Will the FOMC continue to be patient?

If a June rate hike is to be factored in, the word 'patient' must go from the US Federal Reserve statement. However, its removal would still not mean that a rate hike is imminent

WORLD MONEY

ABHEEK BARUA & BIDISHA GANGULY

A single data point on US employment has swung the consensus towards a June rate hike by the US Federal Reserve, having repercussions across financial markets. Not only did US markets react sharply to the news of strong employment growth, but emerging markets, including India, weakened considerably, as investors became cautious of an early rate hike. Given that markets are quickly pricing in a June rate hike, it is interesting to examine whether there is any case for delaying that hike.

The payroll data for February showed that the US economy added 295,000 jobs, bringing the unemployment rate down to 5.5 per cent. This is close to the non-accelerating inflation rate of unemployment (or NAIRU) for the US, the point at which the economy begins to overheat and the rate of inflation accelerates. Yet, there is no sign of that happening. Personal consumption expenditure inflation remains tame at just 0.2 per cent, while the Consumer Price Index printed negative in January. The fall in the unemployment rate was accompanied by disappointing wage growth and an increase in the number of people dropping out of the labour force, raising questions about the strength of the recovery.

At the same time, US retail sales fell in February, making it the third consecutive month of decline. While this is being attributed to bad weather, softness in retail sales indicates that Americans have been conservative in their spending habits even though their disposable incomes have been enhanced by the drop in fuel prices. Defying the stereotype, Americans have decided to use their extra income to save for a rainy day or reduce their debt level. US stock markets recovered only after the release of this data point led to a rethink on the timing of the rate hike.

The key question is whether the American economy can accommodate any more strength in the dollar before starting to hurt. The dollar has been rallying against the euro for eight straight months, touching a 12-year high as the European Central Bank begins its quantitative easing programme. The stronger dollar is not only a headwind for the US economy but it is also putting a lid on inflation by lowering the price of imports. In other words, it is doing the work that higher interest rates are supposed to do, that is, tightening financial conditions. Raising interest rates too soon may be an over-reaction to a single data point on jobs.

Yet, contrary opinions continue to be heard, making it necessary for the Fed to state its position on how it sees the currency impacting its rate decision. Retaliating against a slew of complaints from CEOs of large companies with international operations who have been suffering on account of the rising dollar, the President of the Federal Reserve Bank of Dallas, Richard Fisher commented: "It's not the end of the world". He went on to make the rather puzzling claim that sharp gains in the US dollar are good for the US labour market.

After the US Fed releases its post-meeting statement later this week, there will be much quibbling over the language used by it. The key to look out for is whether or not it continues to use the word "patient", when it talks about normalising monetary policy. Fed Chairperson Janet Yellen had earlier indicated that the Federal Open Market Committee (FOMC) uses this word to mean that it does not expect to raise rates "in the next couple of meetings". So, if indeed, a June rate hike is to be factored in, this word must go from the statement. However, its removal would still not mean that a rate hike is imminent. The statement will also be examined for clues on the rate at which the Fed continues to raise rates after the initial hike.

Tailpiece: The Reserve Bank of India justified its out-of-meeting rate cut earlier this month by referring to the global trend towards easing. As currency markets are factoring in an impending rate hike by the US Fed, the rupee has started sliding.

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MUDRA Bank: A catalyst for India's 10% GDP growth

Bringing in the untapped informal sector into the formal one will benefit business and economy. It is to address this large population that the Budget has proposed the MUDRA Bank, says **Rajeev Chandrasekhar**

The mandate that the Narendra Modi government was emphatically given in May 2014 by the people of India, was a mandate for change and a break from the *status quo*; change in our governance and politics, as well as a change in the economic architecture, growth and inclusion.

While the Modi government's first Budget was a status-quoist, placeholder Budget, the Budget in 2015, the government's first full year Budget, is surely redrawing the economic architecture of the country.

The Indian economy is structured as a pyramid, with the rich and middle class as the top two layers of the pyramid and the bottom being the poor, which has been the political focus and the 'intended' recipient for several thousand crores of spending by successive governments. The spending on 'programmes' has continued with little or no change, despite evidence of rampant corruption, leakage and an increasing culture of entitlement rather than enterprise that has taken root in our country. It is this Budget that has started the process of restructuring and developing a more effective way of targeting these spends through its JAM (Jan Dhan-Aadhaar-Mobile) platform.

