

The European Central Bank (ECB). One Bank Ruled Them All; Trichet's Powergrab

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On Thursday, European Central Bank head Jean-Claude Trichet announced that he would continue the ECB's low interest rates (1 percent) and easy lending policies for the foreseeable future. Wall Street rallied on the news sending shares skyrocketing 273 points on the day. Trichet also said that he would continue his controversial bond-purchasing program which has drawn fire from wary German leaders who fear the onset of inflation. The bank chief adroitly dodged questions on the program suggesting that he will operate secretly like the Fed, buying up downgraded assets and concealing their original owner. By appointing himself the de facto Fiscal Czar of the European Union, Trichet has stopped the fall of the euro, scattered the short-sellers, and zapped the markets upward. Not bad for a day's work.

Up until yesterday, credit conditions in the EU had been steadily deteriorating. Hoarding by banks had intensified while the rates that banks charge each other for short-term loans was on the rise. Lenders were afraid that the \$2.4 trillion in loans to countries in the south (the PIIGS) and East Europe would not be repaid and that that would push more banks into default. Euribor had been creeping upwards while overnight deposits at the ECB were setting new records every day. Jittery banks have parked over \$390 billion at the ECB's deposit facility since the crisis began. Banks would rather get low interest on their deposits than lend in the money markets where they might not be repaid at all.

From Bloomberg News:

Jean-Claude Trichet said the European Central Bank will extend its offerings of unlimited cash and keep buying government bonds for now as it tries to ease tensions in money markets and fight the European debt crisis.

"It's appropriate to continue to do what we've decided" on sovereign bonds, ECB President Trichet said at a press conference in Frankfurt today. "We have a money market which is not functioning perfectly."

Trichet's ECB is buying debt and pumping unlimited funds into the banking system as part of a European Union strategy to stop the euro region from breaking apart. While Trichet refused to bow to some investors' demands for more details on the bond purchases, he said the ECB plans to offer more help to financial institutions struggling to raise cash in money markets.

The ECB will give banks access to unlimited three-month funds at a fixed rate in July, August and September, he said. The measure is a key tool used by the ECB since the collapse of

Lehman Brothers Holdings Inc.” (Bloomberg)

It’s Christmas in June. By providing a safe location for overnight deposits, limitless funding for collateral that the market will no longer accept, and a (bond) purchasing program that keeps asset prices artificially high; the ECB is performing all the tasks of the market while eliminating all the risks. Trichet has made protecting the banking system the primary responsibility of the EU superstate.

“We have the best track record on price stability over 11 1/2 years in Europe and among the legacy currencies,” Trichet boasted. “What we have done and what we do with the same purpose is to help restoring an appropriate functioning of the monetary- policy transmission mechanism.”

Trichet’s actions have nothing to do with the so-called “monetary-policy transmission mechanism”. They’re a straightforward bailout of banks which invested in sovereign bonds that are steadily losing value. Greece has already received loans that will cover its funding needs through 2012. Trichet’s bond buying-spree and lavish liquidity provisions are a lifeline to his banking brethren who are trying desperately to keep their chestnuts out of the fire. The ECB boss is merely helping them shunt their losses onto the public’s balance sheet, like Bernanke has done in the US.

For the EU to survive, the member states will have to create a governing authority that can implement fiscal policy. Regrettably, Trichet has usurped that authority while circumventing the normal democratic process. It’s not Trichet’s job to arbitrarily underwrite the bad bets of reckless speculators or to prevent the market from clearing because some of his banking buddies might go broke. That’s well beyond his mandate. *The ECB needs to be reigned in and Trichet’s powergrab stopped. The European Union should be based on more than the profitability of its banks.*

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