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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: -0.10%: the negative rate for bank deposits at the ECB. A first.

ECB: No false hopes possible about a communication operation during the crisis.

The ECB seems to have just set up quite an impressive arsenal with the base rate dropped to 0.15%, with a negative rate for banks' deposits on its books, plus a new long term refinancing operation over four years, this time for 400 billion euros. It seems that even the Germans agree, and that says something!

After a moment of euphoria, the markets fell back. The euro rate versus the dollar quickly regained strength after having fallen to a little below 1.36.

The markets would have been deeply disappointed had the ECB done nothing; they were delighted that something was done. They realise that all of that will have little impact. We might summarise the sequence thus. The guiding principle for action, including that of the central bank, is henceforth the illusion of deflation. Let us not forget that the annualised price increase in the zone for the last three months is over 1.5%, far higher than the 0.7% of the 12 month trailing rate (this very poor indicator of the economic climate), and that the slowing in inflation is mainly due to price drops for raw materials. Despite that, the ECB feels obliged to meet the markets' aspirations, something that had not been done before.

Clearly, credit demand will not be rekindled simply because the base rate moved from 0.25 to 0.15%. Indeed, demand for credit is key; if it is absent, the negative rate on deposits will be profitable for treasury bond issues, as will be the injection of central money brought in by the new long term easing.

Realising this, the markets now await something new. Aware of the insoluble problems that will be raised by any ECB intention to purchase government bonds, they now hope for the purchase of asset-based securities (ABS), with the assets being banks' credits to businesses, something that would free up banks' assets. Without, of course, bringing back the demand for credit. Remember that it was securitized loans in particular that were at the origin of the global financial crisis, one for which we have not yet finished paying the consequences! Action of that sort might well not be the kind needed to restore the confidence that we overlook when we recommend falling back on those haywire measures.

One hopes one is wrong.

The stock market is happy. Well then!

Can the ECB cause the euro to weaken?

According to a study released by the French Ministry of Finance, lowering the euro rate against the dollar could result in an increase in growth of 0.4% and 150,000 extra jobs. Maybe.

To drop the euro versus the dollar by 10% is to take it back to the rate it had at the worst moment of the single currency crisis in 2012. It is clear that today's market is not in that frame of mind. To get such a result, therefore, requires widespread action, action which technically poses no difficulty. The ECB can make massive purchases of dollars to push up its value and is not limited in such an operation since it issues the very money with which it buys the American currency. With equal ease it can sterilise the liquidities created at that time. It is classic central banking. Except that... to let loose the heavy artillery in place of the "small arms" (the little phrases or expectations of collateral effects of unconventional operations) would be to really commence a true currency war - one that to date has been "polite" between these two global currencies. Are we ready to run this risk?

Things change fast in the ranking of nations.

One year ago, the BRICS countries were the locomotives of the world. Nowadays, Brazil is weakening, India is slipping, Russia is plunging and South Africa is stagnating. The UK had been knocked out by the crisis, its growth is now the strongest in Europe. Finland was a "model", it is now in its second year of recession. Italy was weighed down by its political structures and lack of competitiveness, we now see a new dynamism. Spain was on her knees with the crisis, its exports and growth are starting up anew.

Of course, market extremes have amplified and still do amplify judgements in one way as in the other. The BRICS are not on the road to under-development and Finland is still one of the richest countries in the world. Italy is not taking off and Spain still faces many problems. But what can be learned from the to-ing and fro-ing in these rankings is that political errors are eventually paid for (the glaring insufficiency of public services and infrastructures in India and Brazil is finally, albeit belatedly, showing its harmfulness), but we can also learn, more reassuringly, that correct measures and political will, based on a clearly defined plan, can quickly lead to the emergence of positive signals.

Name of the month: BNP Paribas.

Let's not try to answer the question about who or what was at the origin of this confusion. Irresponsibility, incompetence, cynicism or the concealment of operations carried out via a Swiss subsidiary. To our mind, this business has shown up two facts: first, the Americans are still scandalised that the banks got out so well from the crisis into which they plunged the planet; to punish them financially is a moral act and when it's a foreign bank, so much the better! Second, the one world currency with scope is still the dollar. That the counterparts might not have wanted euros, or may not even have considered them, demonstrates the euro's still-minor position as an international currency, whereas its use in these operations would have avoided all these difficulties.

Zero rate policy or degree zero for monetary policy?

Economists, analysts, journalists, and even the IMF and the OECD – many are those who had energetically pleaded for the maintenance by central banks of an accommodating monetary policy and who are today alarmed by too low interest rates that favours speculative operations rather than the economy. This is stating the obvious, not merely because of operators who turn customarily to speculation, but also because of savers to whom their bank is suggesting investments alternative to their traditional ones, and these alternatives are of course more risky - the start of a slippery slope which has already cost us dearly. There are further consequences: interbank transactions whose running costs exceed remuneration, speculative movements into more rewarding currencies. All the large central banks have taken this direction, even though the Japanese example demonstrated its inefficiency on the real economy when confidence is lacking.

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 views, with total editorial freedom. Email : jppatat@tac-financial.com