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THE BANKER'S COMMENT BY JEAN-PIERRE PATAT
A former central banker looks at the news

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Figures of the month: 3% for Germany's GDP progression in 2011; the second, and less commented upon, figure, of -0.25% for the fourth quarter, could signal the start of a worrying recession.

The S&P pronouncement: a nasty blow for the euro zone.

We start with a detail. The French term "degradation", repeated ad nauseam and holding in the French language a meaning as precise as it is ignominious, is not a faithful translation of the term "downgrading". This latter term applies not to the country but to its rating, which has been lowered but not "degraded". Let's move on. As far as France is concerned, the markets seem already to have integrated this new situation. Let's hope so.

Is the decision fair? Yes and no. Yes, if we consider that the French budgetary "rigor" with its petty measures and taxes on soft drinks richly deserved this sanction which, after all is said and done, is quite light (one notch down on a scale of 21) because, for example, it bears no comparison with the drastic programme set up, and with the full agreement of the population, by the British government - about whom some are annoyed that it has retained its high rating. Is it fair? No, not really; because France remains an eminently solvent country.

We could easily say the same about plenty of other countries that have been even harder sanctioned. Because in our opinion what is really at stake is the euro zone as a whole. A euro zone to which the rating agency is wittingly dealing a bad stroke. First there is the situation of the European Financial Stability Fund; the EFSF saw its rating shaved following that of one of its main contributors. But also, and above all, there is the "degradation" (and here the term is appropriate) of the zone's image by decisions that are as unjust as they are scandalous.

Consider now the fact that Italy - which recently chose a government as rigorous as it is competent, which has just adopted strong budget reform measures, which has a balanced primary budget (i.e. excluding interest payments) and which, what is more, had just succeeded in raising a pretty large amount of funds at reasonable rates (because, say what you might, Italy remains a solvent country and the markets know it) - now finds itself down-rated by two notches!! This puts Italy on the same footing as South Africa and even Colombia! This seems really too much! Several times in the not too distant past, the S&P agency has been seen to have made major errors of analysis. This time, it is no longer incompetence that is involved and we might seriously question the deep motivation behind these decisions.

Budgetary adjustments in the euro zone: will the sick man die cured?

Thus wonder quite a lot of observers and economists looking at very mediocre growth prospects which, they think, are still bogged down by adjustment plans. It's difficult to decide. According to a recent Goldman Sachs study, this a phony problem anyway since "there is room for manoeuvre" with a weight of public expenditure in almost all euro zone countries (including Germany) that is significantly higher than in the other advanced countries (with France gaily skipping in the lead). Worse, the study seems to show that in many countries high public expenditure is of little value in promoting an environment fostering private sector activities. Finally, as a sting in the tail, the authors provide a graph which clearly shows a negative correlation in advanced countries between the weight of public expenditure and GDP growth. But the devil is in the detail. Believe it or not the study stops at 2007, hence it fails to build in the hike in public expenditure motivated by policies for recovery – something that would certainly blur the correlation.

In any case, we are convinced, bearing in mind the vital role played by trust in the present context, that firm action, visible and well calibrated for a reduction of deficits and of the weight of debt, can only improve that trust and so "thaw" savings and foster a revival of business. What is more, and not mentioned for the first time in this newsletter, players in the economy (and markets) need a message that is not just "punishing" but which also brings projects for the future. This is badly missing from recent European agreements.

French creativity at the top.

French experts had already gained notice in European discussions by defending the comical project of transforming (through a change of legal statute) the EFSF into a bank. This would have made it eligible for financing by the ECB, itself being transformed by sleight of hand into a permanent refinancer of States in difficulty. This idea is taken up in a journal in an article co-signed by a former French prime minister. It starts with a startling headline affirming that States are paying interest rates "600 times higher" than those paid by banks. After some serious research, we found a multiple of 60 (it seems the authors had absent-mindedly added a zero in their calculations) between Fed rates and those paid by Italy on the markets - which seems not to make too much sense. To put a stop to this "scandal" the authors recommend that some strong public credit bodies such as the Caisse des Dépôts (undeniably eligible to refinancing by the ECB) lend to States at 0.5% and themselves be refinanced by the ECB at 0.5%. Fortunately, no French official, whatever his political or economic sensitivities, has continued with this reformulation (seemingly more acceptable) of French suggestions concerning the EFSF, suggestions which overlook the fact that banks refinance in the very short term and always backed with guarantees. Such a move would "sink" the ECB's balance by astronomical sums and would certainly "de-responsibilise" governments.

Expression of the month: The Tobin tax.

We should not deny the French authorities' political stroke when they say that if needed they will go it alone in fighting for this tax. There is, though, an unarguable logic in the move: there never will be a European agreement and those who hide behind this fact are hypocrites. That accepted, how can we put this good intention into practice? We have invoked the resurrection of a tax on the stock market, but this source is somewhat meagre and fails to really impose a tax on "speculation" - for which the derivatives market is privileged ground (a market it so happens that Paris keeps a fair part of). There is, then, some "substance"; but how best to seize it? We shall see if by tackling things from that angle (for example by making a compensation chamber compulsory), we can get away from posturing and into effective action.

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
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