Business

Dangers rife as India hits plateau

Economic View

TYLER COWEN

The slowdown in India is one of the biggest economic stories in the world, but it is commanding only a modicum of attention elsewhere.

It may not even look like a slowdown, because by standards in the developed world, India's growth, estimated to reach 6.9 percent this year by the International Monetary Fund, is still strong. But a slowdown it is: The economy has decelerated from projected rates of more than 8 percent, and negative momentum may bring a further decline. The government reported year-over-year growth in the October-to-December quarter of 6.1 percent.

What is disturbing is that much of the decline in the growth rate is distributed unevenly, with the greatest burden falling on the poor. If the slower rate continues or worsens, many millions of Indians, for another generation, will fail to rise above extreme penury and want.

China commands more attention, but Scott B. Sumner, an economist at Bentley College, in Massachusetts, has pointed out that India is likely to end up as the world's largest economy by the next century. China's population is likely to peak relatively soon, while India's will continue to grow, so under even modestly optimistic projections the Indian economy will be No. 1 in total size.

A slowdown will be felt far and wide, and many of its causes cannot be easily remedied.

India is also a potential force for energizing the economies of Bangladesh, Nepal and, perhaps someday, Pakistan and Myanmar. Furthermore, the wealthier India becomes, the stronger the allure of democracy in the region.

Why is growth slowing? The causes are varied. They include a less-than-optimal attitude toward foreign business and investment: Recall the government's reversal of its willingness to let Wal-Mart enter the retailing sector. India has also been assessing retroactive taxes on foreign businesses years after incomes are earned and reported. Another problem is energy infrastructure, which has not geared up to meet industrial demand. Coal mining is dominated by an inefficient state-owned company and there are price controls on coal and natural gas. Over all, India does not seem headed toward further market-oriented overhauls.

These problems can be solved. Other causes have no easy fix.

Agriculture employs about half of the work force, for example, yet the agricultural revolution that flourished in the 1970s has slowed. Crop yields remain stubbornly low, transport and water infrastructure is poor, and the legal system is hostile to foreign investment in basic agriculture and to modern agribusiness.

The earlier growth bursts of Japan, South Korea and Taiwan were preceded by significant gains in agricultural productivity. For all of India's economic progress, it is hard to find comparable stirrings in Indian agriculture today.

Another worry is that India's service-based growth spurt may have run much of its course. Call centers, for example, have succeeded by building their own infrastructure and they often function as self-contained, walled minicities. Those achievements are impressive, but these islands of higher productivity suggest that success is achieved by separating oneself from the broader Indian economy, not by integrating with it.

India also has one of the world's most unwieldy legal systems. On the World Bank's "Doing Business Index," the country stands at 132 of 183 listed countries and regions, behind Honduras and the West Bank and Gaza. One undercurrent of talk is that the days of "the license Raj" have returned, referring to the country's earlier subpar economic performance under a regime of heavy government regulation.

On the positive side of the ledger, India retains a population with remarkable talent, energy and entrepreneurship. It has worldwide networks of trade and migration, and world-class achievements in entertainment and design. Nonetheless, the previous pace of progress no longer seems guaranteed.

India may not be alone in this slowdown. There is a more general worry that the grouping of disparate giants known as the BRIC nations — Brazil, Russia, India and China — has, for some reason, lost much of its momentum. Last year Brazil grew just 2.7 percent, down from 7.5 percent, and Chinese and Russian growth is slowing, too. In the past, many countries engaged in catch-up growth have suddenly slowed and hit plateaus, and economists do not have firmly established theories as to when and why this happened. In any case, it remains a real danger to the economies of the rest of the world.

TYLER COWEN *is a professor of economics at George Mason University.*

ARIS MESSINIS/AGENCE FRANCE-PRESSE

A National Bank of Greece office in Athens. Some experts on distressed debt are looking favorably at Greek bonds, which have yields of 21 percent, on the theory that the worst will not be allowed to come to pass.

Contrarians see buying opportunity in Greek debt

LONDON

BY LANDON THOMAS JR.

As Greece girds for an election this Sunday that top politicians warn could ultimately force the country to leave the euro zone, a hearty band of risk-happy investors have adopted an improbable rallying cry: Buy Greek bonds now.

Among counterintuitive bets, few in Europe match this one.

