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Freezing snows and melting economies

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The 2013 annual meeting of World Economic Forum (WEF) , which concluded last week in the skiing paradise of the world, Davos, Switzerland, was a subdued affair.

The Davos meetings are not official gatherings on the lines of leaders of eight industrialized countries or a larger group of both developed and developing countries, known as G-8 or G-70. The WEF is a jamboree kind of affair usually attended by elite business barons and investors, including the currency speculator-turned philanthropist, George Soros. Readers may recall during the days of British membership of European Exchange Rate Mechanism (ERM), he brought down the value of the British pound in 1992, making billions of dollars. That also led to Britain's exit from ERM.

The WEF meetings are usually addressed by chiefs of International Monetary Fund (IMF) and central banks and by European leaders.

The Davos' spirit this year was just as freezing as the weather outside the Forum venue. It may be partly due to the absence of colorful personalities including Bill Clinton.

Low spirit

Low spirit was more because of what IMF had called "the fragile and timid recovery" by Eurozone. Further, the weak economic prospects in the world's largest economy, the United States (US) and the third largest economy Japan, despite the second largest economy, China growing with enormous appetite for the world's mineral resources, have had a dampening effect on the Davos meeting.

The participants were trying to look to the future with some optimism. After all, the much feared downfall of euro has been averted. Remember the grave pronouncement of the year:

"Within our mandate, the European Central Bank (ECB) is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

That was from ECB President Mario Draghi, who stood ready to make unlimited purchases of government bonds in secondary markets. It was not the objective of the so called Outright Monetary Transactions (OMT) to fund the distressed Eurozone governments, but to "preserve the singleness of ECB monetary policy and ensure the proper transmission of policy stance to the real economy throughout the area". Reactions of markets were swift. The spread of Italian and Spanish bonds between the solid German bonds narrowed. Funding the distressed governments was only a by-product of OMT.

Some good news too!

A large part of ECB emergency lending to European banks a year ago was being repaid early. With the fears of US fiscal cliff disappearing, and the debt ceiling of US$ 16.4 trillion being suspended for three months, there was some relief. That was duly reflected in the stock market performance: The Standard & Poor 500 index rose above 1500 points on Friday January 25, the highest since 2004 and the FTSE Index also reached the highest in 20 months.

There were some brave statements. Referring to austerity conditions imposed on distressed countries, ECB President declared the question of austerity versus growth was nonsensical:

"The question is not growth versus fiscal consolidation, but it is how we mitigate the negative effects of short term fiscal consolidation."

On her part, the IMF Chief welcomed the Japanese Prime Minister's initiative and Bank of Japan agreement to double the inflation target and pump in more liquidity. The Japanese measures are likely to be similar to the US Federal Reserve efforts of quantitative easing, keeping the interest rate low. Defending the new policy, Japan's Minister of Economic and Fiscal Policy was also at pains to deny the intention to weaken the yen to promote exports and get out of the morass.

Sober thought

It came, however, from unexpected quarters.

The speculator king, George Soros observed: "The established theory has collapsed but we haven't actually got a proper understanding of how financial markets operate. We have introduced synthetic instruments, invented derivatives where we don't fully understand the effect they have."

No truer words could be spoken.

On Thursday January 30, the breaking news flashed on the TV screen

The New York Dow Jones Industrial Average index and London FTSE index fell.

Why? The financial markets were rattled by the latest report card on the US economic performance. America which grew at 3.1 percent during the third quarter of the year, July to September 2012, shrank at 0.1 percent during the last quarter of the year, October-December 2012.

The market reaction was unexpected, as the recent indications were different. Fiscal cliff had been settled and debt ceiling has been suspended.

That is how the markets behave!

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