



THE BANKER'S COMMENT - JEAN-PIERRE PATAT

A former central banker looks at the news

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Figure of the month: 0.3%, the q/q contraction in French GDP in 2012Q4: a negative "carry-over" weighing on 2013.

Nostalgia for devaluation, still here.

It's one of France's features and a rare point of consensus for all in politics, the economy and the media, this complaint about a too-strong currency. It came up yet again recently, as economic forecasts led us to expect nil growth in 2013.

The euro entered the markets at a rate of 1.17 dollars in 1999. Today, at 1.35 dollars, is it really over-valued when since that time US inflation has been on average 0.5% higher than that of the euro zone and its balance of payments has always been in deficit? Truly, two questions need asking.

Does a 'strong' currency act negatively on growth? Yes, answer those who hit us with models showing that a 10% increase in a currency's value induces a 0.3, even 0.5, percentage point reduction in GDP growth. Well - no! With those models based on the past and having nothing in bearing with production conditions in today's globalised world, those who invoke such models are misled or are misleading us. French external trade which was in surplus to the end of the 1990s (with the strong franc policy) began to drop when the euro was at its cheapest. The record rate of 1.65 dollars didn't prevent Airbus gaining record orders. Despite a fall in sterling rates, British exports remain anaemic. Nor has the euro's increase prevented Spanish exports from making an impressive claw-back.

The second question: can one do anything to buck the trend? The French President seems to think so, saying that one should not let the euro wobble at the whim of the markets. That, however, is the destiny of all floating currencies. For a world "core currency" like the euro, the possibilities of seriously manipulating rates are nil - unless an international agreement of the Plaza type were to provide for coordinated activity by the largest central banks, or unless the ECB and the Fed were to act together. All our euro zone partners would have to be in agreement to launch such a process. A polite silence or unfriendly remarks greeted the French complaint.

So, while a strong currency leads to structural improvements in competitiveness, a weak one seems to allow an effortless improvement in this competitiveness. A difference that our partners grasp quite well.

Name of the month: Draghi.

Him again. Analysts credit him with magician's words which should, even so, be played down as far as semantics and reach are concerned. What did the ECB chairman say? : "The exchange rate ... is an element that counts in terms of growth and price stability". Obviously! Insightful commentators saw in this a warning against an excessive appreciation for the euro which would provoke deflation. The proof? Following these declarations, the euro fell back in the markets. But could it be that this was a result above all of Mr Draghi's preliminary remarks, to the effect that there would be no recovery before the year's end? That, on top of the political goings-on in Italy and Spain, is quite enough to chill passions for the common currency.

Grandad's "multiplier".

In announcing that its services had minimised the public expenditure multiplier and that efforts for reducing expenditure in euro zone countries might have a stronger than foreseen recessive effect, the IMF delighted devotees of public spending. First let us point out that the IMF's 'chief economist', Olivier Blanchard, a brilliant chap, views the euro zone as an aberration and worked vigorously to obstruct its creation. Above all, though, in today's wide open economies where each euro of public expenditure feeds imports to a large extent, where markets can react and provoke an interest rate hike, and where in certain countries they sometimes wonder where public cash is going, given the gulf between the sums forked out and the efficiency of the public service sector, does the Keynesian concept of multiplier still have any sense, created as it was when economies operated in near isolation?

The structural deficit ... but of course.

Is it better to reduce the overall budget deficit or the structural one, the latter "removing" the effects of the present economic climate and taking into account potential growth? Asking the question seems to give the answer. Yet some governments in the euro zone think it makes sense to refer almost exclusively to the structural deficit. Except that growth potential is a datum not easily made concrete at a time when the international environment is ceaselessly changing and that there are several ways to calculate structural deficits. European budget rules, as far as observers, the media and even the markets go, are based mainly on simple (some say simplistic) but clear concepts. To replace them by concepts that are hard to understand and which would clearly raise suspicions of tampering is probably not the best way to enhance the zone's credibility. All that is simple is false, they say; but all that is complex is useless.

European banking supervision: a Copernican revolution.

A revolution, because we must recall the 'high level' European working group's conclusions. Delivered barely three years ago, they were somewhat 'radical-socialist', careful not to change anything and foreseeing (new!!) coordinating bodies, but above all they compiled lists of arguments that seemed unassailable against confiding banking supervision to the ECB: 1) risk of interference with its basic mission for price stability and risk of conflicts of interest (the classic argument); 2) should a banking establishment be in difficulty, risk of pressure and interference from the administration; 3) not all central banks are in charge of supervision in the euro zone; 4) the treaty does not give the ECB oversight of insurance companies whose activities, in many groups, are closely linked to banking activity.

What was true three years ago seems not to be so today, and so much the better! That list of reasons against, actually shows the difficulties, real though by no means insurmountable, of putting to music some aspects of unified supervision (for example in the realm of insurance companies). Of course, the guardians of the temple were not slow to show themselves. The Bundesbank, still unable to digest the fact that it might have only 1 of 17 votes, realises that, in the department which, within the ECB, will be in charge of supervision, it will be the same set-up and, horror of horrors, the countries of the south will have a voice in deciding the fate of their banks.