The Banker's Comment - Jean-Pierre Patat

A former central banker looks at the news

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Each month, Jean-Pierre Patat, Honorary Director-General of the Banque de France and a TAC ECONOMICS advisor, offers his own point of view, on the economic and financial views, with total editorial freedom.

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Figure of the month

+232 billion Euros; the current account balance for the Euro zone. In surplus everywhere, except France.

What is the impact of the quantitative easing conducted by the ECB?

Initially, let us remind that this quantitative easing (QE) includes, since the start of the year, debt bond purchases to the value of EUR 70 billion, and EUR 600 billion of central money brought into banks over the same period by exceptional long term refinancing (LTRO), while outstanding debts for such operations had increased at a much slower pace in 2014. The ECB had tacitly set out to stimulate growth in broad money supply and credit, to maintain low long-term interest rates, and to increase inflation rates.

By the end of March 2015, the large monetary aggregate M3 is increasing at an annual rate of 4.5%, significantly above the 1% observed for several years. However, the M3 acceleration started in mid-2014: 1% in May, 1.8% in June, 2.5% in September and 3.5% in December. The main source for this new monetary creation was the increase in credit distribution by banks in the euro zone (monetary financial institutions), but there too the movement had started in mid-2014. Since then, the "production" of banking credits has supplied EUR 440 billion in money but almost half of those credits benefitted public administrations. The direct role of the ECB in this pick-up in monetary creation is no doubt marginal in the ECB's view (purchasing bonds from non-banking agents). As far as credit is concerned it is demand that drives the process, but it could be that making these EUR 670 billion of central money available to banks has made them less reluctant to meet demand for credit.

On the other hand, debt purchases (still quite modest) have not been able to prevent the upward movement in long term rates that is being seen everywhere. As for an increase in the inflation rate, the ECB modestly admits that it is due above all to the increase (50% since the beginning of the year) in oil prices.

In fact, growth recovery in the euro zone proceeds mainly from households regaining confidence (due to a great extent to the very low inflation that, however, "they" want to drive up!). In this favorable climate, the ECB's activity no doubt contributes to the maintenance of this improvement. In any case, this QE is an excellent business for the national central banks (in charge of its working) in the euro system, which are reaping the profits, as well as for States, share-holders and tax collectors.

Disturbance or a turn-around?

Rather it's the second phenomenon that is occurring, in that the price of oil, the exchange rate of the euro and interest rates continue to move in the same direction, but upwards. The price of a barrel has gone up by 50% since the start of the year, the rate of the euro which most analysts viewed as having parity with the dollar has gone back up to about 1.13 and, finally, French and German long term rates have doubled for the former's and quadrupled for the latter's. Should we be surprised?

Exactly as trees never reach the sky, a dive (even a steep one) always ends up reaching a bottom. It is hard to believe that the price of oil would remain eternally indifferent to the situation in the Middle East, that the euro exchange rate would distance itself even more and against all valid reasons from its balanced equilibrium, or that borrowing in the long term at close to zero percent would be a lasting condition. At the risk of being upsetting, we say that the present data are far more satisfying for the global economy and financial stability than the extravagant figures to which some had assigned all the appearances of normality.

The fragile British economy.

Mediocre English growth for the first quarter of 2015 (+0.3% q-o-q) has revived criticisms and doubts about the soundness of that growth. Let us not dwell upon reservations about "mini-jobs", certainly justified, but which those in France who do not care about the millions of unemployed (and who will not agree to the slightest advance in reforms aiming to reduce this epidemic) are disqualified from expressing.

The fundamental problem resides in the very low productivity of British workers, about 20% below that of European wage earners. To get a job done by two that only requires one person is not the best way to reduce unemployment and build a future. Whatever we think, high intrinsic productivity, far from destroying jobs, creates wealth and sophisticated goods and services. That is to say that it maintains a virtuous circle, itself a job creator.

Name of the month: BNP Paribas.

It is again under legal scrutiny for having provided mortgages drawn up in Swiss francs but repayable in Euros. First, let it be said that there had to be loads of naivety to rely on the durability of the interventionist policy of the Swiss National Bank that set out to block any appreciation in its currency; in itself this policy demonstrated the strong pressure that existed in the markets for a raise in the currency. Since then, after the withdrawal of that policy, the Swiss franc has appreciated by 20% vis-à-vis the euro. For all that, should one approve the complaint made by the BNP Paribas customers? Were they childish enough to believe that they would inevitably win out and that they had such a right when the option they agreed to was risky by its very nature?

Inflation-Indexed Bonds, a fatal but inevitable trap.

France, the UK and Italy are issuing more and more bonds of this kind. Is that because we believe we are in a lasting period of close to zero inflation and hence of very low rates? That would be absurd, and the recent rise in bond rates, just about everywhere in developed economies, is making a lie of this belief. Is it not rather that the "serious" investors (pension funds, insurance companies) cannot be satisfied with the minimalist rates seen until very recently? An indexed bond is far more attractive for them, and the lenders must bend to their demands.