Three companions enjoyed a midday meal. The first says, "I'm satiated. The food and drink have done the trick. I'm ready to return to work." The second says he still has room for a dessert to top off the wonderful meal. They look to the third, who doesn't know quite what to do. She did not eat much to begin and needs her energy, but she is too disciplined to have dessert.

The ECB meeting has gained extra significance given last week's developments. The Federal Reserve ended its asset purchase program, which it did not call quantitative easing, but rather credit easing. It also offered a constructive assessment of the labor market. Their concern about the decline in inflation expectations, measured by the break-evens, was minimal. There was no recognition of the elevated market volatility in the middle of the month, which had prompted at least one regional Fed president to opine about tapering the tapering.

At the end of last week, Japan announced to bold steps that were more aggressive than anyone expected. With cutting its growth and inflation forecasts, the BOJ announced an acceleration of its balance sheet expansion from JPY60-70 trillion to JPY80 trillion, which includes the tripling of equity ETF purchases. At nearly the same time, the government's largest pension fund (GPIF with roughly $1.15 trillion of assets) indicated it would diversify its portfolio more aggressively. This involves purchasing more than $150 bln of foreign assets. The government bonds that will be sold are largely made up for by the increase in BOJ purchases.

Separately, reports indicate that a somewhat larger than expected supplemental budget is in the works. Estimates in the press suggest JPY3-4 trillion (0.6%-0.8% of GDP). Some observers see the supplemental budget as a sign that Abe intends to push ahead with the sale tax increase next year. BOJ and MOF officials seem to agree. Yet it remains a contested issue. An adviser to Abe suggested postponing the tax until January or April 2017. Our understanding is that it would require a vote in the Diet, which Abe wants to avoid. The legislative process complicates matters and costs Abe scarce political capital.

What it took the Federal Reserve several years to do through its three iterations of asset purchases, the Bank of Japan seeks to do in a year, in terms of balance sheet growth relative to GDP. After these warm-up acts, the spotlight turns to the European Central Bank.

Unlike the Fed and BOJ, which are designed to have a strong leader, the ECB is designed to preserve as much as possible the national interest of its members. At the Fed, when fully staffed, the Board of Governors has a majority of votes on policy. At the ECB, the executive board consists of only six
people. According to a Reuters report, Draghi is being accused by many of his colleagues as being Caesar. Draghi is said to have a secretive management style, erratic communication, and weak on collegiality.

The ECB is a house divided. The Reuters report likely comes from information leaked by a partisan. The report makes it appear that contrary to conventional wisdom, Germany is not isolated. It claims that nearly half of the 24-person council is opposed to a sovereign bond purchase program. These leaks help explain the conditions under which Draghi is operating.

The Bundesbank's Weidmann testified before the German High Court seeking to overrule a decision made by a large majority of the ECB's on the Outright Monetary Transactions (OMT). What's more, the German Chancellor Merkel also supported the ECB. At the recent IMF meetings, Germany reportedly briefed against the ECB. The leaked story on Reuters indicates that the meeting between Draghi and Weidmann, which Merkel insisted on, was held last week, but produced no resolution.

It is true that Draghi has stretched his authority as President of the ECB. There are three examples of this that Draghi's critics cite. The first was at Jackson Hole where Draghi recognized the decline in inflation expectations and seemed to promise a policy response. The second is that apparently the ECB Governing Council explicitly agreed to avoid a specific figure for balance sheet expansion. Draghi indicated a desire to bring the balance sheet back to levels at the beginning of 2012. This essentially put the price tag of around 1 trillion euros. Third, Draghi may have over-stepped his authority again in reference to the release of minutes and, at least according to some, may have given the Governing Council a fait accompli.

It could be, as the leak suggests, flaws in Draghi's management style. However, to take it at face value is to ignore the political context. It seems that it is the Bundesbank that is resisting the majority of the ECB. It is not without sympathy we consider Weidmann's position. On Trichet's SMP, and Draghi's OMT and asset purchase program, the Bundesbank, the largest shareholder of the ECB, has been continuously overruled. Moreover, starting next year, it will not vote at every ECB meeting. It is fighting a rearguard action. No wonder Draghi is frustrated.

The BOJ's decision was made by the slimmest of margins (5-4 vote). This is not the ECB way. The ECB often has, especially in the early years, made decisions without formal votes, according to reports. The collegiality that Draghi is said to lack is a product of simpler times. It is much more difficult to be collegial when one is fighting an internecine struggle. If one shares ideas, they are often leaked. Circulating papers can be helpful, but this too can be used to obstruct.

