



The Bundesbank's Bond Purchases in 1975

- The Bundesbank has raised objections to the ECB's potential sovereign bond purchases.
- However, back in 1975, when private demand for long-term bonds plunged, the Bundesbank bought post, telecom and sovereign bonds worth around 1% of GDP.

In 1975, the Bundesbank bought around DEM 7.6bn of public bonds (post, telecom and sovereign bonds) in the secondary market. This was equivalent to around 1% of GDP.

The asset purchases started early in 1975, but the bulk of them were made between May and October 1975, via open market operations.

The Bundesbank's archives are not available online that far back, but Deutsche Bank reports these figures in its annual report of 1975, and some newspapers also provide evidence of this.

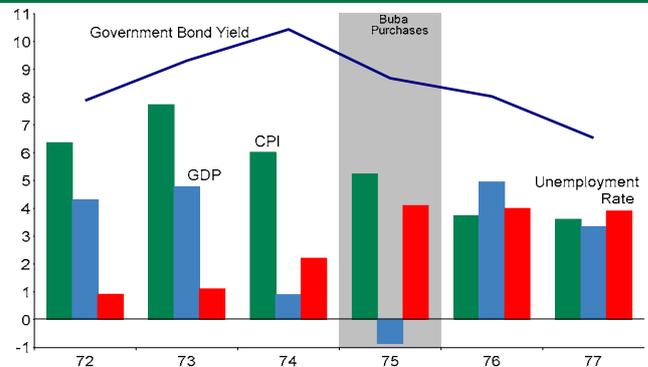
Interestingly, the information from that time suggests that the Bundesbank bought bonds because the economic outlook was deteriorating (GDP contracted 0.9% that year) and it was worried that further rises in long-term interest rates (from a 10.4% average in 1974) would threaten growth and drive inflation.

Demand for longer-dated bonds plunged in the summer of 1975 as investors feared that soaring inflation would offset the returns on their investment. Reports suggest that the Bundesbank purchased bonds of a 6-year maturity and longer.

Note that public bond purchases were against the central bank's mandate because it implied debt monetisation. Moreover, policymakers objected to the move. But Bundesbank President Karl Klasen had "accidentally" announced the bond purchases in a press conference, and then had to stick with this policy.

Hence, the Bundesbank had to tweak its own rules. Helmut Schlesinger, board member and chief economist of the Bundesbank at the time, justified the policy action as follows: "we can only operate open market policy in order to regulate the money market, but not to finance the public deficit". In other words, the Bundesbank needed to purchase bonds in order to maintain monetary policy's transmission

Chart 1: GDP and Inflation (% y/y)



Source: Reuters EcoWin Pro

channel. The Bundesbank had set a monetary growth target for the year for the first time, which it risked missing (money growth slowed to 5.7% in May 1975, below the target for the year of 8%).

There are clear parallels between the situations in 1975 and 2012. At his first press confidence last year, ECB President Mario Draghi declared his "great admiration" for the Bundesbank. At the time, we suspected he might be thinking about the Bundesbank's successful inflation or monetary growth targeting (although, effectively, the Bundesbank only met its targets about 50% of the time, see our article "ECB: The Ghost Bundesbank Future", *Market Mover*, 1 December 2011). But now that Mr Draghi has announced potential ECB open market operations in order to purchase government bonds, he might actually have been thinking about 1975's bond purchases. While it might not be surprising that Bundesbank President Jens Weidmann has the biggest objections to such a policy (Chancellor Angela Merkel is reportedly less critical these days), his objections to ECB bond purchases contrast with his own institution's history.

For those who read German and are interested in the original sources, please see:

- Der Spiegel: "Der Freund fehlte", 27.10.1975 <http://www.spiegel.de/spiegel/print/d-41392790.html>
- Deutsche Bank Annual Report 1975 http://www.bankgeschichte.de/downloads/gb/gb_1975.pdf



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