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# THE BANKER'S COMMENT BY JEAN-PIERRE PATAT

A former central banker looks at the news

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**Figure of the month:** 13.178,59, the Dow Jones' level on March 13th 2012, a historic high and no doubt not over yet.

**European Central Bank (ECB): critics did not hold their tongue for long.**

Last month we reported that the Eurosystem, with its generous refinancing to banks over three years, had managed – putting the banks between itself and the State debts that it was being urged to buy – to put an end to the "orthodox" opposition stemming from the board. The respite has been a short one. Already some of the more pernickety members of the Board of Governors are becoming nervous at the inflationary risks posed by this massive supply of liquidity. It should be said that commentators are not helping to calm the analysis, using the frightening term "bazooka" in describing the operation. May we say yet again that we fail to understand the German monetary analysis? Inflationary risks are not dependent on the amount of liquidity held by banks; rather it depends on an excessive demand for credit. If such a demand arises, banks have no need to have previously stocked up with central banks' money to satisfy it.

A more serious question concerns the risks taken by the institution with the swelling of its balance sheet, which sits at 3 trillion euros, while its capital is at 82 billion euros. The Eurosystem is therefore working at a level higher than are the Fed's operations. One US observer even evaluates the figure as higher than that of Lehman Brothers. What is more, the institution has to extend the range of bank assets taken as guarantee. A recent operation of this sort, known as Additional Performing Credit Claims, includes 200 billion-worth of untitled debts; that is to say, credits to the private sector in the "collaterals" list. A very high number of banking establishments which have applied for the offer of refinancing over three years do not by any means all hold the highest rating. The ECB's Board of Governors carry the risk of potential default, a classic risk for a central bank, and of the non-recovery of its guarantees. In fact, if the latter were to transpire it would certainly concern a sum far below what would have to be carried. This is particularly the case with sovereigns that hold Eurosystem debt bonds among their assets.

**Back to calls for a weak euro.**

On this question it was thought that reason had carried the day and that the old moons of the thirties had finally been laid. In a special issue devoted to competitiveness, though, a daily newspaper puts the euro's exchange rate at the top of ways to relaunch growth. An analyst declares that the ECB ought to "assume the role of last resort lender", just like, he declares, "all other central banks". Were the ECB to do so, "it would help bring about a considerable devaluation of the euro, indispensable for a return to competitiveness for many member States". Of course!!! Another one claims that the euro zone's member States should ask the ECB to intervene on exchange markets to bring down the euro. Let us remind ourselves that 1) the zone's member States are not by any means all in agreement about this; 2) a central bank managing a great currency has no chance of perceptibly modifying exchange rates if it acts alone; 3) the member States which are deemed to need devaluation to regain competitiveness all came into the euro zone with under-valued exchange rates, an advantage that they have happily wasted and one which they will waste once again if we administer another dose of the drug. Let us recall also that French external trade, in surplus from 1994 to 1999 (at the time of the strong franc) only began a slide towards deficit at the time when the euro, new to the markets, suffered a spectacular depreciation. It is clear, when reading this daily, that some people are nostalgic for such a drop. Should we also remind them that with a "strong euro" Airbus has built up an impressive order book? What, though, would be the point?

**Greece: Should we now be so euphoric?**

Greece's arranged default, which sees private creditors losing almost 55% of their loan, has been met with satisfaction by political leaders and enthusiasm by the markets. My goodness! What a reward for poor management and cheating! What an example for future candidates to such a providential gift. Unbelievably, some Greeks would like even more. They are angry that the 130 billion euros that European taxpayers are going to pay Greece as a second aid-plan will as a priority be devoted to honouring a large bond payment due next week: "Markets are being put before the people". Of course! And future retirees, whose pension funds manage the payments, and savers whose savings-plans create the funds will be quite happy about that.

**Word of the month: optimism.**

The word optimism has come back with incredible speed these last weeks: ECB activity yes, but also an unexpected US recovery, a Europe which is getting itself sorted out, and a China getting to grips internally. Hell fire! The Greek problem that is thought to be fixed is certainly not the main abscess source in the euro zone; not by far. You need rose tinted glasses to perceive a real US recovery; while as for the Chinese getting to grips!!! There is some possibility that this euphoria will not last (and some, in the markets, will not fail to profit from this). However, let's enjoy this moment of respite, which could perhaps strike the spark for a small return to confidence.

**Changes keep happening at the ECB.**

In the space of a few weeks, management practices that we thought to be almost engraved in marble have been seriously hit. The German take-over bid for the position of chief economist did not resist the departure of the last holder of the post, replaced by a Belgian (the French candidate was sidelined, which avoided a strong punch in the eye for our friends over the Rhine). And now, the practice followed since the birth of the institution of systematically giving a position at the helm to the four "big" countries (Germany, France, Italy, Spain) is itself in question because the Spanish post-holder should, they say, be replaced by a Luxemburger. That practice, clearly lacking in competition, had the merit of reducing the impact of the "one man (woman) one vote" rule and, giving de facto two votes on the Board to the "big" countries, counterbalancing the sometimes tyrannical weight of the "small" 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.