

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. Email: jppatat@taceconomics.com

The fiction of central banks' independence.

At the end of the 20th century the main aim of the central banks' statute of independence vis-à-vis political powers was to safeguard a public asset - price stability. Governments were not viewed as incapable of doing this, but what one team accomplishes can be undone by a following one. This was well understood by the markets that became the inescapable judges of management by already indebted States. The world has changed. Inflation, in the present economic climate, is not the main threat for developed countries. The preservation of financial stability, another universal public asset, has become an additional priority task for central banks; an evolution which already puts back into play those governments that might be tempted to use public money to keep banks afloat.

But henceforth the dependence of central banks - because independence is no longer a fiction - is more diffuse, more multiform. With markets drugged by over-abundant liquidities, with over-indebted States that would pay heavily for a rise of just a few base points on the cost of their loans, there is a general ambience of lament for a growth seen as insufficient but for which nobody wants to see the main cause - the increasing inequality of revenues - preferring to invoke the weak demand for credit or too low inflation levels. Not to mention the uncertain political climate. The central banks no longer seem to have room to manoeuvre.

So, whilst the main move to benefit public assets would be to end, most gradually of course, the absurd policy of zero, even negative, rates whose impact on activity and demand for credit is derisory, but which threatens financial stability and the management balance of financial institutions, the central banks - rigid from fear of the markets and the anguish of the States - lose no opportunity to insist that they will change nothing. We doubt their independence when we see the Fed hesitate to proceed to an indispensable rates rise on the pretext that the USA has a new president, unanticipated by the markets (and who, it is hinted, could call into question the status of that institution); when, and still in reaction to this political context, the ECB president declares that he is ready for any eventuality, in other words ready to increase by a degree or two the outpour of liquidities; when, reacting to rumours (?) about a stop to quantitative easing by the ECB he hurriedly reassures the markets that this will continue until at least April 2017 (which the markets interpret as being able to carry on until September 2017); when he gives himself the target of getting inflation up to 2%, which would contribute less to boosting activity than it would to lessening the public debt? Where is independence when the governor of the Bank of England is denied the right to the first expression of independence - to have an opinion on a question of general interest?

Name of the month: Paul Magnette, minister and president of Wallonia, and his resistance to the CETA (treaty for free trade between Canada and Europe).

Immediately presented by the exasperated partisans of the treaty as a demagogue surfing on populism in order to deal with a domestic political concern, the man showed himself to be extremely cultivated, extremely pro-European and one of the few to have read the 1200 pages of a treaty negotiated in full opacity. We repeat that we are convinced that protectionism is the worst of things, but should not free trade be subject to some rules? We can be sure that henceforth the CETA will be viewed otherwise by a number of European leaders and that other requests for modification will be made. Is it normal that a treaty concerns only custom duties and various "norms" without dealing with what sometimes harms competition more seriously: business taxation, or environmental constraints that the imported products would be exonerated from? Is it normal that the Chinese currency, non-convertible and manipulated by the authorities, should enter into the DTS basket? More seriously, is it normal that Europeans should not react to the problem of size that will be created in a few days' time from the admission of China into the market economies, despite all objective reality? Paul Magnette has certainly not created a happy globalisation with a wave of a magic wand, but maybe his action will incite Europe to exit from its role of global village idiot.

Figure of the month: 0.8, the French ten-year rate, a rise linked mainly to the share hike following the US election.

Moaning without taking action on the dictatorship of American law on global financial affairs is not good enough.

A French parliamentary report shines a light on the exorbitant power, so viewed though not expressed, of American judges who give themselves the right to judge foreign banks (mostly European) and to sanction them, sometimes with heavy fines - usually for acts of corruption or failure to respect embargo rules, or for the use of dollars in transactions not authorised by American legislation. Let us keep calm.

First of all there is no abuse of extra-territoriality properly speaking. The sanctioned establishments are punished because they are carrying out an activity, often a huge one, on American soil. Second, they are under no obligation to pay the imposed fines, apart from their presence and their activity in the United States which they obviously do not want to abandon. But above all, nothing prevents the Europeans from adopting the same legal arsenal and attacking the same offences committed by American companies working in European territories - something which could sometimes hold back the arm of the judges across the pond. For that we need a united viewpoint and action from European countries. A unity that is somewhat weak when we observe the fine inflicted on Apple for fiscal fraud, a salutary decision which aroused screams from the USA and which was challenged by Ireland whose government let it be known that in any case it would not collect this fine.

Basle IV or an extension of Basle III: a useful step forward.

An extension of Basle III in so far as the banking regulators, having worked on the numerators of prudential ratios, will now get onto the denominators. These, indubitably, are the weak link in the Basle regulations, notably with the increase of risks to assets from methods internal to credit establishments. This initially was a sensible idea but its application is often conducive to an excess of optimism. Although, in the proposed measures in terms of interest rates risks, the French banks are, rightly, against a spread of variable rates for mortgages, other suggestions are interesting; controlling internal methods of evaluating market risks; replacing "value at risk" which is too cyclic by an "anticipation of extreme loss"; the abandonment of internal methods for compensation risks; thresholds beneath which the estimate for a credit risk could not descend. On the other hand, concerning country risks (an explosive topic) we can anticipate no changes - at this time the assets for all countries of the EU have the same weighting, very favourable.

It is said that several central banks are opposed to these improvements on the grounds that they will weigh heavily on banks' earnings. Let's hope that this is wrong.