THE BANKER'S COMMENT - JEAN-PIERRE PATAT

A former central banker looks at the news

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Figure of the month: 3,800 billion dollars, close to 30% of GDP: increase in US debt over the last three years (+ 17% in the eurozone).

The European Central Bank: unlimited interventions? Just wait and see!

In committing itself to buying bonds issued by Eurozone members in difficulty for unlimited sums of money, the European Central Bank has aroused enthusiasm in the markets, the anger of the Bundesbank president (who voted against this decision and who also made this noisily known after the Board meeting), and unleashed the outrage of many German media. In the view of observers, particularly those in France, this shows that German rigour is defeated and that the ECB has taken a decisive turn.

However, the devil is in the detail and, this time, there are lots of details. It is not a matter of the ECB's acting alone and unconditionally buying government bonds; rather the ECB will complement purchases made by the European Financial Stability Facility (EFSF) and the future European Stability Mechanism (ESM) which will not itself be able to provide assistance to a State by buying its debt unless the said State adopts a reform programme. It can be seen that these operations, baptised Outright Monetary Transactions (OMT), are in fact less accessible than previous debt purchases made by the institution; these may have been deemed insufficient in quantity but they did not carry such a battery of conditionalities. The Spanish Head of Government was not taken in when he demonstrated a very tepid enthusiasm for these announcements. Is this surprising?

Those and they are many, who detested J.C. Trichet whom they viewed as a *hawk*, wanted to be convinced that Mario Draghi was a *dove*, he was 'somewhat Italian' dared to write one editorialist. He is not, and the new President of the ECB no doubt shares German philosophy far more than did his predecessor. This escapes professional denigrators of Germany, who allowed themselves to be impressed by Germanic protests (one can't help wondering if these protests might not be play-acting). In any case, all this is a blessing as far as Mario Draghi is concerned since it confers on him a stamp of flexibility and pragmatism in the eyes of the countries of the 'south' ... and of France.

The conviction that a policy to reduce budget deficits would provoke recession is an enduring one.

After the French President's very strong re-affirmation of a policy aiming to bring down public deficit to 3% of GDP during 2013, the Keynesian temple choir, well staffed, gave voice with all the seeming logic stemming from true evidence: lower public expenditure, higher taxes hence lower income and demand, hence less growth. They cite as examples: Greece, quite acceptable given the size of their budgetary restrictions; Italy, where it is hard to relate recent quarters' GDP figures to fiscal measures decided upon less than a year ago (the figures were more probably due to the country's dive in competitiveness and the increase in long-term rates); and Spain, where it was the housing bubble burst that sparked the recession. When one examines the measures envisaged for France in detail, it is difficult to find even one that would have some tangible impact on growth. Moreover, the confidence of households and businesses (who have almost certainly not read Keynes and even less Ricardo), the confidence so indispensable for a positive growth reversal, would be seriously damaged if the government was seen to hesitate over a problem of whose gravity and urgency they are well aware. Not to forget, more concretely, the hike in market rates that would follow such hesitation.

The Fed cannot be set up as a model for the activities of the European Central Bank.

No doubt I have already broached this point and I ask any attentive reader to forgive me for rehashing a topic of which some refuse to perceive the realities. For those, and they are many, who continue to deplore the fact that the ECB does not imitate the Fed in conducting a policy of massive repurchase of public debt bonds, we can never sufficiently repeat the fact that the Fed buys only American Treasury bonds – bonds that are perfectly homogenous and fungible, issued by an entity whose orientations and activities the Fed knows full well and is even often discretely associated with. The Fed does not buy bonds issued by California or Texas. Were it asked to do so and if it considered following up such a request, it is certain that the Fed would set conditionalities and insist on guarantees. The European Central Bank is in exactly this situation.

Names of the month: Draghi and Merkel.

Yes, Draghi and Merkel, since it is clear that this couple has replaced the tandem Sarkozy-Merkel in giving impulse to a Eurozone in which other organs of governance are either non-existent or failing. An American economic periodical even claims that they talk on the telephone ... daily!! If this is true, some will mourn the supposed disappearance of the previous French President which would be the outcome, but (more seriously) this would mean – as is claimed by the President of the Bundesbank – that the independence of the ECB would be seriously compromised; not at all because of the infamous 'unlimited' debt purchases, but because of a too-great proximity with a powerful member of the zone.

An overkill of authorised advice on the Eurozone crisis.

The latest expressed opinion comes from a Brazilian former Finance Minister who suggests 'putting an end' to the euro in a 'planned' way with countries returning to their national currencies and, after having (for some) devalued theirs to recapture competitiveness, getting together by means of an agreement like the European Monetary System (EMS). Let us gloss over the illusion of a planned end for the euro, which would be more like a nuclear explosion than the dissolution of a board of directors. Let us gloss over the old chestnut of devaluation. This minister seems to have not the least idea of how the EMS worked, its having become by the force of things a Deutsche Mark zone with the Bundesbank serving as guide to the monetary policy of the other countries. Is this the situation that we want to go back to, by abandoning a Eurozone where monetary policy is everyone's business?

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.