The Other Side December 31, 2015

**Some end-of-the year thoughts**

As we come to the end of 2015, it looks like one megatrend of the last few decades of the International Monetary Fund, and relatively right wing governments. The financial economy would continue to be the master of the real economy – rather than playing a supporting role.

One example is the currency market. We have almost forgotten the purpose for which it was born: to facilitate cross-border trade in goods and services. Since the birth of the floating rate era, and the IMF's ideological belief in a library capital account and market-determined exchange rates, has hugely benefited banks hedge funds, currency funds which "trade" i.e. speculated in currencies even in the volatility of exchange rate has increased risks for the tradeable sector for the global economy. To give just one example from the last year, the euro fell forces $ 1.22 to $ 1.05 in the first couple of months of the year, even as US inflation was higher than the euro zone's. As Nobel Laureate Robert Mandell waited a few years back, "from essay"? **To quote from an interview by Nobel Laureate Robert Mundell (The Wall Street Journal, October 18, 2010), "*The whole idea of having a free trade area when you have gyrating exchange rates doesn't make sense at all..... All this unnecessary noise, unnecessary uncertainty; it just confuses the ability to evaluate market prices.*"**

And not only currencies. The power of the financial economy also extends to commodity prices, increasingly dominated by speculators. One example, the oil market one element in the FICC segment of global bank treasuries: fixed income, currencies and commodities. Major bank's exposure to speculating in oil price fluctuations has reached a level where regulators are stiffening stress tests on their trading portfolios.

Even the third element of FICC, namely interest rates, long the preserve of central bank seems t be increasingly coming under the influence of financial markets. To quote Stephen Roach from a recent project Syndicate article "*the Fed, like other major central banks, has now become a creature of financial markets rather than a steward of the real economy.*". Overall one should not be surprised that the "markets right and wise", any interference wrong and foolish" ideology has led to major crises once a decade for the last 30 years: the savings and loan crisis of the late 1980s; the crisis in Asia Brazil and

Russia in the late 1990s; the mortgage market crisis of 2007-08. Will we see another major financial market driven crisis as we come nearer to the end of the second decade of the 21st century? **Or as John Kay wrote some time back, in an article in the Financial Times (November 2, 2011) "*A semantic confusion leads us to use the word market to describe both the process which puts food on our table and the activity of gambling in …*(financial markets)*"*.**

In Europe, the six-year old crisis in Greece will likely continue for at least 2016, if not longer. It is difficult to see any end to the fiscal austerity mantra so long as Germany remains the dominant power in the euro zone. There are some signs that other member countries, in particular Italy, are also getting tired of the extremely imposed fiscal politics. While a break-up is unlikely, Europe is likely to continue to face an influx of refugees from the middle-east and North Africa. This is adding to the discontent of the unemployed, and recent election results suggest the growing popularity of relatively right wing parties, in countries from Poland to Spain.

Both China and Japan are likely to continue their acquisitions and investments abroad. Chinese may continue on the zero growth, zero inflation path for some more time.

What about the world's fastest growing major economy, namely India? It is difficult to see any major change whether positive or negative, either in the macro-economic policies, both fiscal and monetary or in ease of doing business. But growth rates of 7 or +/- may well continue to come out of Delhi, with little reassuring data at the micro level, and despite overvalued exchange rate. Falling exports, and very high real interest rate at least in terms of the wholesale price index (WPI).

A.V.Rajwade (avrajwade@gmail.com)