123. A second point is that there may be a risk that the distinction between primary and secondary market purchases becomes blurred in the event that a central bank holds too large a fraction of government bonds, thus becoming the dominant purchaser of such debt instruments.¹⁶ However, it is rather difficult in practice to make such objections subject to a rigorous legal review. For example, falling government bond interest rates in the course of bond purchases motivated by monetary policy objectives are unlikely to be sufficient evidence of monetary financing. In this context, there is a danger of confusing the *means*, i.e., the transmission channel of monetary policy impulses with the *purpose* of prohibited monetary financing. In practice, it is probably also virtually impossible to determine the critical volume of bonds an NCB can hold before becoming a dominant purchaser in the secondary market.¹⁷

ANFA places no explicit requirements on the national central banks regarding the composition of non-monetary policy NFA portfolios. However, Point 13 of the Preamble of the Agreement on Net Financial Assets states that NFA purchases are subject to Article 123 of the TFEU and, as such, may not be misused for monetary financing purposes. In addition, ANFA contains no further restrictions and/or specific requirements regarding security purchases with the explicit purpose of preventing a possible circumvention of Article 123 from the outset. However, the ECB regularly monitors purchases made by the NCBs and checks that these do respect the monetary financing prohibition. The results of these reviews are published in the ECB's Annual Report. The ECB's actual scope for intervention in the event of a possible violation of Article 123 is likely to be rather limited however. Although the Governing Council can veto such purchases, this requires a two-thirds majority vote which is a tough hurdle to clear. Should the national central bank refuse to follow the instructions of the ECB, a more laborious procedure would likely have to be followed, maybe culminating in the NCB in question being taken to the European Court of Justice (ECJ).

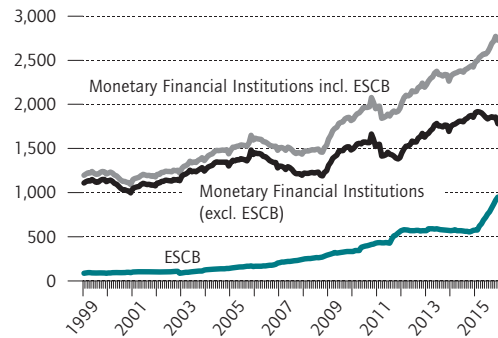
¹⁶ See, for example, relevant statements made on monetary financing in L. Feld, C. Fuest, J. Haucap, H. Schweitzer, V. Wieland, and B. Wigger, *Das entgrenzte Mandat der EZB – Das OMT-Urteil des EuGH und seine Folgen* (Market Economy Foundation (Stiftung Marktwirtschaft), Scientific Council: 2016).

¹⁷ See the relevant comments made by the President of the *Deutsche Bundesbank*, Jens Weidmann, in an interview with the German newspaper, *Frankfurter Allgemeine Zeitung* (FAZ) on January 29, 2016: https://www.bundesbank.de/Redaktion/DE/Interviews/2016_01_29_weidmann_faz.html

Figure 7

Government securities on the balance sheet of ESCB central banks

Euro billion



Source: ECB (Statistical Data Warehouse, Weekly Financial Statement), own calculations.

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The stock of government debt on the balance sheets of the ESCB central banks has steadily increased since the introduction of the euro.

It is informative to examine the government bond portfolios which the members of the ESCB have held on their balance sheets since the introduction of the euro (see Figure 7).¹⁸ During the initial phase of the common currency, the volume of domestic portfolios on NCB balance sheets was frozen at the same level as prior to the introduction of the euro.¹⁹ Accordingly, the government bond portfolios also only increased very slightly from 1999 to 2002. Since 2003, however, this balance sheet position saw stronger growth. It is likely that, since 2010, the lion's share of additional purchases of government bonds is a result of large-scale asset purchase programs related to monetary policy. At the same time, as has already been discussed, an increase was observed among precisely the NFA items on the asset side of the balance sheets of certain NCBs where government bonds are registered.

This is unlikely to constitute sufficient evidence of covert monetary financing, however. First, for national central banks too, government debt instruments are an important tool for balance sheet and portfolio management.²⁰

¹⁸ These data are not publicly available for the individual national central banks and so it is not possible to conduct a detailed analysis on the level of the individual countries and/or NCBs.

¹⁹ Papadia and Valimäki, "Eurosystem Framework": 253 point out that in the first few years of the common currency, the ECB limited purchases of domestic securities so as to avoid compromising the effective functioning of its newly developed monetary policy instrument.

