GOLD KEEPER: Bundesbank President Jens Weidmann, here outside a safe at the money museum in Frankfurt, says the bank should be a 'stability anchor'
REUTERS/KAI PFAFFENBACH

The once-mighty German central bank is now just one voice among many. Can Jens Weidmann get it to roar again?

The Bundesbank's fight to be heard

BY ANDREAS FRAMKE AND PAUL CARREL
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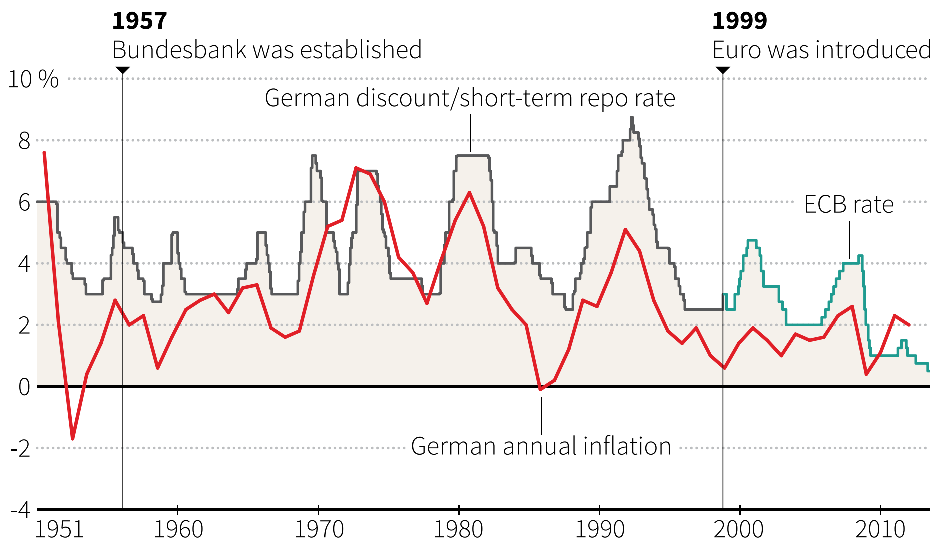
Meeting in Bratislava's neo-classical Reduta concert hall on May 2 this year, the 23 men who form the European Central Bank's policymaking Governing Council were divided.

With inflation undershooting their target of close to 2 percent and most of the euro zone in the clutches of recession, the vast majority wanted to cut borrowing costs.

Seated two places to the right of ECB President Mario Draghi in the grand, gilded room was Jens Weidmann, chief of Germany's Bundesbank and, in his country's post-war tradition, an inflation-fighting hardliner. Weidmann resisted the impulse to cut, worried it would have little impact and use up some of the ECB's remaining room for manoeuvre.

Ruthless inflation fighter

The Bundesbank developed a reputation as an inflation buster. Now the European Central Bank is doing its work



Sources: ECB; U.S. Bureau of Labor Statistics, Division of International Labor Comparisons.

A large screen on the wall showed fluctuating market prices.

The quiet German assessed the mood around the oval table. A significant group in the room wanted to cut the main interest rate by half a percentage point.

Seeing that a cut was inevitable, he chose to accept it and instead focused on trying to limit its size. When Draghi brought the meeting to a conclusion, Weidmann's compromise position prevailed: the bank would cut by a quarter point.

This is Weidmann's world: a series of battles over basis points and policy shifts, and rearguard actions fought with limited ammunition used to maximum effect.

Thrust into the Bundesbank presidency in 2011 when his predecessor resigned in protest at ECB policy, Weidmann heads a once-mighty institution that still employs nearly 10,000 people - far more than the 1,600 at the ECB - but which is struggling to adapt to life as just one of 17 national stakeholders in the ECB, albeit the biggest.

The 45-year-old's task is daunting: often in the minority at the ECB, he must use all his tactical nous to gain traction with the Bundesbank's conservative, inflation-fighting policies.

Failure would jeopardise Germans' confidence in the ECB, and the euro - a scenario that could hit support for the single currency project in its biggest member state.

Weidmann says his motivation is simple. "A stable currency," he told Reuters.

That is not something to be taken for granted in Germany, where the national psyche is still scarred by the experience of hyperinflation in the 1920s and Draghi, an Italian, is viewed with widespread distrust for pursuing policies perceived to be fast and loose.