For all these years, a big part of this economic pyramid has been ignored by the spend-and-forget strategy. This slice of our country's population, amounting to several hundred million jobs rooted in enterprise and hard work, is referred to as the non-corporate or informal sector. For the purposes of this article, I will refer to it as the informal sector.

The Economic Census Survey of 2012 revealed the scale and magnitude of what we have been ignoring for several decades. There are 57.7 million enterprises in India, and it generates employment for 460 million people, of which 262 million people are self-employed. That this long ignored informal sector is a significant part of our economy is obvious from the following statistics. It accounts for 90 per cent of our non-agricultural workforce, 50 per cent of the gross domestic product (GDP) and 40 per cent of the non-farm GDP. This informal GDP is almost completely out of the direct tax net and lacks any formal form of access to credit or risk capital to allow it to grow and join the mainstream economy. A recent Credit Suisse report stated: "Unlike in developed economies, where informality is a deliberate choice to avoid taxation or regulations, in India it is more structural, a reflection of the lack of development and limited government reach."

Reports have concluded that Indian GDP can be raised by almost 15 per cent if the informal sector data is incorporated in the GDP series. Yet, only 4 per cent have access to institutional credit, with loans between ₹50,000 and ₹10 lakh almost impossible, forcing them to go to moneylenders. The non-corporate sector faces stiff competition from larger firms, and are further impeded by the lack of infrastructure and access to easy credit. They are often unable to procure adequate financial resources for the purchase of machinery, equipment or raw materials.

BATTING FOR GROWTH The MUDRA Bank will boost loans and cut borrowing costs for the cash-starved domestic small businesses PHOTO: PTI

Bringing in the informal sector into the formal has many advantages for both business and economy. It is precisely to address this large population of Indians that have been kept out of the economic radar for the last six decades that the Budget has proposed the Micro Units Development Refinance Agency (MUDRA) Bank, which will be set up with a corpus of ₹20,000 crore and a credit guarantee corpus of ₹3,000 crore to help microfinance firms to lend more.

The MUDRA Bank will boost loans and cut borrowing costs for the cash-starved domestic small businesses. It will create a framework that regulates and provides refinancing capital flows to micro-finance institutions that are in turn in the business of lending to micro/small business entities engaged in manufacturing, trading and services activities. This will create and expand the financial ecosystem that is a source of capital and finance to the unbanked and also reduce the cost of capital from the last-mile financers to the micro/small enterprises, most of which are in the informal sector.

The 'change' to our economic architecture could be deep and transformational. It involves funding the unfunded, and unlocking the potential of a new pool of entrepreneurs and future taxpayers in this country. It is encouraging for entrepreneurship across the economic strata. It is using micro finance, an economic development tool whose objective is to assist the lower income groups to develop and grow their small businesses, many of whose owners are traditionally excluded communities such as Scheduled Castes, Scheduled Tribes or other Backward Classes, who own almost 60 per cent of all enterprises in this sector. It represents a real way to make the dreams of millions in the informal sector, long neglected and ignored, a reality. This formalisation of the informal sector would expand the tax-GDP ratio and expand the number of taxpayers and, in turn, government revenues.

This government is right to see the potential of this sector to drive up jobs and taxes. It has realised the force multiplier impact on the economy and tax revenues by a successful formalisation of the informal sector. It has realised the failure of both the Reserve Bank of India and the banking system in credit-supporting this sector. This also is core to this new economic philosophy of supporting enterprise wherever there is a desire for that in our economy, while continuing with better targeted and well-conceived social security framework for the poor and needy. This also marks an end to the Manmohanomics corporate sector-driven growth era and marks a beginning of a deeper and broader enterprise and entrepreneurship-driven economic model. This clearly fits the expectations of 'change' from this government.

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CHINESE WHISPERS

Privacy concerns

Former Union minister and senior lawyer Kapil Sibal appeared in the Sahara case for the first time on Friday. At one point, when the judges asked Sahara to share the details of a proposed deal to raise ₹10,000-crore bail money with the Securities and Exchange Board of India and *amicus curiae* in writing, Sibal expressed concern that these details were confidential and could be deal-breakers if they found their way into the media prematurely. When it was suggested that Sahara should share the details on telephone, judge A K Sikri intervened and said: "(If it is confidential) don't say it on telephone." Those present in the courtroom burst into laughter.

