TAC
Applied Economic & Financial Research

THE BANKER'S COMMENT - JEAN-PIERRE PATAT

A former central banker looks at the news

September 2014, TAC Newsletter - www.tac-financial.com

Figure of the month: -0.11%, the negative interest rate on two-year government bonds issued by the French State.

The crash of the German model? Hoped for by some but it's not for tomorrow.

This crash is viewed as unavoidable by one university professor[1] for various reasons. First, for the increase in precariousness. This phenomenon is undeniable. What, then, could be driving this crash? Too many small-wage earners or mass unemployment that is becoming structural and about which, despite flowery words, little is really being done. His second argument is a too-great dependence on exports. If that is true, we should also see the crash of the Belgian model (85% of its GDP is exports), the Dutch one (88%) and that of 16 of 28 EU countries. Our professor should ask himself, rather, why this « model » is so widespread and should realise that these countries, overall, are doing better than the others. A third reason given is the disparity between the regions in the east and the rest of Germany. Undeniable again. However, other countries (France with its overseas departments and territories, Italy with its south) face the same problems and without any crash in view. Finally, the most important reason, the demography. Yes, it is catastrophic in Germany but again a similar situation tends, unfortunately, to become the norm in developed countries with a few exceptions (USA, France, UK). What we do see, though, is that Germany is managing this problem well by remaining open to immigration and, increasingly, to having more women in the workforce (unlike Japan where such directions, so important, seem not to be on the agenda of the prodigious « abenomics »).

Finally, the German balanced budgets, mocked by improvident countries, provide a safety reserve for retirement funds that demography risks eating into (unless there is a quick recovery).

We could treat all of that with derision. This relentlessness, not to seek a lucid analysis of our real problems but to desperately strive to find what is going or could go wrong for those who are in a better state than ourselves, is both indecent and pathetic. As is this obsessional belief that Germany is the yardstick for our budgetary performances, whereas the rules in this respect result from a European consensus to which we contributed.

«No inflation no growth».

You have to be in France to hear such rubbish. I tend always to trust my economy professors who taught me that inflation resulted from two factors.
From demand, when demand is superior to production capacities. From supply, when the manufacturing sector is handicapped by a hike in input costs (raw materials costs in particular).

In neither case does inflation generate growth. It can even cripple it, as, unfortunately, was the case in 1973. While households are spared, businesses have to bear the brunt of any increase in the cost of imported raw materials (at that time it was oil, the price of which multiplied by five). That was the start of what was called « stagflation » and our national industry has yet to recover from that policy, the fruit of incompetence or maybe demagogy.

Let the inflation lovers go and ask those with small incomes what they think of today's present slight price increases.

Unhealthy interest rates.

That Italy could borrow at 2.5% over 10 years is not really abnormal, since inflation stands at below 0.5%. But when Italy, very poorly rated, exhibits government yields below those of the United Kingdom which has retained its triple A rating, you know that something is wrong.

There we have the « Draghi effect », not only because of the strong words he came out with about two years ago, but also because of the billions of euros of central bank money that the ECB lends to banks via its non-conventional operations. The snag is that such operations are meant to get banks lending to the economy, and this is an illusory incitement as long as demand for credits remains flat. Moreover, why look for a risky client when government bonds are so much safer?

This is an unhealthy operation, one which is unlikely to incite a State whose debt is well over 100% of GDP to reduce it seriously; also it encourages those for whom this is the right time not for budgetary rigour but rather for taking on more debt!

Name of the month: Jean-Claude Junker.

Ought we really, readers will ask, honour this old timer of politics? Especially since we might well be annoyed at seeing two natives of a country which flouts the tax system take two key posts in Europe (member of the ECB Board and president of the Commission). Junker, though, caused a small revolution by making vice-presidents of the Commission, until then honorific posts, real heads of department with various Commissioners under their authority - something that serves well to break any incipient tendency to national bias, towards which some might be tempted. There is however a downturn; with Junker at the Commission and the Dutchman Dijsseibloem at the head of the Eurogroup we have two «northerners » in the most strategic positions, a north which already is distancing itself from the south economically now distances itself institutionally, in spite of the post of High Representative for Foreign Affairs (wholly useless and toothless) being given to Italy.

We risk being disappointed by the drop in the euro.

Some rejoice at the depreciation of almost 6% of the euro versus the dollar. We are not, though, still in the 1930s, when the productions in industrialised countries were to a great degree interchangeable, which made « price effects » work. Nowadays, examples abound of the inefficiency, the harm even, of a weak currency. Airbus resists and even does better than Boeing. Falls in the pound sterling and the yen accompany spectacular weakening of British and Japanese external trade. The only time France enjoyed large surpluses in external trade was in the years 1994-99, during the period of the so-called « strong franc » policy. The depreciation of the euro will bring no succour to French industry and it even risks slowing down the efforts needed to improve structural and non-price competitiveness.

[1] Gabriel Colletis, professor of Economics at the University of Toulouse-I, author of an article titled *Soon the explosion of 'German Model'* published in the French newspaper Le Monde on August 28, 2014.

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