Many of the men who ran the Bundesbank as long ago as the 1980s are still active and behave like a Greek chorus, warning that the ECB's current course will end in disaster.

This emboldens Weidmann in his mission to be a 'stability anchor'. Softly spoken and far younger than his predecessors, the president says his purpose was forged by early experiences, including childhood holidays in Italy, after which the family, mindful that the Italian currency was unstable, would quickly convert their remaining lira into deutschmarks.

QUO VADIS BUNDESBANK?

Germans have long looked to the Bundesbank as a pillar of stability and guarantor of a stable currency. Its headquarters, where Weidmann has his office on the 12th floor, is a fortress-like 1960s building on the outskirts of Frankfurt that over the decades became a monument to Germany's economic power.

Formed in 1957, the German central bank was a model for central bank independence in the years that followed. In the 1990s, a Bundesbanker giving a speech in deepest Bavaria could send shockwaves across global markets.

"Not all Germans believe in God, but they all believe in the Bundesbank," quipped Jacques Delors, president of the European Commission, in 1992.

Five years later, a clash between then Bundesbank chief Hans Tietmeyer and the German finance minister, Theo Waigel, underlined the Bundesbank's power.

On May 15, 1997, Waigel landed in a helicopter at its headquarters, marched in and asked the board to revalue the bank's gold reserves that year in a ploy to help the government wriggle out of a fiscal straightjacket and ease the path to the launch of the euro. They refused.

With the birth of the euro in 1999, the Bundesbank's power as guardian of the deutschmark waned as Germany bound its future with the fate of the single currency project.

Its struggle to cope with this reduced influence has been further frustrated by the ECB's policy response to the euro zone crisis.

This has fuelled a sense of lost direction among some Bundesbank staff, who paint a picture of a bloated and moribund institution lacking leadership and intellectual vision.

"The Bundesbank used to be like a bull – strong. But with the euro, the bull has been castrated," said one Bundesbank employee with years of experience at the bank. "Now it's an ox, growing old – the meat isn't getting any better."

Staff are directionless, the employee said, and "increasingly in a situation where they say 'I'll wait for my pension cheque.'"

Weidmann recognises that the bank has been through a tough period after the resignations of presidents Ernst Welteke, in 2004 over an expenses scandal, and Axel Weber in 2011.

Weber, Weidmann's predecessor, quit in protest at the ECB's first government bond-purchase programme. The policy was intended to help save the euro by lowering borrowing costs for crisis-hit governments. Weber believed that risked compromising the central bank's independence by taking it into the fiscal policy arena.

Juergen Stark, who acted as Bundesbank president in 2004, followed Weber and quit as ECB chief economist later in 2011 - also in opposition to the bond-buying plan.

The resignations showed the Germans' frustration that the ECB was morphing out of the Bundesbank cast in which it was forged: a mould based on 'Ordnungspolitik' - the dogma in which the role of a totally independent central bank is solely to ensure stable prices, not to promote economic growth and employment or to help governments with fiscal problems.

But Helmut Schlesinger, who preceded Tietmeyer as Bundesbank chief in the early 1990s, said the departures achieved little.

"The resignations of Weber and Stark didn't achieve much politically - not at the ECB and also not with the government, which is a blow for the Bundesbank," Schlesinger, 88, told Reuters at his home in the hills outside Frankfurt.

FADING STAR: A five Euro banknote in Weidmann's office. **REUTERS/ KAI PFAFFENBACH**

> "The Bundesbank used to be like a bull – strong. But with the euro, the bull has been castrated.
>
> Longtime Bundesbank employee

Weber's departure to Switzerland to take up the position of UBS chairman even fed a sense at the Bundesbank that the leadership was transient and out for itself.

"Where is the intellectual head who can draw a vision for the bank, and who is going to stay?" asked the long-serving employee.

To address this unease, Weidmann has made contact with the Bundesbank rank-and-file a top priority. He holds staff lunches and "Weidmann direct" town hall-style events across Germany.

But to really keep his staff on side, he needs to give them a sense that the Bundesbank can make a difference.

"At a European level, what policy decisions can the board take? None. And people (in the bank) know that," the employee said. "People are waiting for a new mission."