Dog pollution?

The Karnataka State Pollution Control Board is beset with complaints regarding – you guessed it – cases of pollution in the burgeoning city of Bengaluru. The largest number of complaints to the board pertains to noise pollution and, guess what, stray dogs. The staff at the board have coined a term for the second one — 'dog pollution'. These complaints relate to the stray dog problem in the city that is fast assuming menacing proportions.

Enemies and friends

Two days after cruising through the confidence vote, Bihar Chief Minister Nitish Kumar is faced with a strange predicament. Lalu Prasad Yadav (*pictured*), chief of its ally, Rashtriya Janata Dal, was found praising Kumar's one-time protege-turned-foe Jitan Ram Manjhi. Lalu said: "Manjhi is a good man, with wisdom. I have also supported him in the past." Interestingly, Lalu praised Manjhi the same day the latter launched a bitter attack on the Bharatiya Janata Party (BJP) for bringing about his government's downfall, saying he could have mobilised the required number of MLAs had the BJP extended support in advance.

BREAKINGVIEWS | REUTERS

Time to strike

Eurozone recovery may dampen reform drive

BY NEIL UNMACK

Governments are slowing reform across the Eurozone. Brighter economic prospects and loose monetary policy seem to lessen the urgency for tough political choices. Yet the opposite is true: better times should make reform easier and less costly.

The pause in the Eurozone crisis is a not-to-be-missed opportunity for the region's governments. During the 2010-2013 saga they were required to liberalise their economies in a recession whilst simultaneously reining in their fiscal deficits. The European Central Bank's reticence in bringing down bond yields didn't help.

2015 is different. The ECB's new-found conviction to print money and buy government bonds has turbocharged the zone's recovery, as has the low oil price. The central bank expects growth of 1.5 per cent and 1.9 per cent over the next two years, up roughly half a percentage point over its own December forecasts. For once, both the economy and monetary policy could help reform.

Austerity is also on the wane, albeit in a haphazard way. Lisbon's fiscal deficit should fall to around or below 3 per cent of GDP, though mostly due to the recovery. Spain may just miss its 4.2 per cent target. France has secured an extra two years to bring its deficit below 3 per cent of GDP. Yet the fiscal stance is still rigid when unemployment across the zone is twice the rate in the UK or the US, and investment half the average between 1996 and 2000, according to the European Commission. With borrowing costs near or below zero, governments should be investing more while slowly cutting wasteful spending.

Reforms, meanwhile, could move to the back burner. Portugal's reforms have stopped since it left its bailout last year. Spain's scandal-ridden government crows about its competitiveness, but shies away from deeper labour or tax reform. France is struggling even to liberalise Sunday trading. The outlier is Italy, whose brash Prime Minister Matteo Renzi relishes a fight with the country's unions. Across the zone, tough choices on writing down debt and pushing ahead with fiscal union have been deferred.

Politicians have reason to relax. With the economy growing, there is little chance that markets will turn on them again. Meanwhile populations are sick of austerity and support for the euro project is low. Elections are looming in Spain, France, Portugal and probably Italy, and populist parties are on the rise. Yet if the Eurozone's revival proves short-lived, governments may come to regret the missed opportunity they had in 2015 to truly reform.

Painting by numbers

China's art market paints itself into a corner

BY KATRINA HAMLIN

China's art market appears to have grown up. As curators and collectors descend on Hong Kong's enormous Art Basel fair this weekend, the appetite for art from the People's Republic looks robust. Yet minimalist cross-border trade sketches a picture of an introverted giant.

On paper, the country has become one of the world's largest art hubs. Sales in the Greater China region totalled $12 billion last year, or almost a quarter of the global total, according to figures compiled by art fair organiser TEFAF.

In contrast with globe-trotting gallery owners, however, China's art crowd increasingly prefers to stay at home. In 2007, international auctions accounted for almost a third of the value of works by Chinese artists. Last year, the figure was just 4 per cent. Most of those sales go to Chinese buyers: art exports from China were just 6 per cent of the global total in 2014.

Such introspection is rather unusual in the art world — in other major markets like the US or the UK, exports and imports more closely reflect the size of the domestic market.

