The ECB failed to make the euro irreversible (Christophe Brochard)

Posted on May 2, 2017 by Cyceon in Economy / Interviews

Support *Cyceon* with **8 euros**: Become a Member.

Christophe Brochard, an independent investment advisor and asset manager, is among the growing number of experts who believe that the **euro is not irreversible** and that **leaving the euro zone is possible**. The return of the "convertibility risk" indicates this, explains Christophe Brochard, adding that since **97% of the French public debt** is in national law contract, it **can be paid off in francs** in the event of a Frexit, a France exit from the euro zone. Considering that the euro presents the "congenital defect" of an undervaluation for the most economically solid countries and an overvaluation for the weakest, Christophe Brochard concludes that no monetary policy can fix such a fault. He responded to *Cyceon*'s questions:

Version française disponible ici.

Background

A philosopher by training, **Christophe Brochard** is an independent investment advisor, and a wealth manager. He cofounded *Brochard Finance*. He is also a member of the asset management company *Financière Galilée*'s investment committee, and he teaches a Master in wealth management at Strasbourg's Law University. He specialises in investment strategy and in direct investment in company capital. He won, in May 2016, the contest for best fund selectors organised by the journal *Les Échos – Investir*, and since 2010 he contributed to saving the Mulhouse company *Manurhin*.

The Interview

1) The rate of French 10-year bonds rose substantially due to the increased political risk given the uncertain result of the coming presidential election in April and May 2017. What does such an upward trend imply? Does it mean that the French public debt will become unsustainable? In short, is France headed for default?

C.B.: We haven't reached this point! After having tripled between last November and mid-March, the French 10-year borrowing rate (rising from 0.35% to 1.10% in mid-March 2017) remains historically low. France still borrows at negative real rates, and the Agence France Trésor (AFT – French Treasure Agency) keeps reducing the overall cost of the French debt when refinancing it. The default risk is thus still a long way off.

In fact, we are witnessing a more general movement on the euro zone rates, which is very important because of its significance: it is the return of the "convertibility risk." This is how Mario Draghi called it in his historic press conference in July 2012, when he announced that he wanted to save the euro "whatever it takes."

Besides usual bond risks, investors in euro zone bonds need to hedge against the "convertibility risk," i.e. against the risk of being repaid in another currency than the euro, if the borrowing country were to leave the common currency. Countries whose investors deem that currencies would be devaluated in the event of an exit of the common currency thus see their borrowing rates increase (investors seek to offset the risk of loss on exchange rates by rising the borrowing rate), while conversely, countries who would witness a currency appreciation, in the event of an exit of the common currency, see their borrowing rate decrease over the same period.

This is exactly what is happening these months on European rates: the 10-year borrowing rates of southern countries, and France, increase substantially (those are the countries whose currency would be depreciated compared to the euro); while German rates remain low, despite the return of growth and inflation. With the convertibility risk, the European rates market slowly but steadily becomes a money market substitute again, where investors speculate on the level of future national currencies.

The return of this convertibility risk today, while we are at the height of the ECB's monetary injections, tells us something very important: the TLTRO, the negative rates and the historic monetary injections of the ECB were unsuccessful in making the euro

MEMBERS AREA

> Login
> Members only
> Logout

SUPPORT CYCEON

with ju

I SUB

Secu

Cyceon is fully inde
production costs mu
support is **crucial**.

HEADLINES

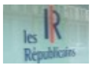

François
Républic
or disap


Very hur
compare
Kennedy


If Emma
elected, I
political

TALK


Is Emma
of a new


France's
must lea
dissolve


Obama's
tower wi

IN BRIEF

irreversible.

2) The Front National (FN) candidate, Marine Le Pen, would worry the financial markets because she wants the exit of the euro zone as well as the *Frexit*, namely the exit of France from the European Union (EU), in the manner of UK's *Brexit*. Should this happen, do we risk the much-speculated catastrophe scenario of having to pay a debt denominated in euro when we would be back to the franc? Which assets can we readily invest in so as to guard against an adverse conversion effect?

C.B.: Despite the current political turmoil, we cannot say that the markets are panicking! Investors, on the contrary, incorporate the convertibility risk in the borrowing rates of the zone's member states, in complete composure (at least for the time being).

What would happen in the event of the exit of a country from the euro zone depends on the nature of bond contracts that make up the country's debt. In France, over 97% of the public debt is in national law contract, meaning that, unlike what is often repeated, if France were to exit the euro, the money-lenders would be repaid in the future national currency, with no particular difficulty. This is not the case for countries whose debt was restructured by the Troïka, Greece in the first place (1).

3) Greece returns to the front-page of financial news after nearly nine years of a crisis that seems never-ending. Italy stares into the abyss with a banking system that is under-capitalised and overloaded with doubtful receivables. Does this herald the inevitable end of the euro, as Alan Greenspan, former president of the U.S. Federal Reserve System, said? Considering the "new mediocre" shown by the slow economic growth in Europe, where then are the billions of euros injected by the ECB?

C.B.: Europe is the victim of its leaders' historic collective delusion, that is to think that a monetary or fiscal policy could resolve the effects of the euro's structural faults, all while retaining these faults.

Indeed, the congenital defect of the euro, which is still very little analysed today, is the following: the euro, the common currency representing the wealth of the 19 countries that adopted it, is first and foremost an "average currency". This means that the euro is structurally undervalued for the most economically solid countries (particularly Germany), but it is structurally overvalued for the least economically robust countries (Latin countries). It all starts there: the German trade surpluses on the one hand, and the Latin countries' slow descent into the hell of debt and deindustrialisation for 15 years on the other. No monetary policy, however brilliant and ambitious, can fix this defect.