However hard he finds it to influence ECB policy, Weidmann has no intention of following Weber's example and resigning. He believes he is better off staying in the room and exercising influence rather than sniping from the outside.

Stark endorses this role.

"The Bundesbank is not the anchor anymore that it used to be, at the beginning of the currency union. But it still plays a crucial role, warning about the medium-term risks and the limits to monetary policy," he told Reuters.

The departures of Stark and Weber fuelled German public suspicion of the ECB, fanned by a posse of conservative academics led by Hans-Werner Sinn, head of the renowned Ifo research institute, who has denounced plans to make the central bank the supreme banking supervisor for the euro area - a project that could draw on Bundesbank expertise and give it a new lease of life.

This incessant criticism of the ECB makes it harder for Weidmann to retain German public support for Draghi's bank.

Born in Solingen, near Duesseldorf in the industrial heartland of northwest Germany, Weidmann studied economics in Bonn and in France, and was an intern at the French and Rwandan national central banks. He then worked at the International Monetary Fund before later moving to the Bundesbank, where he led the Monetary Policy and Monetary Analysis group.

In 2006, he had to think hard when German Chancellor Angela Merkel asked him to move to Berlin, to serve as her economics adviser. Moving back to Frankfurt was far easier.

"I always wanted to return to the world of central banking," he said. "This is my home."

His patient style is having some success.

LIMITED LEVERS

With fewer levers to pull than Schlesinger, Tietmeyer and other predecessors, Weidmann takes a cautious approach to policy, building his case slowly and influencing opinion where he can.

Weidmann's job is much more difficult than that of his predecessors, said Clemens Fuest, head of the ZEW economic institute and an academic adviser to the government in Berlin who Weidmann sometimes consults.

"He doesn't have this enormous power that former Bundesbank presidents had," he added. "I think the fact that Axel Weber resigned highlights how difficult this job is. Personally, I think Weidmann does a very good job of playing this role."

Weidmann pulls the levers he does have to great effect.

In March of this year, the Bundesbank used an accounting ploy to ram home to Berlin its concern that governments are pushing too much of the burden for dealing with the euro zone crisis onto the ECB.

Presenting its 2012 results, the Bundesbank almost doubled its risk provisions due to what it saw as risky ECB policies to which it is exposed. The upshot was a much smaller transfer of Bundesbank profits to the German government than Berlin expected. The central bank increased its risk buffers by 6.7 billion euros to 14.4 billion euros, which meant the amount it transferred to the German government was hardly changed from the previous year's 643 million euros despite "significantly higher interest income" in 2012.

"He doesn't want to let the governments off the hook," said Fuest.

Instead, he wants to focus on the core business of price stability. This explains Weidmann's readiness to accept the May rate cut, but limit it, while reining in the ECB's ambitions in so-called 'non-standard' policy areas, such as its endeavour to boost lending to small and mid-sized enterprises (SMEs).

This is paying off. Draghi has shifted from saying the ECB is looking for a solution to the problem of SME lending to pushing the issue towards the European Investment Bank.

To press his case, Weidmann has also appeared in court.

Last month, he went into battle with the ECB at Germany's Constitutional Court in a hearing into the ECB's role in Europe's crisis-fighting strategy.

Countries wanting to tap a yet-to-be-used ECB plan to buy bonds - dubbed Outright Monetary Transactions (OMT) - that Draghi masterminded last summer must apply to a new bailout fund for an aid programme that would require reforms and deficit cutting.

Germany's federal Bundesbank President Jens Weidmann walks in a corridor of the Bundesbank headquarters during a photo shoot with Reuters in Frankfurt May 17, 2013. **REUTERS/KAI PFAFFENBACH**

Weidmann's opposition to the bond plan helped ensure this condition was attached. Now the court process threatens to gum up the plan completely, at least in the short term. Political analysts say a verdict is unlikely before Germany's September election.

Sources close to the German government, which endorses the ECB's most effective response to the euro crisis, have voiced concern that the court might try to get the ECB's mandate updated and demand it be renegotiated with Berlin's partners.

Despite his constant battle to gain traction at the ECB, Weidmann said he does not feel isolated.

"I feel very comfortable," he said.

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