



JEAN-PIERRE PATAT'S MONTHLY CHRONICLE

A former central banker looks at the news

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Figure of the month: 26% - the proportion of poor globally. They were 52% in 1981, but there is no decline in sub-Saharan Africa.

The United States of America: delicate management of the 'moral hazard' factor.

The 'moral hazard' is the risk of encouraging the continuance of unsound management by going to the rescue of a failing financial institution.

In this respect, the US authorities have done well over past weeks. For Fannie Mae and Freddie Mac - on whose survival depends the financial lot of tens of millions of households - we see what is to all intent and purpose a process of nationalisation. And this despite the calamitous management of these organisations, that have shamelessly profited from their image as state-guaranteed bodies. Authorities are trying to find an arrangement with a consortium of banks for Lehman Brothers, a merchant bank funded by the markets and with a small private clientele. Should this fail, though, there is no question of using public funds, and the 'moral hazard' factor applies. Note that Lehman Brothers, being a merchant bank, is not under Fed supervision, and this fact probably has something to do with its downfall. As for AIG, whose survival equally affects tens of millions of citizens, the tenet of 'moral hazard' is quashed; given the institution's particularly opaque management with past profits seeming in the main to result from off-shore murky financial deals, there is no question of having the tax-payer foot the bill. The outcome, therefore, is a complex funding arrangement with a Fed loan of 85 billion dollars to AIG for two years at a high interest rate (libor + 850 base points) and with AIG's assets held by the Treasury as security. What is more, since this untimely injection of central money coming from a Fed loan has to be 'sterilised', the treasury is issuing 85 billion dollars in bonds to the banks and placing the money in its own account with the Central Bank. Great footwork!

What sort of provisional conclusion can be reached? That the US authorities are better at managing crises than avoiding them, and are even better at managing them than avoiding provoking them.

The latest crisis development is a plan for a gigantic state buy-out of toxic assets. "Bravo" is the unanimous reaction. Yes, of course! But when we compare this to the unwillingness to add 2 or 3 billion dollars to the Fund against AIDS and tropical diseases... Immortality does not guarantee efficiency.

Is a new Bretton Wood needed?

That a global consensus is required to bring about various reforms is clear: no fuss needed to implement concrete measures such as plugging the giant holes in regulations (merchant banks, hedge funds etc.); introducing competition and improving ethics in the running of appraisal agencies; polishing the new accountancy norms; and supervising the introduction of securities. Do we, in effect, want to totally revise the present financial system? To reverse the liberation of the movement of capital? And above all, do we want to return to the wholesale interventionism of the 1950s and 60s, when almost all financing came from banks, whilst, since their liberalisation, the money markets have shown their worth? Some may dream of going back. But, to use a well known expression, do we want to throw out the baby with the bath water?

The (swear) words of the month: 'those responsible'.

This expression was used in front of the United Nations Assembly by the President of the Republic, saying that those responsible should be found and punished. From skepticism to derision, all reactions are negative. 'We are all guilty', is the response from the abominable politically correct. Everyone is guilty - the managers of Fannie and Freddie, bosses of hedge funds, and let us not forget those modest savers who buy securities hoping for an adequate return. If that is so, why seek out those responsible for a plane crash, since passengers who choose to travel on a budget airline are also 'responsible'? Examples of this sort abound. It's the system's fault, they tell you. Well, it isn't!!! Finding those responsible and analysing what they did is indispensable if we really want to understand what started the crisis, and at last fine tune measures which could bring order to the financial system.

Euro zone: who is the worst off?

'France, our country', chorus economists, analysts and commentators. Comparing ourselves with Germany (ah, those Germans!), its growth in 2008 of between 1.5 and 2% leaves us far behind (1%). The GDP is an average of results over one year; it is true that at the end of the period, the Germans will have grown richer than us and this is important. But as a trend, to know where we are headed, which of the two countries is in the least poor position? Ours! Germany surfs on the 'gains' of a magnificent first quarter (1.5%), whilst we grew by only 0.4%. That early gain was sufficient to give Germany a comfortable result for the whole of 2008, yet forecasters reckon that its growth will be negative in the coming quarters. On the other hand, these same forecasters predict positive (though not brilliant) growth for France for these matching quarters - quarters whose relative weighting in calculating the average diminishes as we move from the start of the year. We, therefore, will show poor performance for the quasi totality of the final result, weighed down by our weak 'gains', even though our trend is less calamitous.

Oil: an outlook of yet more price hikes.

Each US citizen consumes 25 barrels of oil a year, each Chinese 2, each Indian 1, each European 14. Allowing a catastrophic hypothesis of China and India catching up with US consumption, a rise of about 40% in world demand would ensue. A more moderate scenario, with American, Chinese and Indian consumption 'limited' to the European level, would result in an increase of 20% in demand - all things being equal in other respects (Africans will soon number one billion). Conclusion: barring a technological revolution which will not come tomorrow, surges in the cost of oil are far from over. We can, hence, ascribe its true value to G. Soros' remark (he who always has something to say to the media) when he translates the present (but fragile) decline in crude oil prices as a sign of ... deflation most definitely requiring an immediate lowering of interest rates.

Basel 2: are there unwanted outcomes?

Two elements could cause a problem: i) the evaluation, by appraisal agencies whose present successful actions we are familiar with, of the quality of bank assets, and ii) risk estimation by the banks' own internal models. Experience has shown that these models take too much notice of the past (as models do), and that bank managers are reluctant to admit that what used to happen every thousand years might well henceforward occur every decade.