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The Banker's Comment - Jean-Pierre Patat

A former central banker looks at the news

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Figures of the month: +7; +1.4; +1; -1.8. The surplus as a % of GDP on the balance of payments for Germany, Spain, Italy… and France!

ECB: Surprise rate cut mainly sends message.

The ECB surprised the markets by lowering the main rate from 0.5% to 0.25%, contradicting the famous principle of "forward guidance". Its president justified this gesture by an inflation rate that should remain under 1% for some months to come. It is all about easing off the brakes without pressing on the accelerator, to return to a rate close to 2%, as some believe - seeing this move, perhaps wrongly, as a commitment by the ECB to tie inflation to somewhere below the 2% level.

What might we expect from this rate action? Not much, as far as the presently low demand for credit is concerned; despite very low rates (for good risks!), big businesses can finance investment at 2.6%. Small businesses pay dearly for credit but this gesture from the ECB will not change that.

Not much either on the exchange rate, given the dysfunctional political environment in the US which is weighing on the dollar. One source of weakening for the euro would be if that money were to be used for "carry trade" operations (borrowing a currency at a really low rate of interest to sell in favour of a currency with a high rate of interest). Right now, it's the greenback which is used in such operations and it will probably stay that way, since its interest rate is insignificant. This lowering of rates, therefore, should be seen in a psychological setting. At a time when examination shows that investment is picking up in small and medium sized companies, such a signal is not without significance.

Mario Draghi states that he still has sufficient ammunition. Some are thinking of debt bond purchases from countries in difficulty. The ECB has added such conditions to these activities, but we cannot be sure of any commitment in that respect in the near future. If it is a question of coming up with liquidity, the ECB is doing that already thanks to long term refinancing operations (LTRO) for banks. Concerning lowering interest rates paid by borrowing states, the Federal Reserve manages this by buying completely safe bonds from the Federal government. To ask the ECB to buy mediocre bonds, to say the least, is to set it on the path to potential losses which could happen and would undermine its credibility. In this case, Germans would be quite right to oppose it energetically.

Argentina: Crime doesn't pay.

Lauded, admired by "anti-globalisationists" for its refusal to pay its international debts and for thumbing its nose at the IMF, Argentina is today paying the price for this attitude and for the zero degree economic policy it carried out afterwards. Banished from international financial markets, something that fails to save it from falling out with those it owed money to, the country conducted a policy of facility in profiting from the devaluation of its currency so as to develop almost exclusively the export of raw materials whilst barricading itself behind import taxes. All this while the State delved shamelessly into the Central Bank's reserves to reduce its debt and gain margins to increase expenditure. Today, with competitiveness destroyed, growth is very weak, below that of other Latin American countries (except Venezuela!). The weak currency is generating real inflation of 25% (whilst the administration claims 10%), a rate that is ravaging for the popular and middle classes, while protectionism (and the hand-in-hand corruption) is causing shortages worthy of former communist countries.

Public Debt: Nostalgia for safe investments.

For the second time, Italy has just started a "patriotic issue" of public borrowing, aiming to attract households. Like the first, it will be a success. We could do the same in France, not because "savings are abundant", which is what one minister unfortunately said. Savings are insufficient in France, because current transactions are deficient (in that respect Italy, now in excess, has more leeway than us). No doubt a similar operation would also find favour with our public. It would, though, be a step towards modifying the share-out of the funding for French economic deficits. Today this is assured by international savings as far as administrative deficits are concerned and by domestic savings for business deficits (i.e. funding needs). This is the share-out which to us, overall, seems the more satisfactory.

Word of the month: "Buffoon".

Excuse me dear readers. This term is not to be found in the press and I introduce it myself. In certain French "problem schools" this is the descriptor thrown by failing pupils at those who work. Germany is implicitly being treated thus by the European Commission which is about to carry out an investigation into the scandalous behaviour of this pupil who works too well, so harming his comrades. In fact, it is not the pupils, rather it is the Head Master who is attacking the top pupil. Apparently this is to counterbalance reproaches for the bad pupils (France is one). If it's really so, we might well question the sense of responsibility and judgement of our community leaders.

The scarecrow of deflation.

Mario Draghi has dismissed the risk of deflation in the euro zone whereas the chief economist at the ECB has spoken of it, sending fear of this new scarecrow into some economists who take that opportunity to accuse budgetary adjustment policies of being responsible for it. But deflation is not price lowering (not seen in the zone by the way), it is a depressive context composed of price lowering, a lowering of monetary mass, a lowering of salaries, plus a lowering of demand – a context not seen since the 1930s and which was in part due to an aberrant economic policy. Let us evoke the Japanese example, whose economic evolution this last decade was due not to prices but rather to a catastrophic demographic situation.

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