DRAGHI'S CIVILISED WAY OF TALKING DOWN THE EURO

Mario Draghi, the European Central Bank president, is doing his best to talk down the euro – but in a civilised way that doesn't break the leading countries' compact to refrain from competitive devaluations. The ECB's insistence that monetary tightening is currently unnecessary flies in the face of expected faster US interest rate increases as a result of an accelerated American economic expansion.

All this is likely to cause problems for European currency management in the coming months if the euro comes under too much downward pressure. Draghi's successor may have to deal with a highly uncomfortable legacy if circumstances warrant a sharp increase in interest rates after the ECB president steps down at the end of October 2019.

Unsettled by a euro rise in recent weeks that the ECB believes is unjustified by the underlying European economy, Draghi is signalling that international holders of US Treasury bonds have been selling dollars and buying euros, which he sees as countering the ECB's efforts to raise inflation.

Some observers believe official Chinese investors may have been selling US securities and shifting into the euro as part of Beijing's extension of investments in Europe – a move that could be connected with Sino-US trade tensions.

The result is that, after several months of wavering between sending dovish and hawkish signals to the financial markets, the ECB's leading officials are leaning towards indicating continued monetary accommodation, despite probable accelerated US monetary tightening.

Draghi has criticised past US attempts to depreciate the dollar as infringing international agreements. In turn, he has tried hard to couch his unease over the euro's rise in relatively oblique language that cannot be construed as euro-weakening verbal intervention.

Linked to this, in a remarkable overture in monetary diplomacy, the Deutsche Bundesbank is signalling readiness to continue quantitative easing purchases of government bonds until the end of the year, and possibly beyond, if needed, to meet the ECB's 2% annual inflation target.

In a move that is both technical and political, the Bundesbank has been diversifying its bond-buying actions, with the effect that a previously-predicted scarcity of eligible German government bonds is unlikely to materialise. The ECB's bond-buying rules prevent official purchases of more than 33% of individual government issues, as a precaution against central banks becoming dominant creditors of governments.

However, the Bundesbank has been buying an increasing amount of triple-A rated German Land (state) government bonds, as well as supranational and corporate issues (where there has been an upturn in German corporate bond issuance).

This allows Jens Weidmann, Bundesbank president, extra manoeuvring room if faced with a request later this year from Draghi and other members of the decision-making ECB council to maintain loose monetary conditions by maintaining bond purchases longer than expected.

Weidmann is in a delicate position. On the one hand, he has been a constant critic of the ECB's QE, which is highly unpopular with conservative German monetary opinion. He has voted against most of the ECB's easing action of the past three years.

On the other hand, the Bundesbank president has been making conciliatory gestures to Draghi ever since the two engaged in a disagreement over the ECB chief's celebrated pledge in 2012 to do ‚whatever it takes' to sustain the euro. Weidmann is maintaining his hopes of taking over from Draghi when the former Banca d'Italia governor steps down from the top ECB job. German officials know that such a transition would be highly unpopular with many southern debtor states, which regard Weidmann as an over-stringent standard-bearer of Germanic orthodoxy.

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