TAC
Applied Economic & Financial Research

THE BANKER'S COMMENT - JEAN-PIERRE PATAT

A fromer central banker looks at the news

November 2014, TAC Newsletter - www.tac-financial.com

Figure of the month: 4,500 medium-sized companies in France versus 12,700 in Germany and 8,500 in Italy.

The ECB stress tests: serious or just a joke ?

The outcome of the stress tests conducted by the ECB on 145 European banks was seen as satisfactory, with only 9 institutions showing a need for further capital. Even so, there are a few grumblers who are ready to question the scope of this operation ("a huge joke" for some).

It is true that the stresses "imposed" on the banks under examination were theoretically to face are, by quite a long chalk, a lot less "stressful" than those by which the global financial system was recently confronted in reality. A tacit principle in the conduct of central bankers is that the worst is always certain... but bank regulators are not central bankers. In fact, those who design up the exercise are split between a wish to be very strict and a fear of the catastrophic impact on the financial and economic world of any outcomes that could in consequence be disastrous.

The stress tests do not resolve the problem of the weighting of assets used in the computation of the capital ratio. Common sense says that not all assets bear the same risk, and applying common sense would see the establishments themselves assessing the degree of risk via their in-house models instead of this being done by some distant technocracy. Except that these practices are likely to lead to under-estimates of risk, the effects of which we saw in the recent crisis, with a total of "weighted" assets being two, even three times less than the total of non-weighted assets. Should regulators be more closely tied to risk-calculation? Regulators who, some claim, have a "bankers' association" bias?

A solution could lay in applying an additional ratio, a global "leverage ratio", which relates capital to the totality of assets, non-weighted. "One more ratio", protest the banks, with their current 8% capital ratio (with two sub-ratios for tier-1 and other capital), with their buffer ratio of 2.5%, and with their contra-cyclical "core capital" of reserve funds scaling up to 2.5%.

The large French banks, comfortably at ease with the existing capital ratio would only show a leverage ratio of just over 3%.

What heading for the ECB?

Recent remarks by Mario Draghi carried many economists and analysts, as well as the media, into an ecstasy open to all kinds of fantasies. The president of the ECB said that if necessary the ECB would not hesitate to increase the totality of its assets by one thousand billion. "At last", some say. "The ECB, with a balance sheet far less augmented that the Fed's, is now on the right track". Speculation sped up on the assets which would be acquired when it happened. It was sure! The ECB would directly purchase public debts on issue, "as the Fed and the Bank of England have been doing for a long time". Clearly, this is wholly false; no modern central bank allows direct funding to States – such operations being specifically ruled out in the ECB statutes. But, after all, one never knows!

Let us admit to being somewhat surprised by the ECB's orientations, or rather those of its president. A thousand billion more on the balance sheet? If in practice it is not about buying bond issues, it would mean gorging the banks with liquidity, and why? For what result on the real economy? Unless it is all just "words" with no intention of follow-up. Since talk is of transparency, we would welcome a convincing measure of the expected macro effects of such a massive-scale dosage from the ECB itself.

A rouble that portrays the Russian economy.

More than inflation (8.3%), possibly more than the West's sanctions, more than the credibility of a central bank whose independence is uncertain, the rouble's fall (down 30% against the dollar since the start of the year) reflects the very mediocre strength of the Russian economy, whose drive depends at far too great a ratio on the price of oil.

The decision to let the currency float is reasonable. A central bank alone cannot do much against strong speculation. However, the flotation does not resolve the basic problem. The Russian economy, which has great potential, needs massive investments if it is to regain a level worthy of its past as a Great Power. A past that they are nowadays trying to revive by political, diplomatic, even military coups.

Name of the month: Soros.

Here he is again in the media, even in the "gossip press" which is no doubt trying to give itself a badge of seriousness. Having caused the pound to fall in 1992, and having gained billions in that operation, then having attacked the French franc with the big guns from 1992 to 1996 in order to scupper the single currency project, the good doctor Soros is now seriously worrying about the health of the euro zone. Complaisant questioners pick up his pearls of wisdom about the too-rigid ECB being dominated by Germans. Mister Soros seems not to have noticed the cascade of resignations by representatives of the Bundesbank from the ECB's board of governors. This is not really an indication of the institution's domination.

Luxemburg: details on what we already knew.

Recent revelations on the role of the Luxemburg banking system in tax evasion for the profits of many very large companies are raising scandal. As if (albeit without exact figures) nothing was known beforehand, when two representatives of this country (0.1% of the euro zone population and 0.2% of its GDP!) were nominated for European positions at the highest levels, President of the European Commission and member of the ECB management. It is true that for the second position, the Germans – fed up with the snubs they were suffering within the ECB board – had exercised strong pressure for the nomination of a personality whom they thought to be in tune with their views.

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