The information contained here is based on or derived from information generally available to the public from sources believed to be reliable. No representation or warranty is made or implied that it is accurate or complete. This has been prepared solely for information purposes and for private circulation and does not constitute any solicitation to buy or sell any instrument, or to engage in any trading strategy. Markets can be volatile and opinions may change without notice. The opinion expressed here is solely that of the author and does not purport to represent the views of Axis Bank.

MOVING BEYOND ENDLESS QE’S & THE LIQUIDITY TRAP

21st June 2012
Global risk aversion has diminished the risk taking ability of market participants. The relentless & synchronous austerity measures adopted simultaneously by most Western economies is being touted as a panacea for the debt binge (consistent misallocation of capital and insistent misuse of debt) of the last decade. However if everybody deleverages at the same time, the consequences are not very difficult to gauge. We are truly in a downward spiral, and coordinated monetary easing is not resulting in money going into the real economy because no one wants to borrow since each and everyone is already deleveraging(liquidity trap at the lower bound of interest rates is contributing in this pessimism here as well). Banking assets that have turned bad must be quarantined into a Bad Bank that is placed directly under the respective Banking supervisor. It is important that there is a clear demarcation of bad assets into the single “Bad Bank” which will have separate recovery targets and capitalization. The rest of the “good banks” could only then function better with better credit targeting and allocation without the haunting fear of the ghosts of the past which irrationally constrains credit even to deserving candidates.

In an era where every private entity is deleveraging, the State cannot also simultaneously deleverage. To rationalize take a simple case: In a closed economy, where there are only two agents, you and me, my spending is your earning and your spending is my earning. The entire world is a closed economy. If everybody is deleveraging, if unemployment is high, wherefrom economic growth will come? Hence the State has to spend by borrowing, no matter if it is already neck deep in debt. So, are we talking like the two K’s: Keynes and Krugman? And what about the lessons from Reagan, Thatcher & the highly acclaimed Chicago clique? Surely Reaganomics and Thatcherism taught us that there is a lot that Keynesian thinking missed out upon. Sure. And that is follows:

After forceful public spending lifts the economy from the depression, the private sector develops the 'animal spirits' to restart investment, borrowing and hiring picks up. In this stronger phase of economic growth the private sector is more efficient than the public sector. Now here is where Keynes writings did not resolve issues because he wasn’t around to witness the decadence of public enterprise in the 1970’s in the US/UK, and indeed in much of the globe including the USSR. However it was getting very obvious that in the 1970’s, the size of the public sector was inefficient, gigantic and it was trying to borrow money from the same public resulting in crowding out of the more efficient private sector. The need of the hour then, was to cut down the size of the government and restrict the role of the state to only those areas where no other actor could qualitatively contribute. That's where Reagan and Thatcher came in, in the 1980’s.

But this is 2012. The situation is different. We are entering a global depression.

The only way out for a global recovery to gain ground is that Governments globally borrow massively * and invest directly in the productive sectors of the economy. Roosevelt's "New Deal" needs to get replicated and for that to happen we need to really ignore traditional thinktanks like the IMF that had messed up in Latin America in the 80’s and S.E. Asia in the late 90’s and are now looking to repeat the same errors in the Western world.

Those who hold Reagan and Thatcher in great esteem can come in later, say in 2016, if by that time the global economy has been safely pulled out of the woods, and the private sector is getting back its mojo. By all means then, dismantle the government and cut down upon activities that the private sector can do better. There will be lethargy on either ends of the economic cycle. Functioning democracies can tackle this type of lethargy and rent seeking on either ends of the cycle provided institutions are allowed to function the way they ought to.

*The only way out is for Governments globally to ignore the rating agencies in the defacto Force Majuere situation we find ourselves in and borrow massively a la Marshall Plan and invest directly in the productive sectors of the economy.

The information contained here is based on or derived from information generally available to the public from sources believed to be reliable. No representation or warranty is made or implied that it is accurate or complete. This has been prepared solely for information purposes and for private circulation and does not constitute any solicitation to buy or sell any instrument, or to engage in any trading strategy. Markets can be volatile and opinions may change without notice. The opinion expressed here is solely that of the author and does not purport to represent the views of Axis Bank.
Strategy
Anupam K Mitra, AVP
Financial Markets Group, Global Markets- Treasury
Axis Bank
Treasury, Global Markets Group
Contact details – 66043222, 42026622. anupam.mitra@axisbank.com

Standard Disclaimer:
The report and information contained herein should not be altered in any way, transmitted to, copied or distributed, in any manner and form, to any other person or to the media or reproduced in any form, without prior written approval of Axis Bank. The material in this document/report is based on facts, figures and information that are obtained from publicly available media or other sources believed to be reliable and hence considered true, correct, reliable and accurate but Axis Bank does not guarantee or represent (expressly or impliedly) that the same are true, correct, reliable and accurate, not misleading or as to its genuineness, fitness for the purpose intended and it should not be relied upon as such. The opinion expressed (including estimates, facts, figures and forecasts) is given as of the date of this document is subject to change without providing any prior notice of intimation. Axis Bank shall have the rights to make any kind of changes and alterations to this report/ information as may be required from time to time. However, Axis Bank is under no compulsion to maintain or keep the data/information updated. This report/document does not mean an offer or solicitation for dealing (purchase or sale) of any financial instrument or as an official confirmation of any transaction. Axis Bank or any of its affiliates/ group companies shall not be answerable or responsible in any way for any kind of loss or damage that may arise to any person due to any kind of error in the information contained in this document or otherwise. This document is provided for assistance only and should not be construed as the sole document to be relied upon for taking any kind of investment decision. The recipient is himself/herself fully responsible for the risks of any use made of this information. Each recipient of this document should make his/her own research, analysis and investigation as he/she deems fit and reliable to come at an independent evaluation of an investment in the securities of companies mentioned in this document (including the merits, demerits and risks involved), and should further take opinion of own consultants, advisors to determine the advantages and risks of such investment. The investment discussed or views expressed herein may not suit the requirements for all investors. Axis Bank and its group companies, affiliates, directors, and employees may: (a) from time to time, have long or short positions in, and deal (buy and/or sell the securities) thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn commission/brokerage or other compensation or act as advisor or lender/borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The applicable Statutory Rules and Regulations may not allow the distribution of this document in certain jurisdictions, and persons who are in possession of this document, should inform themselves about and follow, any such restrictions. This report is not meant, directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would not be in conformation to the law, regulation or which would require Axis Bank and affiliates/ group companies to obtain any registration or licensing requirements within such jurisdiction. Neither Axis Bank nor any of its affiliates, group companies, directors, employees, agents or representatives shall be held responsible, liable for any kind of consequential damages whether direct, indirect, special or consequential including but not limited to lost revenue, lost profits, notional losses that may arise from or in connection with the use of the information. Prospective investors and others are cautioned and should be alert that any forward-looking statements are not predictions and may be subject to change without providing any notice. Past performance should not be considered as a reference to future performance. The disclosures of interest statements if any included in this document are provided only to enhance the transparency and should not be construed as confirmation of the views expressed in the report. The views expressed in this report reflect the personal views of the author of the report and do not reflect the views of Axis Bank or any of its associate and group companies about the subject company or companies and its or their securities.

The information contained here is based on or derived from information generally available to the public from sources believed to be reliable. No representation or warranty is made or implied that it is accurate or complete. This has been prepared solely for information purposes and for private circulation and does not constitute any solicitation to buy or sell any instrument, or to engage in any trading strategy. Markets can be volatile and opinions may change without notice. The opinion expressed here is solely that of the author and does not purport to represent the views of Axis Bank.