



JEAN-PIERRE PATAT'S MONTHLY CHRONICLE

A former central banker looks at the news

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Figure of the month:
818 dollars - the price of an ounce of gold, down 20% in a matter of weeks. Good news, on the whole!

Trichet: a masterly double whammy ?

The ECB's president always showed modesty when savouring the praise showered upon him following the euro zone's good growth figures for the first quarter. "A complete and utter triumph, unarguably" wrote a columnist who laid it on thickly and who, for good measure, ridiculed ECB critics whom he dismissed as the "patchwork Keynesian Fitoussan gang"! A couple of weeks ago, aware that one numeral replaces another and suspecting that the second quarter would not be as flamboyant, J.C. Trichet put the finishing touches to what could be a superb double master-stroke.

Stroke number one: the 0.25% ECB rate rise, so that no-one could doubt that inflation remains the institution's main priority. This notified hike surprises nobody.

Stroke number two: a tiny and exceedingly discreet comment about risks for growth within Europe. This by no means indicates that he has switched priorities, as one journalist naively wrote. Nor does it show that he has surrendered to arguments put forward by the President of the French Republic. His words are being taken to imply that there will be no more rate hikes. This may be so, but let us admit that stability at 4.25% would not really point to policy change. Above all, though, the ECB's President judged that it was the right moment to make that remark - whilst the price of oil was still falling. Result, a drop in the value of the euro against the dollar, a welcome small boost for the zone's exports and a continuation, even an acceleration, in the price fall of Brent oil.

Let us focus on the timing. Such words would have had no effect had they been spoken when oil prices were rising. This shows that you can do a great deal with a mandate viewed as too rigorous and rigid by those who dream of modifying it.

Naturally, the duration of this easing of is not predictable.

Are the new accountancy standards to be modified?

It is known that, because of the IFRS's calamitous accountancy standards, financial institutions' assets are henceforth publicly and permanently appraised at market prices or, lacking that, on the basis of internal models. This scheme demonstrated its harmful effects during the present crisis, with the brutal and oft-times irrational market swings having serious consequences on large banks' asset values, despite their being in no intrinsic difficulty. Alas, those who inspired these mechanisms, and for whom markets cannot be wrong whatever the outcome, will not abandon their totem. However, one could modify the instrument, for example by publishing both values, the historic one and that of the market, at least for those assets held in reserve until the end of their term for which current market value has no true founding.

Expression of the month: "planning for economic revival".

This is the sole topic. Spain declares 20 billion euros, Germany hesitates. In France, the government, accused of inertia, replies that it had already planned for (?) a revival as from last summer through the Tépé law. Yet, the futility of budgetary revivals in an open and globalised world - where the sums spent evaporate in imports, savings, loss of confidence and interest rate hikes - needs no further demonstration. France has frequently experienced this. And Japan, which quite recently and to virtually no effect spent colossal sums, bringing its public debt up to 180% of its GDP, has started all over again by announcing a plan involving almost 50 billion dollars!

As far as Europe is concerned, we need concerted action targeting clearly defined objectives (e.g. those on the Lisbon agenda) with participation from the BEI. However, the European Union, which has a single central bank, chose to give itself a Minister of Foreign Affairs (whose usefulness was not evident during the recent Caucasus crisis) rather than an Economics Minister.

The euro zone does not deserve this.

Last month, I wrote that the situation was far healthier in the euro zone than in the United States. I stick to this. So, why this fall in the GDP for the second quarter? Inflation, of course, oil, and their effects on household purchasing power. But there is something else. Yet again, countries in continental Europe are feeling the full effects of collateral damage from a crisis born across the Atlantic, one for which they are scarcely responsible. The inflating and deflating stages, harsh or otherwise, of the various American bubbles (internet, property, etc.) are mainly passed on through the markets, in particular the stock exchange. Anticipating new and massive depreciations, and given the problems of Freddie Mac and Fanny Mae, Wall Street takes a dive and the European stock markets rush to amplify the trend. Then the morale of business managers plummets, joining that of households which are permanently seeing black in certain countries (ours in particular, where it becomes schizophrenic when at the same time we learn that French women are the European champions for fecundity!). The plunge in house sales in the second quarter has clearly put the brake on growth; there, too, the American debacle is paralysing decisions to purchase because of fears of a price crash in Europe. It should be noted, however, that the bad news for European growth has not caused - not even for the French (!) - the least criticism of ECB policy!

Inflation: light at the tunnel's end?

Are we about to see a slow-down in the pace of price rises just as most analysts are ringing the death knell? In France, the rhythm of inflation annualised over the last three months (with price changes negative in August) is 2.5%, i.e. more than one point below the inept slide over the cherished 12 month period, but one whose evolutions are as much formed by year-old data as by recent figures. A lowering of prices for raw commodities and food, as well as for oil (which lately has resumed downwards, having hesitated) clearly augurs well for the immediate future. Careful, though! In a domain where anticipation plays a major part, the moderate level of long term interest rates is encouraging, but the situation in the US is far from clear. Ben Bernanke means to be encouraging but there are some worrying indicators, such as soaring production costs (nearing a 10% annual hike) and the famous "underlying inflation" (which does not take into account energy and fresh foodstuffs), an indicator so dear to authorities and now reaching 3.5%. One might well wonder if the FED boss's optimism really supports an interest rate of 3.5% that is negative in real terms.