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THE BANKER'S COMMENT BY JEAN-PIERRE PATAT

A former central banker looks at the news

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Figures of the month: First, 200 basis points: the spread between 10-year French bonds and German Bunds on November 17. Then the Italian 10-year bond hits 7%, despite the nomination of a new Head of Government.

ECB "last resort lender"? But to whom?

Clearly it is a last resort lender, the European Central Banking System, but for banks! Using that expression, several French economists (and certain respected ones at that, inspiring certain stars of the political class) link that crucial requirement for a central bank to their own desire to see the ECBS directly subscribing to borrowings issued by euro zone States. In this way, they argue, with States having access to theoretically unlimited funding, speculation would automatically stop. A suggestion, not to say an injunction, that the French are alone in supporting inside Europe, one that has not the merest chance of coming about. No central bank has done or is doing it. Not the Fed, nor the Bank of England; these are cited by our economists as examples, whereas in fact they buy back from banks (and do not buy directly) debt bonds taken up by those banks at the time of issue. Even in the past, when central banks did make advances directly to States, it was within the framework of dispositions covering these operations; the potential raising of the ceiling for those advances was carefully negotiated - and never with this "on tap" absorption of State bonds.

Let us leave aside the risk of the "printing press"; whether it be a commercial bank or the central bank taking up the issues, there is monetary creation. No! The fact is that such a proposition pulverises the central bank's independence; it looses mastery of its assets operations and equally (perhaps above all) its capacity to make decisions about interest rates. How on earth can these be freely increased with "clients" of this kind? In practice, it would require a profound revision of treaties to fully transform the ECBS into a revenue supporting fund.

Such a step, far from solving problems, would end up decredibilising the one body viewed by investors as the safest pilot for the euro zone. This does not of course prevent the ECBS, on its own initiative, increasing its buy-backs of public debt on the markets, so contributing to the global response that the zone must bring to the present crisis (see below).

The euro zone: are the despicable manoeuvres of the 1990s making a comeback?

We say it again; Italy is a solvent country and her public debt, large indeed but held at above the 80% level by her own residents, runs no risk of default. They tell us that investors are worried for the future of an economy which cannot overcome its loss of the devaluation drug, as is shown by the slow-down in its manufacturing production. If we admit this, the Italian situation would foreshadow that of France, which had followed a detoxication cure between 1992 and 1996 with the so-called "strong franc" policy but which has subsequently allowed its salary costs to drift again. There is some truth in it, but if we push such reasoning to extremes only Germany would merit its place in the euro zone. In other words there would no longer be a viable euro zone. And, as though to illustrate this, we see a widespread tension on rates for all countries in the zone except Germany: Spain, Portugal, France, Belgium – but also the Netherlands, Austria, Finland; none is spared. In such conditions, how can one refute the hypothesis that, apart from honest pension fund managers, some operators are gambling on an explosion of the euro zone? A few months ago, one of these individuals boasted of his ability to make this happen. We know him well; he is one of those who in1992, 1993 and 1995 tried, in vain but with such violence, to sabotage the project for monetary union. Beyond measures taken at the national level and which obviously no longer interest the markets, a global response from the euro zone as a whole is needed.

Impacts from recapitalisation imposed by Basel III regulations.

These provisions lead in practice, we all know, to a tripling of reserve requirements. According to research by the Bank of International Settlements (BIS), this strengthening, were it to be implemented in the allotted time frame of 8 years, would have a negative impact upon growth globally of 0.22% of the EU's GDP, which is to say 0.03% a year. Were the banks to comply within 4 years, a hypothesis not beyond possibility in view of the recent European agreement, the annual impact would be in the order of 0.05% of GDP. In the longer term, the impact would become positive; as well as lowering the cost of financing bonds, the stabilisation of banks' balance sheets would safeguard (if not totally at least for the most part) the economy during the banking crises which seem to occur roughly every 20 to 25 years. Reducing by one point the probability rate of a crisis occurring generates a gain of 0.6 of a point of GDP. These figures may be arguable, but they are far from the 2% impact on GDP put forward by the banking profession.

Name of the month: Mario Draghi.

With a lowering of rates implemented at the very first board meeting of his mandate, the ECB's new President gained the admiration of many commentators. He "dared to do", they write, what J.C. Trichet obstinately refused to do. One editorialist, fearless of ridicule, went so far as to ask him to "remain somewhat Italian". Was this naivety or perhaps posthumous revenge on a person long vilified, but whose qualities of governance must be recognised in these troubled times? That ECB decision was taken by the board members unanimously. In the intervening 15 days, those members did not "unanimously" change their minds. J.C. Trichet could have taken advantage of this rates lowering at his last board meeting, but he had the grace to leave the glory to his successor. End of story.

Governments by technocrats: democracy discredited.

In Greece, Papademos, former Vice-President of the ECB, in Italy Mario Monti (clean and hard) former European Commissioner, are forming teams in which the lion's share goes to technocrats. This reassures the markets, some say. The personality of these people is not in question. Can we be sure that the abstention (some forced but mostly voluntary) by politicians from the hard work of implementing the reforms which must be made is going to convince investors of the deep-rooted willingness of the two countries to stick with them? In any case, it serves to reinforce the populist and unjust (but increasingly widely held) view of a political class which is incompetent- to put things mildly.

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
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