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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: 4,000: the Nasdaq level overtaking its records before the internet bubble burst in the year 2,000.

Restlessness in the Eurozone markets.

Having lauded Mario Draghi, the markets are getting impatient. Not the institutional investors, of course, rather the portfolio managers who have taken positions and have persuaded their clients to do likewise. They await the miraculous measures that were hinted at by the ECB president.

First, we must be aware that central banks are better armed to counter inflation than they are to stimulate economic growth: "One cannot push with a length of string". It's the Americans that are saying this, even though the widespread practice of having interest rates indexed to market conditions for mortgages allows the Fed's decisions on interest rates to have an instant effect on household buying power.

This is a latitude not enjoyed by the ECB, with the great majority of home mortgages in the eurozone being contracted at fixed rates (not necessarily a bad thing since variable rates can become ravaging when rates climb). The ECB's actions therefore affect only new credits and investment intentions on the part of economic agents.

The ECB does though have two non-conventional weapons readily available; long term funding at fixed rates for banks (LTRO) and the ability to impose negative interest rates on banks' reserves held at the ECB - amounting today to some 250 billion euros (not including compulsory reserves). I have already written that LTROs were not of the kind to boost credit distribution, which depends on demand, and negative interest on bank deposits will not do so either.

On the other hand, the combination of the two measures, together with "good timing", can swell banks' demands for public debt bonds, something that would slow down increases in long term rates.

This increase in long-term yields will be seen across the Atlantic when the Fed reduces its purchasing of market securities. If the ECB could reduce the impact of this hike upon European yields, a hike that unfortunately will not fail to happen, it would have conducted a very nice coup. This may not be as spectacular as debt bond purchasing, but it works.

Fears of deflation.

We must, though, return to this deflation syndrome which is grabbing analysts and many French economists. I maintain that deflation is not simply a question of price decline. Even so, lamentations are multiplying regarding an increase in retail prices in the euro zone (because there is no decrease) which at 1% is deemed insufficient. In my opinion these lamentations are based on two challengeable ideas: first, the certainty that price reductions would bring about a decrease of activity. This is by no means proven, since reductions provide purchasing power to consumers who are not obliged to apply the reasoning of economists concerning the opportunity of waiting for prices to drop even more. Conversely, in no way does inflation favour growth in all circumstances (consider the stagflation of the 1970s). The second challengeable idea is that the central bank must fight risks of deflation. As an example, they point to the Bank of Japan which absurdly undertook to carry inflation up to 2% and is clearly quite unable to achieve it, provoking new worries. So much the better if it can't. Those who adore inflation seem to overlook that this is not an isolated phenomenon and that an acceleration of price increases would, at the very least, have one immediate effect – a hike in long term interest rates with negative consequences on growth and the State budget. Nice outcome!

Extravagant German surpluses.

Such is the headline in one of our nice economists' chronicle. I will not debate the adjective, but I will dwell on a claim by its author to the effect that when we ask countries in deficit to make efforts to reduce their deficit without the surplus countries making efforts to reduce their trade surpluses (by stimulating internal demand), one introduces deflation in the first group of countries. We are not, though, in a zero-sum game. Germany derives only 25% of its surplus from other Eurozone members. For those Eurozone countries, there is a potential market beyond the zone of 5.5 billion individuals. Clearly they can do lots without requiring the Germans to reduce their surplus. And, can anyone truly believe that increasing the consumption of 40 million German households (representing only 20% of the zone's GDP) would bring about any significant improvement in the external accounts of the other countries?

Name of the month: Danielle Nouy.

That's the name of a member of the executive management of the Bank of France, called upon to head up the European supervision body from next January. This nomination is for a job which will be colossal, a nomination which rewards an unequalled competence in matters of the control and analysis of the banking system, and which also has a symbolic element: in view of the extreme concentration of its banks, France will see almost all of its credit institutions go under the authority of the European body. This is not the case for other countries and for Germany in particular. Apart from supervision of the great establishments, this body will have to set up the Asset Quality Review of the 128 largest banks and, probably, be implicated in separating banking activities into high street banking and so-called speculative banking as the result of a reform a minima (fortunately) of the Commission - the practical implementation of which will be complex, because the banks will do everything possible to see that the "speculative" aspect will concern as few operations as possible.

The euro zone worse than Japan.

That's the conclusion of an American research group. Growth rates have been more or less identical for some years, yet the two economies show very different labour productivity figures: +3.8% between 2010 and 2012 in the euro zone and +6% in Japan, seeming to validate the conclusion that it really is the decrease in active population which is causing the Japanese flatness. What is certain is that both zones need serious structural reforms: in Europe to improve manufacturing competitiveness, in Japan to strengthen competition, services and distribution circuits.

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