Recall that just two months ago, foreign investors were forced to accept a 75 percent loss on their Greek debt holdings. And the widely held view is that even the newly restructured — and already deeply discounted — Greek bonds will soon face another write-down once the country runs out of cash again.

The common wisdom holds that the new Greek government, whatever its composition, will be unable to force another round of public spending cuts on its people. That could prompt Greece to leave the currency union and default on its debt.

But the contrarians, who are mainly distressed-debt experts, see a buying opportunity.

They favorably compare the junk-like 21 percent yields on Greek bonds to the much lower returns, but comparable risks, on bonds of international renegades like Venezuela and Argentina, which now trade in the 11 percent to 13 percent range.

"This is the trade of the year," said Hans Humes president of Greylock Capital, a New York-based hedge fund. Greylock is actively buying the debt at knockdown prices that have ranged from 19 cents to 25 cents on the dollar. "It's a no-brainer," Mr. Humes said.

To be clear: The strategy is fraught with risk. But unlike previous and largely unsuccessful hedge fund gambits that tried to game how and when Greece might pay off investors, this bet is a pure play that Greece is going to survive as a member in good standing of the euro zone.

Investors like Mr. Humes are betting that a new Greek government — even if it is a coalition that includes unruly splinter parties — will have to accept demands from the Europe Union and the International Monetary Fund that the country implement yet another round of to-the-bone spending cuts, to secure the money it needs to survive and make good on its debts.

Bond traders say that others now doubling down on Greece include Banco BTG Pactual, the Brazilian investment bank; Finisterre Capital, a London-based fund company that specializes in emerging markets; and, in particular, Brevan Howard, one of Britain's largest hedge funds.

Mr. Humes was a member of the steering committee that negotiated the historic deal signed in March that erased €100 billion, or $131 billion, from Greece's still-staggering debt load, but left investors like his firm with eye-watering losses. Even after that bailout deal, Greek government debt is 160 percent of gross domestic product, still the highest level in Europe.

But instead of selling the revamped bonds, thinking they are almost certain to fail, the way many investors have done, Mr. Humes has been aggressively adding to his position.

His thesis is simple. With European governments and the International Monetary Fund now owning nearly three-quarters of Greek debt, there is not likely to be another restructuring that would force bondholders to take another big haircut.

That is because, according to this theory, the European Union and I.M.F. will do whatever it takes to prevent the ultimate holders of that debt — taxpayers in Europe and the United States — from suffering the type of losses on Greek bonds that commercial investors had to stomach.

Traders also note that the amount of Greek debt in private hands is relatively small, about €12 billion — a level that back in the heyday of Greek borrowing earlier this decade might have been the size of a single bond issue.

With so little debt in private hands, investors like Mr. Humes say, it would make little sense for Greece to force another restructuring on private investors because it would make no more than a small dent in Greece's daunting debt burden.

"Greece will not default on the private sector this time around," Mr. Humes predicted.

The investors buying Greek debt, particularly BTG Pactual and Mr. Humes's Greylock, tend to be veterans of the debt restructuring wave in Latin America in the 1990s. Then, countries including Mexico and Brazil forced bondholders to take a loss on their original securities and to accept so-called Brady Bonds in return.

"The politics are shambolic and the recession is massive, but in the end Europe cannot walk away from Greece."

When these countries made good on their promises to reform their economies, the new bonds — which took the name of their intellectual father, a former U.S. Treasury secretary, Nicholas F. Brady — soared in value. They made a mint for those who were brave enough to load up on them at the beginning.

Bravery — or thrill-seeking, at least — is once again key.

This week, the ratings agency Fitch said a Greek exit from the euro zone was increasingly likely. And in a pre-election report on Greece, economists at UBS said that investors should be "worried, very worried" about the prospect that the vote would result in a government without the strength and credibility to push through the next round of spending cuts. UBS calculates that Greece still needs to come with budget trims equivalent to more than 7 percent of G.D.P.

With the Greek economy in its fifth year of recession and with unemployment at more than 20 percent, even the strongest of governments would be hard-pressed to ask such an additional sacrifice from its citizens — to say nothing of the new government that, whatever the election results, is likely to be one of the most fractious in recent history.

What is more, UBS contends, even with the recent restructuring, Greece's interest payments remain too much for the country to bear over the long term, at 15 percent of government tax revenue. Even a 10 percent figure would be considered by credit analysts to be unsustainable.

