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THE BANKER'S COMMENT BY JEAN-PIERRE PATAT

A former central banker looks at the news

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Figure of the month: between 100 billion euros according to the European Banking Authority and 298 billion euros according to Goldman Sachs; the sum needed to recapitalize European banks after stress tests that should be more "stressful" than before.

European Central Banking System (ECBS). An increase in the balance sheet because of the crisis, a fairly modest rise.

Quite deliberately we talk here of the ECBS and not of the ECB, since almost all operations are carried out by national central banks; commercial banks having no account at the ECB.

Between the start of 2007 and today, ECBS assets went from 1,337 billion to 2,071 billion euros. Of the 734 billion increase, 230 billion result from growth in gold reserves and currency (almost wholly from rises in the value of gold holdings). Classic refinancing operations increased moderately, from 473 billion to 573 billion euros, with the ECBS having above all replaced short term operations by long term refinancing. It is of course the purchasing of sovereign bonds, so controversial, which increased most: from 173 billion to 534 billion. We might note, though, that the holding of such bonds were already 173 billion before the crisis.

The downside of the 734 billion growth in assets is its immediate production of an equivalent amount of central money, broken down into a 200 billion increase of banknotes in circulation (which would have happened anyway, without the crisis) and a 534 billion increase in bank holdings at the ECBS. This is quite a hike, since in normal times banks only leave small sums at the central bank over and above their compulsory reserves. This evolution shows the persistence of (or rather a return to) a climate of mistrust, with banks preferring to keep their liquidity surpluses at the central bank rather than lending them out on the inter-bank market. It also shows up the "sterilization" process through which the central banks withdraw liquidity from the markets by borrowing to banks.

In sum, the balance sheet rack-up due to "non-conventional operations" is only 400 billion euros (i.e. 4% of the zone's GDP). And their monetary sway, thanks to bank holdings at the central bank, is brought down to 150 billion. Jean-Claude Trichet is not handing over a rudderless ship to his successor.

The Greek default: an expected catastrophe.

Presented as the only realistic solution by economists and analysts and rejected with more or less conviction by politicians, the notion of a Greek default gathers pace. After all, say those believers, this will do no more than bear out the facts. With the current stratospheric rates on Greek sovereign bonds on the markets, the "second-hand" value of the Greek debt is well below its nominal value. But there is a difference between suffering a potential loss and the decision of one State not to honor a part or the totality of that debt. To oblige banks that hold Greek bonds to agree to take into account potential losses is closer to the second case than to the first. We believe that such an issue, towards which we are headed, could be highly punitive for the euro zone. Greece is not Argentina; she is part of a structured group whose failings would seem manifest in such a case. What is more, how does one prevent such a decision from tempting other States? The zone's credibility would be reduced and its banks put into a dramatic position. Greece hardly stands to gain any tangible profit from this issue, which will do nothing to sort out her problems of competitiveness (will she even make efforts in that direction should she benefit from such a respite?) and which risks ruining banks and closing Greece's access to markets for a long time to come. Unfortunately, it seems likely that we shall allow ourselves to be tempted by this new kind of "blindness to disaster". It is possible even that the markets, whose "short-termism" is admitted, could rejoice - believing naïvely that the problem is solved at last.

The EFSF turned into a bank. When French creativity goes crazy.

The French Ministry of the Economy is arguing, it seems that the European Financial Stability Fund takes the statute of a bank. And what would this bank do? Make loans? It would be anything but a deposit bank. So, the miracle solution dreamed up by some is of quite another kind. Once a bank, the EFSF could benefit from refinancing by the ECB; refinancing that the ECB would grant automatically against the handing over of held sovereign bonds as guarantee. In other words, through a body masquerading as a bank, the ECB would become the permanent refinancer of States in difficulty. This is no fairy tale! This project is making the rounds. Let us wager that this time it would not be Germany alone that puts up objections.

Word of the month: indignant.

Indignation is fashionable; the writer of this chronicle at least is indignant. Indignant at seeing Europe - this unequalled land of democracy, liberty, social rights and well-being - being berated, and without reacting, for its slowness in resolving its problems and for its lack of unity in face of the crisis, by certain countries - one of which set fire to the planet via its financial system, and by others which, while they may have flattering growth figures, still remain, for a large part of their population, lands of misery and exclusion from the most basic social rights. Reproaches that show mainly the authors' total lack of understanding of the alchemy between 27 nations with often a thousand years of history in common.

Stock markets: the ingredients of instability.

The turmoil in the markets has, no doubt, deep rooted reasons, but there are new elements that heighten it. The directive on insurance provoked a severe drop, from 25% to less than 10%, in investments on the part of organisms which are essentially stable investors. The sophisticated electronic trading methods, known as "roaches" in the trade, are discouraging traditional investors, who place an order at a certain value and at that very moment see the price shaken by hundreds of orders executed in a flurry. None of that affects fund trends, say specialists. That's as may be! These factors of extreme volatility do not exactly draw savers towards a market which, nevertheless, is vital for businesses' investment capacities.

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 news, with total editorial freedom. Email : jppatat@tac-financial.com
Translation from the French by D. and M. Jouan-Cross.