



BANKER'S COMMENT - JEAN-PIERRE PATAT

A former central banker looks at the news

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

Figures of the month: 0.89% and 2.08% French and US 10 year government bond rates. Such a gap had never been observed.

What might we expect from the euro's fall ?

Down by over 10% against the dollar, the euro's movements meet the expectations of many of our economists, analysts and the media. A decline that is said to continue if we can believe the "risk reversal" figures (difference between the implied volatility of call and a put option on the currency at the same maturity), clearly headed downwards, even though less severely. The euro is also falling versus other currencies, but far less so: 2.8% against the yen, 6% against the pound and 1.5% against the Swiss franc.

In truth, the polarisation of the euro/dollar rate masks, to a great extent, the reality. First because our trade with the USA only represent 8% of the total and have only a weak effect on our external trade (for which the impact of the decline in the Euro could reduce the gains expected); second because the real indicator of the "euro franc's" competitiveness is the effective exchange rate which takes account of relative price and wages variations in countries where we make our sales.

Yet, according to the BIS, the effective exchange rate for the "euro franc" versus all the currencies of our trading partners has slipped by 9% since the start of this century. This is a drop that has had little influence on our external trade which is characterised by a large deficit which tended to deepen over the period and a great sluggishness in exports.

How might it be otherwise with an industrial base that is incapable even of meeting domestic demand? And, what is more, for which the outputs (excepting armaments, transport goods and nuclear power stations) fail to match global demand.

A recovery thanks to the fall in the euro is then more than problematic; the one "advantage" of such a positive effect being, maybe, to put an end to the fantasies which in France follow the evolutions in exchange rates.

Better, no doubt, to count on the providential decrease in the price of oil.

Japan. « Abenomics » in question.

The political revival the Japanese PM is hoping for with the new elections will not in any case re-launch the economy. Presented as an audacious new policy (an evening daily even advised Europeans to take inspiration from it), Abenomics were in fact the same old soup (liquidities poured out by the central bank, public expenditure) but spectacularly increased. Results: the Japanese economy has undergone negative growth for the last two quarters. The external trade surplus has never been weaker, despite strong depreciation of the yen. Presented as a "success", is the fact that inflation has been nicely positive since the start of the year, but that is due to the hike in VAT and increases in energy import costs resulting from the yen's weakness. There could however be one "Abenomic" that might amount to something, i.e. a strengthening of the work force, the weakness of which is definitely the greatest flaw in the country's problems, by an improved opening up for immigration and female labour. This seems not to be among the Prime Minister's priorities.

The ECB in an impasse.

Could commercial banks be more aware than the central bank of the craziness of new massive injections of liquidity to bring about demand for credit? They have not subscribed to a third of the amounts on offer. The introduction of negative rates on their deposits at the central bank seems to lead nowhere. So, how can they swell the ECB's balance sheet by an extra 1,000 billion, its President's aim? By buying back sovereign debt bonds of course! In a recent interview, the president of the Bundesbank wisely declared that the Bundesbank clearly does not have the power on its own to oppose such measures, measures not forbidden by the statutes, but that any comparison with the Fed's actions which faces up to a single Treasury has no sense and that the ECB would be fatally obliged to repurchase the bonds of the most poorly rated States - something that would not help encourage the budgetary efforts of those countries and which would, moreover, be risky for the financial situation of the institution without though bringing the least solution for the problem of the lethargy in demand for credit.

Name of the month: Merkel.

She has triumphantly been re-elected at the head of the UDC, which does not, quite the contrary, calm her adversaries who are particularly virulent in France. As far as the unfortunate and shameful interpellation by one of our politicians is concerned, let us just say that there are a few paradoxes in his claiming categorically that Germany should finally accept its responsibilities as economic front-runner in Europe and in his warning its leaders to shut up as soon as they start to talk. In a recent televised debate, one of the participants deplored that the Chancellor had the mentality of a "small shop-keeper". Judging by the results, one might tend to prefer this "small shop-keeper" to the inspectors of finance. In answer to the "elites", according to a recent poll 70% of the French would like to see her as their Head of State.

Don't you know that it is worse everywhere than it is in France.

We already have "Germany bashing" predicting the imminent collapse of the German model as well as the virulent criticism of the British labour market (with it is true some unsavoury aspects but the trick is to know if unemployment is preferable). Now, what do you know? It's the Swedish social model that is said to be cracking apart. As for the United States, in a recent forum, they predicted an impending homelessness, in view of the condition of their community facilities. At the end of the 18th century, shortly before the Revolution, the British State, just as indebted as the French one, was paying interest rates on its loans twice lower than was the Royal Treasury. One of Louis XVI's ministers declared eruditely: "the English model suits a calculating race but it is not compatible with French genius".