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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: -70%, the drop in FDIs in France, a figure biased by the size of inter-branch financial transfers, hence with little significance.

Recovery in Europe: budgetary rigour is not holding growth back but nor is it enough to maintain it.

Several European countries, the United Kingdom and also the « southern » States which were until recently under supervision by international institutions and plagued by very high bond yields (Spain, Portugal, Italy), now have flattering growth outlooks for 2014. Flattering because although these figures are still modest (except for the UK), the differences from 2013 are considerable: +1.7 for Spain, +2.4 for Portugal and +2.0 for Italy. Excepting the UK, it is exports, favoured by increased competitiveness, which drove the recovery, and in Spain we are seeing the baton being picked up by investments. For upholders of the "supply-side" policy, it proves that budgetary rigour pays off. For their adversaries, it is a servile imitation of Germany, gained through pauperisation and social losses.

The first thing to notice is that devaluation no longer pays. With the pound's depreciation of above 10%, Britain saw its external deficit go from 1.5 to 4% of GDP in the space of four years. Another lesson from these changes is that public expenditure is not necessarily a factor of growth. Everywhere, in fact, budgetary adjustments have been severe, especially in the United Kingdom where the budgetary deficit has dropped 5.3 points of GDP over four years and where recovery has been the most vigorous.

This though does not in itself mean that fiscal virtue that favours cheaper financing for the manufacturing sector will alone bring about growth. I remain convinced that the model turned towards demand by over 5 billion human beings is more fruitful than one focusing on 400 million Europeans. It is still necessary to withstand competition affecting goods that are increasingly sophisticated. Price-competitiveness should go alongside quality-competitiveness, together with innovation, reactivity, improving the legal and administrative business environment, research-development, teaching at all levels, the propagation of new technologies, infrastructures, training and professional mobility. Not even to mention the UK, where the recovery is based mainly on the housing market, it is not at all sure that the countries mentioned are taking such a route.

A brave Governor.

Yes, in a country where banks hold a pride of place in the list of most-hated businesses, courage is needed to do what the Governor of the Bank of France has just done. That is to oppose European Commission projects aiming to separate investment banking activities from those of deposits and credits in the banks, and to vigorously express a few home truths. Firstly, that deposit and credit activities are by no means "safer" than are market ones. In the good old days of the "Glass Steagall Act", the failures of high street banks were counted in their dozens every year. Secondly, that when administrations and businesses are financed wholly or in large part on the markets and when the major part of household savings is placed on security markets (directly or indirectly through unit trusts of life insurance), bank interventions in markets are crucial to ensure needed liquidity and depth - as much for refinancing as for supporting arbitrage operations aiming at optimal management of funds entrusted by savers. Lastly, that in French banks' accounts, gross profits made from deposit/credit activities represent less than 50% of total profits, whereas they create 90% of management costs, and isolating such activities runs the risk of increasing the cost of credit for the manufacturing sector.

France, the last country where "devaluationism" is the rage.

We would prefer not to have to talk of this anymore; however, when a minister superbly declares that he is going to "weaken the euro", does he not realise that he is the last in Europe to go down this path? That the so-called "countries of the south" redressed their external accounts with the self-same euro as us? In a well-balanced study, the French Economic Analysis Council showed that French exports to OECD countries are more sensitive to exchange rates because they are more substitutable with those of the UK and the USA. This is an indirect way of saying that devaluation favours the standardization of production, something which for advanced countries is a blind alley. The research concludes that the effects of any devaluation are not lasting and that "strong" currency is not the real problem. *When you show him the moon, the idiot looks at the pointing finger,* says a Chinese proverb.

Name of the month: The German Constitutional Court.

Everyone rejoiced that the German Constitutional Court, asked by the president of the Bundesbank to decide on the validity of programmes (still virtual) for the ECB to buy Eurozone sovereign bonds on the markets, has (with the few customary reservations) passed on the dossier to the European Court. This, according to some observers, amounts to burying it all. Perhaps, though, the German institution was assailed by doubts on the validity of a proceeding that would make it the judge in decisions concerning 17 countries and for which its technical competence and even its legitimacy to decide are not proven. The Court was created in 1950 by the Allies occupying Germany to prevent ill-fated moves like those that, in all legality, brought Hitler to power. Its vocation was not to act as an instrument for some to use for anti-europeanism, europhobia, or ECB-phobia. Nor was it designed for attempts, with recourse to its arbitration, to paralyse community decisions; something that no institution, in no country in the continent, sees itself as authorised to do.

Deflation: it's existed for over 20 years.

The reasoning of those who worry about the risks of deflation is unstoppable. Lower prices discourage purchasing, economic agents delay their spending in the hope of paying even less for them. Except that, for an important part of expenditure (food, basic services, health etc.), there is no question of delay. As for manufactured products, most have already seen spectacular deflation since globalisation introduced low-cost production from emerging countries onto our markets. TVs, computers, household goods, have seen prices cut in half over the last decades without the prospect of even lower prices in the future having had the slightest effect on sales. The fact is, that with real deflation it is the general decrease in incomes that causes a lessening of demand.

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