To sum up, when Mario Draghi brilliantly succeeded in bringing the euro down by more than 30% against the dollar in the past two years, it was to increase the euro zone's export competitiveness and to boost growth. However, the increase in growth was in fact very insufficient, despite historically favourable conditions for the euro zone (2).

The reason is obvious, if one is willing to look at it: only 10% of the exports of the euro zone countries are destined for countries outside the euro zone. The decline of the euro thus did not change anything for 90% of the euro zone countries' exports, because they are destined for countries that share the same currency. Moreover, Germany accounts for a large share of the 10% of exports to countries outside the euro zone, which are the only countries to have benefited from a more favourable exchange rate.

In 2016, despite the billions injected by the ECB, the TLTRO, the negative rates and the euro's 30% decline against the dollar, Germany announced – thanks to the combined effects of an undervalued currency for over 15 years – the highest trade surplus in the world at 297 billion euros, of which a significant part towards the euro-zone countries. France, on the other hand, announced a record trade deficit of 48 billion euros, of which a significant share with Germany. Growth has therefore barely picked up.

For that reason, the monetary policy, whatever it may be, cannot have an impact on restoring the trade balance between the euro-zone countries. With the decline of the euro zone over the past two years, we left Jean-Claude Trichet's euro-mark (a monetary policy tailored to Germany), to enter the era of Mario Draghi's euro-lira (a monetary policy tailored to southern countries). Yet, neither Trichet's strong euro nor Draghi's weak euro have allowed to stop the increasing discrepancies between Germany and the Latin countries of the euro zone since the creation of the euro – in terms of trade balance, as well as debt trajectory, growth, and foreign direct investment.

For a monetary devaluation to be effective (all central banks in the world know this), the currency must be devalued against that of the main trading partners. Latin countries' currency should thus be devalued against Germany's currency. Consequently, is there no alternative to the exit from the euro? This is what, in my opinion, the gap in credit rates and the return of the "convertibility risk" mean: while we are at the peak of the ECB's monetary injections, and the return of the inflation will compel the ECB to reduce its monetary injections from April on, the euro is thus not irreversible.

Historically, all supranational currencies have collapsed. Similarly, each time a country has indexed its currency on the exchange rate and interest rates of another country (Argentina), it always ended badly: the euro does not seem to be headed for an exception.

Notes

(1) Christophe Brochard points out that this risk of a debt in euros, with a strongly devalued currency in the event of the exit from the euro, is a certainty for countries whose debt was restructured by the Troïka, particularly Greece: in this case, the money-lenders merely discarded the "convertibility risk" of the Greek debt, by making it mandatory to repay it in euros. The Troïka has therefore made the default inevitable, whether Greece exits the euro zone or not (as the IMF has repeated for several years). Let's not forget that France acts as guarantor of 68 billion euros of the Greek debt.

(2) What the markets called the alignment of the planets: interest rates close to 0%, a euro devalued by more than 30% against the dollar, and oil price enduringly halved.

Illustration photo by Wouter van der Veen and provided by Christophe Brochard.

Translation from French to English : Amélie Drouet.

When it's Macron, it's
it's true

The Italian national a
disappear

Alstom receives a new
Coradia Continental t

Imprisonment of an A
amid bilateral tension

In France, Defenders
demonstrating agains

RELATED POSTS

- Growth in Russian banking sector
- Strong trade balance deficit for France
- No monetary policy at face value
- 42 billion euros, optimal military budget for France
- Euro brought sustainable openness
- European political risk could be underestimated
- QE vs. Rate Hike, European vs. American markets
- No Greek relief, Germany said
- €315 billion for EU's growth & jobs
- Fed, ECB confirmed "moderate" growth ahead

Banking | Brochard Finance | Christophe Brochard | Debt | ECB | Economy | Euro | Europe | Finance | FOREX | Money | Politics | Rates

Cyceon is fully independent and its production costs much money, so **your support** is **crucial** :

I SUBSCRIBE

ARTICLES


François Baroin and Les Républicains (LR) must evolve or disappear


Very humble pro-Macron youth compare their candidate to Kennedy


If Emmanuel Macron gets elected, France risks a deep political crisis


The United States will toughen its stance on North Korea and Iran


In all likelihood, François Fillon has been the target of a successful operation

IN BRIEF

When it's Macron, it's false, when it's Fillon, it's true

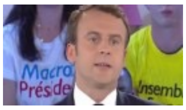
The Italian national airline Alitalia may well disappear

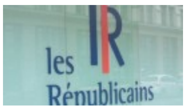
Alstom receives a new order for 25 regional Coradia Continental trains

Imprisonment of an American in Pyongyang amid bilateral tension

In France, Defenders of Democracy are demonstrating against … Democracy

TALK


Is Emmanuel Macron the leader of a new totalitarianism?


France's Les Républicains (LR) must learn to fight for real or dissolve


Obama's coterie and the

POPULAR


Immigration divides America and the Silicon Valley


China Sea, the next likely epicenter of volatility


Deflation risk in the euro

Trump tower wiretap scandal

zone ruled out for now

France could fall into a major political crisis

Fake News is clearly a major power issue

Markets implications of France as a member of EU periphery

Some more turbulence's coming from the Mideast

FOLLOW US

Economy / Interviews

Leave a comment

« If Emmanuel Macron gets elected, France risks a deep political crisis

France's Les Républicains (LR) must learn to fight for real or dissolve »

LEAVE A REPLY

Your email address will not be published. Required fields are marked *

Name *

Email *

Website

Comment

Cyceon is a **World, French and Political News** service.

About us - Contact us - Terms and conditions -