Though China's isolationist preferences may be partly a matter of taste, pragmatism plays a role as well. Heavy customs duties on imported artworks make buying art abroad more expensive for Chinese collectors: levies can be as high as 35 per cent. The statistics also do not take account of the persistent problem of winning bidders who fail to pay for their purchases. The use of art as a channel for corrupt cash may also have inflated sales in the past, though China's anti-graft crackdown will discourage dubious sales.

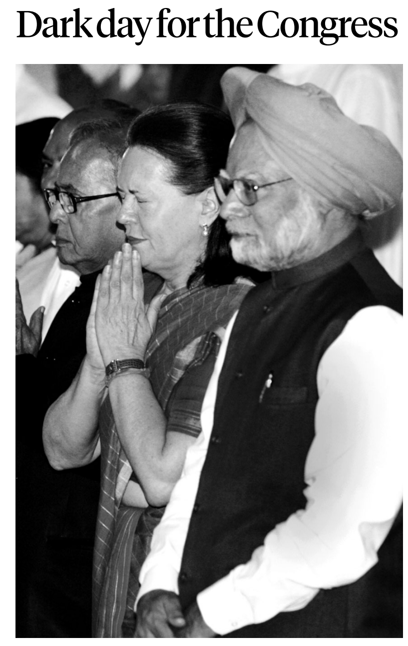
That may explain why the market has declined from its peak in 2011, when Greater China was briefly the world's largest market by sales. Yet even excluding the international hub of Hong Kong, the region probably still accounts for around 15 per cent of the global market.

From the outside, all looks well. Galleries are bustling and auction houses are constantly breaking records for individual sales. But China's art market could be painting itself into a corner.

The authors are Reuters Breakingviews columnists. The opinions expressed are their own. For further commentary see www.breakingviews.com

LETTERS

Dark day for the Congress



This refers to the editorial "Speed is key" (March 13). Setting aside the closure report presented to it, a special Central Bureau of Investigation court sending summons to former Prime Minister Manmohan Singh in the coal block allocation scam raises hope. It vindicates the long-held allegation against Singh. It also validates former Coal Secretary P C Parakh's view that Singh is as culpable since he held the portfolio at that time and was the one who gave the final nod to coal block allocations.

The summon points to the premise of the Constitution that everybody is equal before law. Coming close on the heels of its worst debacle in the general and Assembly elections, which cost the Congress its status as the national Opposition party, it is a dark day for the Grand Old Party and a sad day for a man who accidentally joined politics and was assigned the top post thanks to his integrity and clean public persona. Singh might not have imagined that he was destined to be summoned to appear before the court of law for a crime about which he had no idea. Party President Sonia Gandhi and other senior leaders rallying behind Singh and extending their so-called moral support may not help in what is technically a legal issue.

R Prabhu Raj Chennai

Raw sugar facts

This refers to the article "Sugar shock" (*BS Weekend*, March 14). One solution for this malaise is more domestic consumption of raw sugar. Mills ask for export subsidies on raw sugar exports. Due to the lack of awareness, raw sugar is not consumed by more people, even though it is rich in natural iron, calcium and other nutrients. The sugar industry and the government should create more awareness on the health benefits of raw sugar. The industry should not link the production of raw sugar with export orders. There is an untapped domestic market for sugar.

The Ministry of Ayurveda, Yoga & Naturopathy, Unani, Siddha and Homoeopathy (AYUSH) should launch an awareness campaign about the health benefits of raw sugar, on the lines of *amla* (gooseberry). Some sugar mills sell branded raw sugar – commonly known as golden sugar – and it is available in a few big supermarkets, not the usual mom-and-pop stores. If raw sugar is consumed instead of white sugar, ills such as the arrears of sugar mills to farmers, which run into thousands of crores, can be solved. The government need not dole out crores of rupees as subsidy to sugar cooperatives, which are run by politicians.

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Learning confidence

Bhupesh Bhandari's column "Dilip Shanghvi's X factor" (White Knight, March 13) is quite impressive and inspiring. A small piece of biography must become readable, especially to those students and parents who are keen on getting admissions in business schools with a target to get handsome packages in some business house. Getting admissions into colleges and business schools for a degree is not affordable to everyone. These schools, however, will never teach one subject — confidence. I am still amazed at how a person with minimum qualifications and from a commerce stream, controls and offers employment to pharmacy experts and moreover, controls a major share in the pharmaceutical industry.

Mayur Y Parekh Vadodara

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