TAC
Applied Economic & Financial Research

THE BANKER'S COMMENT BY JEAN-PIERRE PATAT

A former central banker looks at the news

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

Figure of the month: 3.08%, the US ten-year rate. We need to go back to the fifties to find rates persistently staying so low. In those days, too, central bank activity played a part…

American monetary policy: the waiting game.

In his last statement, the Fed's Chairman confirmed that rates close to zero were not about to be abandoned and that, in accordance with what he had stated, he would indeed put a stop to "quantitative easing" in July.

This attitude is in response to an economic situation that is hard to evaluate. GDP rose by 2.5% year-on-year during the first quarter and unemployment is a little below 9.7%. These results indicate a better trend than in the euro zone but are unsatisfactory in a country where the working-age population is growing at 1.5% annually (it is stagnant in the euro zone) and where unemployment benefits are far below those enjoyed by Europeans.

"Monetary policy cannot do everything" admitted Ben Bernanke. One might even say that henceforth it counts for little. Credit distribution remains languid; with a prime rate still at 3.5%, banking conditions only reflect imperfectly those (close to zero) of the money market. This very low rate does little to incite banks holding too much liquidity to loan to regional banks, although these are the main purveyors of credit.

Stuck in zero rates, the central bank has no wish to be in the same position with quantitative easing. Paradoxically, the bank will be ending an activity which has had some good effects - not for feeding demand through cash injections into the economy, as we stressed last month that the growth of M2 remains around 4%. Let us say it once more; by these actions the Fed has not resorted to the printing of money as some continue to write but has, rather, created inter-banking liquidity. No. It is on long term yields that quantitative easing has had a definite impact, since we note that despite a public debt nearing 100% of GDP, despite warnings from rating agencies, the American ten-year rate is only slightly above that of the Bund.

However, the Fed is right to cease these practices. First, because it is unhealthy to maintain an artificial euphoria in the debt market; second because the Fed had announced a few months ago that it would be ending them in the summer. Doing what you said you would do is the very basis of credibility for a central bank.

ECB: major decisions in a few months.

There is a tendency to put the spotlight on rate changes when observing ECB policy. Just as important are the choices to be made on the orientation of an activity that, over the last two years, has favored the maintenance of financial stability: replacing auctions at variable rates (where the reference rate is the lowest, the liquidities made available are limited, and the best-served are those who make the best offers) by auctions at a fixed rate; the provision of three-quarters of refinancing at terms above one year, whereas previously three-quarters were at short term; widening the range of collaterals; purchasing on the markets public debt bonds from countries with a mediocre signature; authorizing national central banks to provide refinancing to banks in difficulty using their own criteria vis-a-vis guarantees. Normally, all these exceptional measures were meant to end soon. Can the ECB do this though, at a time when many banks in several countries (including Germany) still cannot finance themselves on the market in normal conditions, and while two-thirds of its own refinancing are being made for the benefit of such establishments? Then there is the fact that European banks will soon have to face up to debt repayments totaling above 3,000 billion euros? And with Basel III about to make banks even more dependent on long-term refinancing? The next President of the ECB needs to be all and everything, save psycho rigid!

Sovereign debts? Are the apostles of restructuration pyromaniac fire fighters?

S & P has just downgraded the Greek debt yet again. Surprised? Payment default? That's what is being called for by those who view restructuration as inevitable and who (do they realize it?) thus serve to feed a noxious cycle. For Greece, saved by European and IMF help from approaching the markets, the measure is symbolic for the present; but for those who are holding the Greek debt! Negative reactions from the agencies, a rates hike and a contraction of the debt's market value, and an increase in potential losses, in particular those of the ECB which, at the same time, partisans of restructuration criticize as moving towards being a "bad bank"!!

Speculation on commodities - that old chestnut.

Reactions to the French President's indignation at the hallucinating volatility of some prices, a volatility whose harmful effects are now being stressed by many celebrated economists and researchers, bring to mind former reactions to criticisms of hedge fund activity: they're not the problem, "they're the wrong target" (favorite expression, in many circumstances, of the partisans of the status quo!). We even heard "they help the markets work properly".

Name of the month: Christine Lagarde.

This French minister is the favorite for the leadership of the IMF. Should Europe be accused of confiscating this position? Let us remember that with 32% of voting rights (corresponding, and this is sometimes forgotten, to its contributions to the capital), the continent has a weight in that institution comparable to its GDP in the world. This GDP is twice that of the BRICs presented as the beacons of the future, but which failed to agree on a common candidate. True, there are some imbalances (the Netherlands have the same weight as India), but since Europe as a whole is not over-represented we should conclude that there are also under-representations (France, the UK, Germany…). There is then nothing scandalous about the position going to the largest grouping which is also the most unanimous in supporting a candidate.

A European Minister of the Economy.

We had already, in an earlier newsletter, put forward the view that such a function is far more necessary than that of a Minister of Foreign Affairs. It is remarkable that this notion is now being suggested by the President of the ECB at a time when his institution is, to all intents and purposes, the objective beneficiary (in terms of independence and extent of field of action) of the lack of unity, of mere coordination even, of the politicians the bank deals with. When Mr. Trichet's predecessor said "I am Mr. Euro!", he was crudely expressing a reality that was not necessarily healthy.

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.