The Greek bond bulls are not ignoring all of this. They are just saying that these many negatives are already reflected in the price.

"The politics are shambolic and the recession is massive," said Alex Garrard, a senior debt trader for BTG Pactuel in London. "But in the end, Europe cannot walk away from Greece."

U.S.-China talks make progress amid tension over dissident

BEIJING

BY MICHAEL WINES AND ANNIE LOWREY

Chinese and U.S. leaders said Friday that they had made important progress on a range of economic issues at their annual bilateral meeting, with Prime Minister Wen Jiabao of China saying the areas of agreement had included "some important breakthroughs."

The comments came as a senior U.S. official, speaking on condition of anonymity, said the Chinese had agreed to remove what U.S. officials say are unfair subsidies and favorable regulations affecting state-owned corporations and to allow foreigners to take bigger stakes in Chinese securities firms.

China's state-owned behemoths, dominating strategic industries like steel and telecommunications, have become formidable competitors in some global markets and maintain a lock on many domestic ones.

U.S. officials attending the annual meeting, the Strategic and Economic Dialogue, were clearly eager to report some good news from China amid a furor over mishandled U.S. efforts to assist a leading dissident, Chen Guangcheng.

Treasury Secretary Timothy F. Geithner, meeting Friday with Li Keqiang, a Chinese deputy prime minister, said the economic talks had achieved "very good progress." Later, in prepared remarks for the meeting's closing ceremony, Mr. Geithner praised the Chinese for moving toward a more flexible exchange rate system and loosening controls on moving of capital in and out of the country.

"These steps are significant and promising and, we believe, will lead to further appreciation in the exchange rate over time against the dollar and other major currencies," he said.

Wang Qishan, another Chinese deputy prime minister, said the United States had agreed to back China's effort to have the renminbi included in the International Monetary Fund's basket of currencies. China wants to internationalize the renminbi to build it into a reserve currency like the dollar and the euro. But because the renminbi is not freely convertible, the I.M.F. has so far declined to include it in its basket of reserve currencies.

For the first time, according to senior U.S. officials, Chinese policy makers said they would commit to removing advantageous financing and regulatory conditions for state-owned enterprises, a significant step forward in the eyes of the Obama administration, the official said, even though such changes might take years to implement.

China said it would review its policy of providing attractive — and some companies say unfair — financing for its exports. China is the biggest provider of export-credit financing, offering subsidized deals for companies buying goods from Chinese companies.

The United States, the European Union, Japan and other developed economies have a deal limiting the export credits a country can provide — an agreement that China is not party to and a point of contention for many manufacturers and service providers.

ALEXANDER F. YUAN/THE ASSOCIATED PRESS

Treasury Secretary Timothy F. Geithner speaking Friday in Beijing after the annual talks.

The senior administration official, speaking privately early Friday before the talks had formally concluded, also said that Chinese officials had indicated a willingness to require Chinese state-owned enterprises to pay out more of their earnings as dividends.

The official also said Chinese officials had agreed to allow foreign companies to take stakes of as much as 49 percent in joint securities ventures, up from the current limit of 33 percent, giving U.S. financial firms wider latitude to invest in the country. China also agreed to make it easier for U.S. companies to offer financing for car loans.

In return, U.S. officials agreed to start longer-term talks on allowing Chinese firms to invest in U.S. assets and industries and agreed to begin negotiating a bilateral investment treaty.

U.S. officials in Beijing also raised the issue of China's efforts to keep its currency low in relation to the dollar, making its goods relatively low-cost and American goods relatively expensive.

On Thursday, the head of the Chinese central bank said the two countries ha agreed that exchange rates should ul mately be market-determined. "T two sides have some views in commor said Zhou Xiaochuan, the governor the People's Bank of China. "They b think that exchange rates should be termined by a market system."

The administration official also pra recent Chinese policy changes allo more foreign investment and more markets, which the official said had an outgrowth of closer talks.

"China must rely more on dom consumption rather than exports more on innovation by private co nies, rather than capacity expansic state-owned enterprises," Mr. Geitl the Treasury secretary, said as the logue started.

"Our countries have become t oughly, inescapably interdepende Hillary Rodham Clinton, the secre of state, said as the talks opened. " United States believes that a thri China is good for America, and a th ing America is good for China."

Annie Lowrey reported from Washing