

### **The Pilgrimage to Davos**

The annual conference of the World Economic Forum (WEF) in Davos has become a mandatory pilgrimage for the elite in the business world. (Some attend it as faithfully as the devout Muslims go for the Haj. There is one difference: the pilgrims to Davos have to pay as much as \$ 70,000 each for the privilege of attending!) The 44 year old WEF is “committed to improving the state of the world”. Most make the pilgrimage for networking rather than anything else.

The meeting took place in the background of a boom in many financial markets: the indices are trading at record highs in too many countries. This apart, memories of financial market participants being short, and given also the easy and cheap money in most of the developed markets, too many seem to have forgotten the financial crisis of 2008. Leveraged buyouts are back in fashion with lenders only too willing to hand over the money, that too without prescribing any tight conditions (the so-called “covenant lite” loans); so are the payment in kind (PIK) bonds under which if the borrower is unable to pay a coupon in cash, the holder gets another bond! Commercial mortgage backed securities (CMBS) are once again finding favour with investors. And, initial public offerings of technology stocks are being priced at multiples to sales, not profit – because there are not any. Twitter is valued at \$ 40 bn when its last reported annual sales (2012) were barely \$ 300 mn. One is inevitably reminded of the dotcom boom of the late 1990s, which became a bust in early 2000.

To come back to the conference itself, there were three main concerns which seemed to have dominated many of the discussions:

- The deflation caution from the IMF, even as it increased global economic growth forecast for 2014;
- The several emerging market currencies including the rupee which have come under pressure in the last week; and
- The growing income equalities.

While growth has picked up in the Anglo Saxon economies, the euro zone also seems to have stabilized and, at the moment at least, the future of the euro does not seem to be in question. The major problem highlighted by the Managing Director of the IMF is that, despite years of easy money and practically zero interest rates, inflation remains below the central banks’ target. Also, the corporate sector, particularly in the US, is sitting on huge piles of cash, not undertaking expansion or new project investments. Could disinflation, i.e. falling prices, actually set in, as it has for years in Japan? Disinflation can have significant multiplier effects on growth as both consumers and investors in the real economy would prefer to wait to get better prices, adding to

unemployment pressures: as it is, the ongoing technological revolution and interconnected mobile devices may well reduce employment opportunities, at least for the less skilled.

The other major concern at the conference was the recent sharp fall of many emerging market currencies like the Argentinean peso, Brazilian real, Chilean peso, Russian ruble (the superpower of two decades back is now an emerging market!), Venezuelan bolívar, the South African rand, and Turkish lira: obviously, the rupee is not alone.

The major point for discussions was the increasing income inequalities: the WEFs Global Risk Report and a research paper from Oxfam International highlighted this phenomenon (see *The Other Side*, January 16, 2014). Some of the numbers are staggering. The richest 1% own half the world's wealth, amounting to 65 times what the bottom 50% have! The wealth of the richest 85 individuals is equal to that of the bottom half. Is this fair and just or, as the Chinese philosopher Mencius wrote a long time back, *"one cannot become wealthy without being unjust."*?

The Davos pilgrims also voiced their concerns about the issue in various conferences and dinners. However, they also believed that it is for the governments to do something to reduce the inequalities, not so much the private sector. Interestingly, the total compensation paid to the chief executive of J.P.Morgan increased 74% in 2013, a year in which Morgan paid penalties aggregating \$ 20 bn for malpractices and lack of internal controls! To quote from a letter in the Financial Times (January 24), *"When a shoplifter can go to jail for stealing an item worth £50, why is it that a banker can literally defraud other parties of tens or hundreds of millions or more, and the bank just be 'fined' amounts it can clearly afford? (And still pay bonuses on top!) It is obviously the banker who is much more damaging to society."*

Interestingly, even the IMF Managing Director warned of the risk to global economy of income inequalities. This is strange given the fact that the IMF's own research suggests that capital account liberalization and fiscal consolidation contribute to increased inequality (Finance & Development, December 2013, – *Who Let the GINI Out?*). Such research obviously does not constrain the IMF in promoting capital account liberalization and preaching the virtue of balanced budgets to the developing world!

Perhaps the most ominous point was made by the Japanese Prime Minister who said that the present state of the relationship between his country and China, is comparable to that between Germany and Britain a century back. Remember the First World War which started in August 1914?

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