TAC
Applied Economic & Financial Research

THE BANKER'S COMMENT BY JEAN-PIERRE PATAT

A former central banker looks at the news

May 2011, TAC Newsletter - www.tac-financial.com

Figure of the month: 34 dollars an ounce for the price of silver: a 30% decline in a few days for this safe (but modest) investment, quoted forty times less than gold.

A new approach to financial supervision in Europe.

Since October 2010, European financial institutions have been supervised by three bodies: the European Banking Authority based in London, the European Authority for Market Supervision based in Paris and the European Authority for Insurance and Pensions, in Frankfurt. The temptation is to say, yet more "Quango"committees. Not really. These institutions replace three bodies which, in truth, exercised very little control, with "directives" more frequently ignored than followed. Exchanges of information between national authorities had certainly improved but they remained insufficient, in particular for ensuring satisfactory supervision of cross-border institutions.

The creation of these new committees, though, evidences a noticeable jump in quality. To start with they will have available a system for collecting and controlling information that permits the follow-up in real time of their subjects' situation. And, they will create tight legal "standards" and finalise a single set of rules for banks and insurance companies. To this is added responsibility for the direct supervision of rating agencies with the power to impose sanctions and outlaw, if need be, various kinds of financial products or market practices. We can see there is plenty that is concrete. Naturally, all depends on their execution and on the heavy but necessary workload involved in getting them up and running. Obviously they will be aided by national bodies, since competencies in such domains are not legion.

Some may regret the failure to opt for the radical choice of a sole European supervisory body, especially in regard of banks. This viewpoint was mainly upheld in France where we have centralisation in our genes. However, this option made little sense because "proximity" is an essential asset in this respect. There would, too, have been the problem of choosing the body to be in charge of this vital mission, stripping institutions (some of which are central banks, others state institutions) of their charge. Should it be the ECB (some already judge it as too powerful) or perhaps a body created from start-up? The devil is in the detail.

Greece: original sin.

Euro zone countries have yet to finish paying for the fault committed in 2000 in accepting a country, knowing full well that it did not, by far, meet required conditions and that it would not do so for some time. Now, we know not what to do. Exit from the euro? For the zone it would be a solution. However, even Greece's severest critics cannot consider such a hellish outcome for the country. Restructure the debt? A "hair cut" would, quite apart from the losses for the lenders, send out a catastrophic signal for the zone. Perhaps, though, an extension for the repayments is conceivable. In fact the core of the solution lies in Greece itself, where the government certainly has brought thousands of people into the streets but without tackling the real problems: inefficient taxation, an overblown civil service, excessive military expenditure which, moreover, is pointless (do we see Turkey, candidate to the EU, implementing aggressive activities against its neighbour?). These expenses need to be drastically reduced and hard luck for the French and German armaments dealers. It is being said that several Central and Eastern European countries are today less eager to adopt the euro. No doubt they realise that their application would no longer enjoy the same level of indulgence.

Fed: ECB-style transparency.

Bending to a practice that the ECB had adopted at its creation, the Fed recently gave its first press conference. Nothing much emerged except that the central bank is staying with a zero rate policy from which it has neither the wish nor the means to exit. A policy that has few if any positive effects (credit distribution remains flat and the wide M2 monetary aggregate grows at the modest pace of 4%). Nor has it had increased inflationary pressures. Yet this is a policy that they fear abandoning. Is a press conference the height of transparency? ECB's detractors disagree that this is so as they reproach it for not publishing minutes of meetings – something done by the Fed, but with a delay and after some reworking! The difficulty is to find something to say each time.

A comparison of long term rates – the Euro zone accused.

In a recent Financial Times' article, Martin Wolf wonders why England benefits from better long term rates than does Spain. He claims that this is because the UK is not in the Euro zone and is thus provided with chances of rebound denied to Spain, and that the markets like this. The writer ought to have asked himself why France, in the Euro zone, borrows at rates below those of England. That, though, would not go in the direction of his arguments. Above all he is overlooking a determining factor in the lowering of rates, the massive repurchasing of public bonds by the Bank of England.

Name of the month: Mario Draghi.

Few would have bet on him a few months ago as successor to Jean-Claude Trichet at a time when a German personality seemed unstoppable and in any case the "inflationist" reputation of his country was a handicap to this person so eminently suited for the position. Nothing is yet certain of course. If his nomination were to be confirmed, it would in any case show that the ECB is not ensnared in unwritten rules regarding the paralysing share out of positions by nationality. Recently, when a vice-president from a "southern" country was nominated, the "informed" observers deduced that the President would have to come from a "northern" country. We could be on the way towards a denial of such absurd practices; one informal "constraint" alone remains; the one requiring that the four "big" countries be always represented on the board. A practice that we welcome, one which reduces the considerable advantage of the "one man one vote" rule given to the "small countries".

Europe: a slow combustion engine.

It had seemed over recent months that Europe hoped to end the role of global village idiot in which she was stuck in her rigorous attempts to play by game rules that others happily transgressed. There is still a lot of road to cover. We learn that the EU gives India and China the same customs conditions as are accorded to developing countries. China and Benin share the same tariffs! Better yet: we learn that the Commission "is thinking about" (yes, thinking about) ending this … as from 2014, and giving these two countries tariffs applicable to emerging countries.

Each month, Jean-Pierre Patat, Honorary Director-General of the Banque de France and a TAC advisor, offers his own point of view on the economic and financial news, with total editorial freedom. Email : jppatat@tac-financial.com
Translation from the French by D. and M. Jouan-Cross.