



The Banker's Comment - Jean-Pierre Patat

A former central banker looks at the news

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Each month, Jean-Pierre Patat, Honorary Director-General of the Banque de France and a TAC ECONOMICS advisor, offers his own point of view, on the economic and financial views, with total editorial freedom.

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The markets: stupid and/or manipulated?

Phenomenal drops, followed by no-less-spectacular hikes - with intra-day movements just as spectacular - have characterised the evolution of world equity markets over recent times. The cause? Worries about Chinese growth and for good measure the alarm brought about by the (mini) devaluation of the yuan.

Either alarm about China is well founded, in which case there was no reason for the markets to pick up, or it is not, so the drop at the end of August should not have occurred. For sure, State intervention remains heavy and less and less efficient, the financial system is not overly dependable and market speculation is rife (only half the credits distributed by Chinese banks go into the productive economy). Reforms and reining in are needed for certain. Is that a reason to question the mid-term perspectives of a country where hundreds of millions of people still lack the most basic consumer needs? As for the devaluation of the yuan (about which we took three weeks before we began to worry), we know quite well that it is not from the exchange rates that the competitiveness of Chinese industry draws its root advantages.

To crown it all, operators asked themselves if such a context did not throw doubt on the Fed's decision, virtually pre-announced, to raise its rates. We now have their answer. The only positive point about this inaction is the crossing of the sacrosanct "forward guidance" - that absurd constraint that the great central banks burdened themselves with because of market pressure. But as for the rest?

Despite explanations that American growth might not be as certain as it had been thought to be, everyone thinks they understood the true reasons for this lack of action which, in our opinion, is a serious error. First, because it reinforces the far too alarmist views regarding the consequences of the Chinese economic situation, second because it is prolonging this unhealthy situation in which money has no cost. It is true that with the colossal portfolio of debt bonds that the Fed has accumulated through its quantitative easing, the potential losses that a rate rise could bring about are frightening.

Name of the month: Villeroy de Galhau.

A French affair, but one whose implications go beyond national boundaries. Let it be said that even if designating a former banker to head the Bank of France is a first, the quarrel over a possible "conflict of interest" seems unjustified. First, because any key decisions concerning the supervision of French banks will be taken in Frankfurt because of their size; second, because it is insulting to the man to think that as far as the supervision itself is concerned (which will continue to be conducted in France) the new governor might have weaknesses for the bank where he once worked. In that case, why not suspect that a former Treasury adviser might someday have weaknesses towards his old boss, the Economy Minister, and so defend a laxist monetary policy at Frankfurt? As for the argument put forward by some, to remove the drama, that all of this is unimportant since henceforth the Bank of France does nothing, let us recall yet again, even though it appears that nobody wants to listen, that:

- the ECB decides the direction of monetary policy and the Bank of France's governor - like the other governors in the zone - shares in these decisions, a participation that involves at least a minimum of preparatory studies by his research services;
- the ECB does not institute monetary policy because it does not open accounts for commercial banks. Everything is conducted by national central banks on their respective monetary markets. Furthermore, all "central banking" tasks are decentralised, including exchange reserves management, even those held by the ECB which in that respect delegates management to the national central banks.

As well as monetary policy, the Bank of France is in charge of numerous public service missions: credit risk ratings, unpaid debts, business quotations, secretariat for over-indebtedness commissions and so on.

Figures of the month: 33% and 57%, appreciation of the yuan exchange rate since 2005, respectively against the dollar and a broad basket of currencies.

Mario Draghi's outlandish remarks.

"New dangers are threatening growth and inflation" the ECB president declared recently. What could be more natural than a central banker thinking about inflation? Except that Mr Draghi finds it too low and promises to do everything possible to get it up. Ordinary folk will appreciate this, happy as they were about the increase in their purchasing power resulting from modest price increases. What is more, the president of the ECB seems not to know that in many countries in the Eurozone where growth is driven by consumption, it is low inflation that fosters household demand. To increase inflation rates is to impede growth. However, the ECB, in this respect, is "following like sheep" other central banks - the Fed and the Bank of Japan in particular. Having announced a downward revision for the zone of its already low growth forecasts, the leader of the ECB adds: "There is no special limit to the possibility of the ECB's getting into a higher gear in matters of monetary policy". If we understand correctly, Mr Draghi, who has implicitly recognised that his quantitative easing (60 billion euros worth of bond purchases each month) has had little effect on economic activity, promises not only that he will persevere, but that he is quite capable of going even further! Markets are delighted. But what will the balance sheet of the ECB look like when, some day, following an inevitable rise in long term rates, potential losses will have to be accounted for on portfolios that will not be cleared in a week or even a month?

Who profited from the hundreds of billions allocated to the Greeks by the European institutions?

There is no doubt in the Greeks' mind that they themselves did not benefit from that money and that over 90% was used to pay off debts to foreign banks. A German economic institute gives quite a different version: only a third was said to have served to pay foreign banks, another third was said to have financed public expenditure (civil service salaries); a final third would have simply transited via the beneficiaries to go abroad again in capital transfers. The institute does not identify its sources and we know the Germans are not over sympathetic towards the Greeks; however, the first version of the facts was everything but credible.