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THE BANKER'S COMMENT - JEAN-PIERRE PATAT

A former central banker looks at the news

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Figure of the month: EUR 35 and 40 bn, potential resources for the future French Public Investment bank, funded mostly by establishments it will take over.

What kind of banking reforms for Europe?

The European « universal bank » model has stood up to the crisis quite well. Even so, whilst the separation of banking activities into "retail" ones and "investment" ones is presented by a number of analysts and specialists as something evident to put into practice, with the Americans and even the British seeming to be moving in that direction, the Europeans could not easily ignore the question, even if, with Basel III rules, they have introduced some serious safeguards.

Let us not overlook the fact that the Americans voted in the Volker regulation which forbids retail banks from carrying out speculative operations on their own behalf and financing speculative funds over and above 3% of their own funds. In the United Kingdom, the Vickers regulation, still under discussion, would introduce a compartmentalisation of retail activities. It's a long way from the Glass Steagall Act, but even so it's an advance.

In Europe, the proposal is to place a certain number of market activities into legally separated entities once they exceed a certain percentage of banking activity, which might well be around the 25% level.

Whatsoever may be the final text, I venture to make two comments:

- There is no point in hoping that dismembering these "mastodons" would remove all need to rescue them. A bank failure is a tragedy absolutely to be avoided. The "privatise the winnings and nationalise the losses" formulae are misleading. The State gains from banking profits via taxes received, and by replenishing a bank the customers benefit more than does the management.

- In the universal European bank, and especially the French one, retail activities do not produce more, on average, than 20% of the income, whereas they generate 90% of the bank's operating costs. How can you put into place separation or compartmentalisation without provoking a hike in the cost of credit?

The devil is in the detail, plenty of it here.

Ben Bernanke and Bill Martin.

Ben Bernanke justified the Fed's renewing their bond purchasing by the imperative to lower unemployment, adding that the earlier operations had generated three points of GDP and two million jobs. Three points of GDP? It would be nice to believe it, but then what was the point of a budgetary policy which brought about 3,000 billion euros of additional debt? To my mind, what the Fed expects from these operations is, above all, maintaining market conditions advantageous for the US Treasury which must call upon it for huge sums. Something that is not without drawbacks: the American Treasury is not exactly incited to reduce its deficit; investors, whose revenues depend largely on bond revenues (retirement funds), are penalised and turn towards risky investments.

Finally, it raises the question of the central bank's independence when that bank adopts behavioural habits of the sort that bias connections with the executive. This is something that could lead to a situation like that of the 1950s, when the then Fed President, William Martin, agreed to see his institution play, in practice, a role of fund to support annuities.

Developed countries' banking: traces of the crisis are still profound.

Cruel figures, most unfavourable for European banks: since 2008, stock prices have been divided by 3.8 in Germany and by 2.5 in France; premiums on Credit Default Swaps have been multiplied by 4 in the USA and in Europe outside the euro zone, and ... by 9 in the euro zone, punishing the tight relationship between public debt and bank assets. The gulf between the European banks which traditionally show deficits in stable resources (deposits) and the American banks, in surplus, has grown. This emphasises the dependence of the former on external financing. In the euro zone, interbank transactions melted from 1,800 billion to 600 billion euros, reflecting the enduring lack of confidence between banks. Finally, the rentability of European banks remains low, with net interest margins close to 3 times lower than those of American banks.

Word of the moment: de-industrialisation.

A complaint with overtones of tragedy. Yet, a study conducted by INSEE/French MoF provides disturbing data. Between 1980 and 2008 French industry lost on average 70,000 jobs a year; less than 15% of these losses were due to globalisation. The rest resulted from progress in productivity. This progress brought about an immense lowering of prices for industrial products; so much so that industry's share, calculated in value within the GDP, itself calculated in value, has in effect diminished considerably. To the contrary, the share of industry calculated in constant price (volume), within the GDP in constant price, stayed stable at 17%! These figures will contradict the apostles of de-globalisation and might prove that, rather than protesting against the closure of lame mediatised white elephants, we need to concentrate on creating new activities.

Euro zone: countries outside the zone don't want in, but are indignant at being excluded from its proceedings.

We had a situation like this during the creation of the zone at the setting up of the Euro Group, with the United Kingdom annoyed at not participating in the discussion process between countries inside a zone it did not want to join. We find the same situation today with the countries of Central and Eastern Europe upset by projects to create a federal budget for the euro zone. Except that, this time, Great Britain is favourable, hoping to take this opportunity to reduce her contribution. It must be admitted that with the participation, foreseen by the treaty, of all the members of the European Union on the Board of the ECB on the pretext that they all may join the zone some day, the situation is more than ambiguous, with the prospect of some nasty in-fighting when the subject of European supervision comes onto the agenda.

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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