



THE BANKER'S COMMENT BY JEAN-PIERRE PATAT

A former central banker looks at the news

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Figure of the month (or the day): +50 basis point on the Italian ten-year bond yield, at 6.05%, while at the same time there is a 50 bp decrease on the German Bund.

Are inflationary risks in developed countries being under-estimated?

That is the opinion of the Bank for International Settlements in its latest annual report. For sure, advanced countries are less directly affected by price rises for basic products than are the emerging ones, the large consumers of these products. But it could happen that the high increases registered would cause producers in emerging countries to raise their selling prices, something that would have repercussions on wholesale and consumer prices in the advanced countries in view of the increasing inter-dependence of global supply chains. There are also price pressures from demand, they say, threatening the large mature economies. Indeed, it is likely that production capacities (potential GDPs) have been substantially affected by the crisis: firstly by the explosion of public debts which blurs business horizons and discourages private investment; secondly by the slide in returns on large investments made before the crisis (in real estate for example). Available production capacities could therefore be much weaker than supposed.

All things being equal, we must not repeat the mistakes of the mid-70s when governments, including the French one, diagnosed a weakness in demand when in fact it was the production supply which had been ravaged by the giddy hike in energy prices. The Bank's diagnosis seems pretty sensible.

Where we do not agree with the BIS, on the other hand, is when it recommends that central banks quickly put a stop to their "non-conventional" operations: first, because the swelling of the monetary base which resulted from them has had no impact on overall money creation; second, because these operations remain indispensable in preserving financial stability.

Nevertheless, in our mind it is necessary to get away from very low interest rates, given their perverse effects: contributing to a poorly functioning interbank market; feeding speculation on commodity prices; inciting unwanted movements of capital towards selected emerging economies; encouraging reversion to the very debt-loan practices which began the crisis.

Word of the month: Total.

This oil company is without doubt at the top of businesses which the French love to hate. Judging by its recent declaration, we might well conjecture that it enjoys this situation. Its CEO begins by saying that the firm is abandoning the consolidated global profit system, an arrangement allowing Total to pay little in the way of taxes in France. A nice civic gesture, it seems; however, he feels the need to clarify that this is because the former arrangement is no longer advantageous ... and he then announces in the same breath that he will soon increase the cost of fuel because of the rise in crude oil prices. Reverse announcements were never made when crude oil prices went down. Of course not; at such times we saw little change in pump prices.

Economists, a culmination in arrogance.

Not having seen the crisis coming, engaged in piling up inaccurate diagnoses and forecasts and gaily arguing on numerous topics, economists of all kinds agree only on one thing - accusing governments, these incompetent people who lack any kind of vision. Tearing each other to pieces over analyses and suggested cures, these prosecutors are shocked that some States have difficulty in agreeing - all 27 of them (EU), or all 20 (G20). Make no mistake about it: the triumphant standing ovation given to Jean-Claude Trichet during a recent economic symposium in Aix-en-Provence (France) does indeed demonstrate a well-earned accolade, but it also demonstrates a hidden scorn, as unjust as it is dangerous, for the politicians elected by the people and who everywhere are in difficulty.

Italy: the smell of blood.

It is Italy's turn to be in the markets' sights. Nothing new in her situation, though. Her public debt (118% of GDP) has always been high, but it changed little during the crisis (15 points versus 18 in France and Germany, and ... 35 points in England). What is more, Italy's debt is more than two thirds held by her own residents, and the country's fiscal deficit (4.5% of GDP) is not unreasonable. So? Nobody will believe that the delicate political situation of Silvio Berlusconi (he is far from being the only European leader in this case) worries the honest managers of pension and savings funds. No, we have to accept that the Eurozone has its enemies, be they confirmed or by happenstance, whose attacks (in cahoots or not) are evident. We have the usual Anglo-Saxon adversaries: those of good faith (scholars for whom the single currency is not that of an optimum zone) and those who wish to maintain the dollar's role; the chronic euro skeptics (nationalists and devaluationists); and finally, speculators who have bought credit default swaps and who see that help from the traditional enemies of European construction offers them great opportunity. We are far from believing in conspiracy theory, but the continuity of attacks that we see begins to appear suspicious. There are deficits and high public debts in the Eurozone, nobody denies this. But these also exist elsewhere, often larger ones, including in countries where no effort is being made to control them, whereas all the States in the Eurozone are conducting severe budgetary adjustment policies.

The ECB nails its colors to the mast as an untypical yet modern central bank.

Although the Frankfurt institution has long been on the receiving end of the most virulent criticisms for its dogmatism and its outmoded concept of true priorities, within a few days it has recently provided some superb examples of constructive non-conformity. First came the blow delivered on a rating agency, with the announcement that the ECB would continue holding Portuguese bonds in its assets immediately after that agency had severely downgraded that country's debt. At that time, the President talked about the agencies in terms heard more often from politicians than from a central banker. Then, quite recently, in response to the speculative attack on Italy and Spain, Jean-Claude Trichet announced that the ECB was going to buy back some of the Italian and Spanish debt!!! In this context, the necessary increase in the base rate, which at other times would have provoked a concert of indignation, passed without comment.