²⁰ On this, see also P. Engler and C. Große Steffen, "Safe Bonds for the European Monetary Union: Strengthening Bailout Ban with More Robust Financial System," *DIW Economic Bulletin*, no. 10 (2014): 28–39.

Second, it is not apparent from the publicly available balance sheet figures which NCB holds government bonds in which country. Without more detailed information on the balance sheets of the individual NCBs, it is simply not possible for outsiders to draw any kind of definite conclusion about the legality of bond purchases. However, the ECB has a precise insight into the individual NFA transactions of the NCBs and monitors compliance with the monetary financing prohibition. From the ECB's point of view, currently, only in the case of Ireland is there reasonable concern that the liquidation of the country's banks violate the monetary financing prohibition.²¹

Moreover, due to the clearly defined net financial asset ceilings, the national central banks have very little scope to use NFA purchases of government bonds to permanently sustain more favorable market conditions in their own countries.

Conclusions

The Agreement on Net Financial Assets (ANFA) between the national central banks of the euro area and the European Central Bank (known as the Eurosystem) is an essential component of the decentralized structure of the common currency and the single monetary policy. It ensures compatibility between the single monetary policy and the national tasks of central banks. To date, the accusation that covert monetary financing is taking place under the guise of ANFA remains unfounded. However, in this context, it would be legitimate to pose the question as to whether the manner in which NFA purchases are conducted is still in keeping with the times. Simply the fact that the general public has become suspicious of the motives behind the NCBs' actions carries the risk of monetary policy in the euro area losing its most important asset: its credibility.

In order to avoid this, the freedom the NCBs currently have to buy and sell financial assets arbitrarily could be more heavily restricted through a more centralized central banking arrangement, for example. However, further centralization of this type may not be viable in practical or political terms. First and foremost, it would need to be determined what national institutions would take on responsibility for the tasks that are presently being conducted by the NCBs. For example, managing national gold and foreign currency reserves or conducting the activities of a fiscal agent would require an institution with sufficient expertise and financial resources and this is not something that could be easily established overnight.

²¹ Since 2013, the ECB has pointed out in its Annual Reports that there are doubts about Ireland's compliance with Article 123 and has already called for the Central Bank of Ireland to take appropriate measures.

In principle, it would also be possible to further limit national banks' NFA purchases but this would raise several practical problems. To ensure an efficient and effective interest rate policy, the liquidity deficit should not become excessively large, at least during non-crisis times. Otherwise, there is a risk of price distortions on the interbank market, which would mean that the policy interest rate would fail to properly signal the ECB's monetary policy stance.²² In the current environment of extremely low inflation, in which the ECB operates in the vicinity of the zero lower bound and still aims to maintain a certain level of excess liquidity, this objection is unlikely to be valid. However, if the ECB were to return to its pre-crisis mode, limiting NFA purchases would mean creating and maintaining a centralized Eurosys-

22 Papadia and Valimäki, "Eurosystem Framework": 325 ff.; J. Eisenschmidt, A. Hirsch, and T. Linzert, "Bidding behaviour in the ECB's main refinancing operations during the financial crisis," *Working Paper*, no. 1052 (Frankfurt am Main, European Central Bank: 2009).

Philipp König is a Research Associate in the Department of Forecasting and Economic Policy at DIW Berlin | pkoenig@diw.de

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tem bond portfolio, which could be used to manage the liquidity deficit.²³

In any case, the Eurosystem should improve its credibility by increasing the transparency of the participating central banks. The portfolio composition of the NCBs and their balance sheet management strategies are incomprehensible to outsiders. A number of NCBs even fail to provide regular detailed balance sheet data and only present a rough outline of their balance sheets once a year. This opacity has contributed to national central banks being accused of monetary financing in the course of NFA purchases. Even if, on the whole, this accusation currently does not hold, it would still be conducive to the credibility of the NCBs if they were more transparent about the composition of their investments and published the relevant data in full, even if this means a slight delay.

23 Alternatively, the volume of longer-term refinancing operations could be significantly increased.

Kerstin Bernoth is Deputy Head of the Department for Macroeconomics at DIW Berlin | kbernoth@diw.de



DIW Berlin – Deutsches Institut
für Wirtschaftsforschung e.V.
Mohrenstraße 58, 10117 Berlin
T +49 30 897 89 -0
F +49 30 897 89 -200

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Press office

Renate Bogdanovic
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presse@diw.de

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