The Reuters report suggests that at the traditional informal dinner the night before the ECB meeting, "some" of the national central bank heads will more openly discuss this criticism of Draghi. This does not make for a convincing and credible backdrop for strong action at the ECB meeting itself. Perhaps the internecine fighting is the consequence of the uncertainty on how to deal with the disinflation/deflation risks. Consider the large-scale operation of the BOJ over the past six months. During this time, inflation has fallen (core inflation excluding the sales tax hike) not risen.

The ECB cannot neuter Draghi. He needs to speak with authority. That authority is terrible constrained, not only by mandate, but by the recalcitrance of the Bundesbank. We have argued previously that Germany is not as isolated as it is often perceived, but it is the first among equals. At the very least, Draghi needs to affirm that the ECB Council is unanimous in agreeing that additional, unconventional measures will be deployed if necessary.

A few weeks ago, it was leaked that the ECB was considering buying corporate bonds. While it is possible, we noted that 1) there are only about 1 trillion euros of such eligible securities and 2) the issuers are highly concentrated (France 44%, Germany 12%, Italy 12% and Netherlands 10%). There seems to be two other assets that may seem to fulfill the ECB criteria.

The first is the supra-nationals. These include the bonds issued by the EFSF and ESM, EU bonds and EIB bonds. In fact, one promising path on the growth side, especially now that the German economy itself is faltering, is for the EIB to issue more bonds to fund stimulative infra-structure projects throughout much of the region. There are almost 500 bln euros of outstanding paper from these supra-nationals.

The second is bank bonds. The ECB is already buying covered bank bonds. Given the conclusion of Asset Quality Review and stress tests, the next logical step seems to be to buy uncovered bank bonds. There are about 2.3 trillion euros of bank bonds. About 12% are currently being used as collateral for borrowings from the ECB.

It may be difficult for Draghi take fresh initiatives now. The second TLTRO is a month away, and the take down is expected to be more than twice the first. The covered bond purchase program is operational (it has even entered the new issue market) and the ABS purchases will soon begin. There are some indications that the pace of contraction in bank lending is continuing to slow. Both the supply of credit and the demand is improving according to the ECB's own surveys. The euro's decline will also be helpful.

It rarely is mentioned in mixed company, but there is an important subtext that may be lost on many observers. Draghi's term extends to October 2019. It is not yet at its mid-point. Weidmann is his most obvious successor. In fact, Draghi's ascension was a bit of a fluke. The job appeared to have been Axel Weber's (Wiedmann's predecessor), but he had a temper tantrum, and quit the ECB when he was outvoted. Wiedmann is more skillful at these machinations.
Some bombastic talk by a few observers about a mutiny at the ECB is wide of the mark. It accepts at face-value the Reuters report, without asking the motivation of the leaker. It is taking one side of the debate and pretending it is the whole truth. The criticisms in the Reuters report that are levied against Draghi are not the stuff of a mutiny. That said, Draghi's frustration is palpable and cannot be sustained for long. One scenario that we have mentioned before continues to be worth considering, even though it may not be an odds-on favorite.

In the middle of next year, Italy's president turns 95 and wants to retire. He has wanted to retire for some time, but Italian politics being what they are made it impossible. Under a scenario that in 6-8 months the euro zone economy is still wrestling with deflation, stagnant growth and weak lending, Draghi is desperate for the ECB to do more, but cannot overcome what he has called the ECB's DNA (ordoliberalism). The only way Germany might be able to agree to a more aggressive asset purchase program is if it were to run it. If Draghi could get such a guarantee from Weidmann, perhaps Draghi would step down and arrange to become the next Italian president. And from that post, by helping implement structural reforms in Italy, could do more good the euro area than he can as head of the ECB, with the BBK trying to frustrate him at every turn.

ECB: Everything Can't Be is republished with permission from Marc to Market
Economy

WORLD ECONOMY
- Africa Economy
- Americas Economy
- Asia-Pacific Economy
- Europe Economy
- Economics Theories & Systems

EDITOR'S PICK:
- Fastest Growing Economies In 2013

INDUSTRIES & BUSINESS
- World Industries Directory
- International Organisations
- Trade Organisations

EDITOR'S PICK:
- The Blame Game: If The Banks Didn't Cause The Financial Crisis, What Did?

COMPANIES & INVESTMENTS
- Investing and Investments
- Major Companies & Stocks
- Commodities

EDITOR'S PICK:
- Investing in Iraq: Ingenious or Insane?

PERSONAL FINANCE
- Credit Cards
- Insurance
- Banking & Finance

EDITOR'S PICK:
- Money Advice from The World's Filthy Rich

CAREER FINDER
- Economic Statistics By Country
- Economic Indicators
- Price Index Indicators

FEATURED:
- Worldwide Consumer Confidence Index