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WHAT MAY WE EXPECT IN 2014

Beware Of An Erosion Of Confidence In The U. S. Dollar !

The world, today, is unlike the world of the past: What happens in one part impacts on other parts, sometimes for good and, of course, more often than not, for bad.

As Asia witnessed, during the entire 2013 calendar year, the continuous waning of consumer demand in Europe impacted, adversely, on the manufacturing sector of the economy of the People's Republic of China (PRC).

The lacklustre consumer demand in this important part of the world – which is the PRC's largest single customer for its manufactured goods – was a direct result of a number of factors, one of which was the high unemployment levels in some of the largest economies of the eurozone, especially in Greece, Italy, Portugal and Spain.

The **I**nternational **M**onetary **F**und (**IMF**) expects more of the same throughout most of the eurozone in the coming year, resulting in very low growth ... if any growth, at all.

The knock-on effect of the European economic crises of 2013 was staggering in the south of the PRC as one watched, almost on a monthly basis, the number of factories that were forced to close their doors, for good. This was, especially, telling in Guangzhou, the capital and largest city of Guangdong Province.

Managements of many of the factories in this part of the country were unable to cope with the very difficult situation when orders for manufactured goods, such as electronic products, failed to materialise or, in many instances, when previously confirmed orders were cancelled.

As a direct result, many tens of thousands of workers were laid off while many Chinese, Hongkong-dollar billionaires suddenly became Hongkong-dollar millionaires, overnight. The very unlucky ones, however, had to declare bankruptcy.

The situation in the PRC had the almost immediate effect of disenchantment among many factory workers, not just in the south of the PRC, but in other parts of the country, also.

Disenchantment among the working class was seen by the PRC Government as an urgent condition that had to be addressed as a matter of great importance in order to maintain law and order.

The PRC Government does not embrace social unrest – at any level.

The determinations of the US Federal Reserve can, and often do, impact, indirectly, on the purchasing power of the lowest-paid workers in some of the most-remote parts of the world, in tiny hamlets with no names as well as hard-to-pronounce, small towns.

The cook, who decides to bake a pumpkin pie for the Thanksgiving dinner, cannot forget to include any of the spices of nutmeg, ginger, cardamom, cinnamon, or cloves when preparing the filling for the pie shell because the omission of any of these important ingredients will have an effect on the taste of the finished product.

During 2011 through to 2013, when the price of petrol at the pumps of the United States rose, rapidly, it had an immediate effect on domestic tourism throughout the country, not just on the number of motor cars on the country's roads and highways, but also in the air, as carriers were forced to raise airfares due to the higher cost of jet fuel.

Hotel rooms, in many parts of the country, were not even half-filled, restaurants witnessed a decided paucity of patrons, and supermarkets and discount warehouse companies saw a rapid falling off of customer spending.

The persistent increases in the price of crude-oil exports, especially from Middle East, had, as everybody noted over the past few years, almost immediate effects on the price of petrol at the pumps, around the world, and increases in the price of many manufactured goods.

The Islamic Republic of Iran, one of the world's largest producers of crude oil, is supposed to come into a formal and permanent agreement with the United Nations within the first half of 2014 in respect of its nuclear intentions.

If an agreement is not reached in accordance with the present agreed timetable – which **TARGET** () believes is almost a certainty – one can only speculate as to the determination of the world body due to the intransigence on the part of the Iranian, theocratic government to bend to the demands of the UN Security Council.

The State of Israel is convinced that Iran is intent on becoming another nuclear power, being able to produce weapons of mass destruction at the first available opportunity.

Israel will have none of it. This is, also, a certainty.

Among other things, Iran has made it very clear, in numerous, official public statements, issued by Iran's senior politicians, statements that were very definitive, that it wants to destroy the State of Israel, wiping it from the face of the earth, forever.

If Israel were to attack Iran in order to destroy its ability to become a nuclear power, it would have immediate repercussions, round the world.

What has been overlooked for some time by a number of people is that Iran is a huge country. It is, in fact, the 18th largest country in the world, its landmass, being that of the United Kingdom, France, Spain, and Germany combined.

The Israeli Government would be advised to think very carefully before considering an attack on this Muslim country whose military might has yet to be tested since the Islamic Revolution of 1979.

It is known that the country has a well-trained army, navy and air force of about one million, men and women with the potential of calling up another 11 million reservists if Grand Ayatollah Sayyid Ali Khamenei, the Supreme Leader, determines to conscript available fighting men and women.

Whether such a situation will materialise is anybody's guess, but it is a frightening scenario because it is quite likely that other Muslim countries would join hands with Iran: The Jewish State of Israel is not the most-beloved of countries of the world.

Nobody wants to suffer a Third World War.

Looking at US Economics of Today

The US economic situation, today, looks as though it could well surprise a great number of people, around the world.

Some stock-market gurus of the US are shouting out: 'Buy America!'

On December 18, 2013, the Federal Reserve went on record, stating, inter alia:

> *'Information received since the Federal Open Market Committee met in October indicates that economic activity is expanding at a moderate pace. Labor market conditions have shown further improvement; the unemployment rate has declined but remains elevated. Household spending and business fixed investment advanced, while the recovery in the housing sector slowed somewhat in recent months. Fiscal policy is restraining economic growth, although the extent of restraint may be diminishing. Inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.*
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> *'Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will pick up from its recent pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the risks to the outlook for the economy and the labor market as having become more nearly balanced. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, and it is monitoring inflation developments carefully for evidence that inflation will move back toward its objective over the medium term.*
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> *'Taking into account the extent of federal fiscal retrenchment since the inception of its current asset purchase program, the Committee sees the improvement in economic activity and labor market conditions over that period as consistent with growing underlying strength in the broader economy. In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee decided to modestly reduce the pace of its asset purchases. Beginning in January, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $35 billion per month rather than $40 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $40 billion per month rather than $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. The Committee's sizable and still-increasing holdings of longer-term securities should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate…'*
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> *'The Committee also reaffirmed its expectation that the current exceptionally low target range for the federal funds rate of 0 to 1/4 percent will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored…'*

On studying The Fed's much-publicised Release, the key indices of the world's largest and most-prestigious equity markets, rose to record-breaking highs.

Two days before The Fed made its statement to the world, it announced:

> *'Industrial production increased 1.1 percent in November after having edged up 0.1 percent in October; output was previously reported to have declined 0.1 percent in October. The gain in November was the largest since November 2012, when production rose 1.3 percent. Manufacturing output increased 0.6 percent in November for its fourth consecutive monthly gain. Production at mines advanced 1.7 percent to more than reverse a decline of 1.5 percent in*

October. The index for utilities was up 3.9 percent in November, as colder-than-average temperatures boosted demand for heating. At 101.3 percent of its 2007 average, total industrial production was 3.2 percent above its year-earlier level. In November, industrial production surpassed for the first time its pre-recession peak of December 2007 and was 21 percent above its trough of June 2009. Capacity utilization for the industrial sector increased 0.8 percentage point in November to 79.0 percent, a rate 1.2 percentage points below its long-run (1972-2012) average.'

Then, on Boxing Day (December 26, 2013), the US Department of Labour made the following announcement:

'In the week ending December 21, the advance figure for seasonally adjusted ***initial claims*** *was 338,000, a decrease of 42,000 from the previous week's revised figure of 380,000. The 4-week moving average was 348,000, an increase of 4,250 from the previous week's revised average of 343,750.*

'The advance seasonally adjusted ***insured unemployment rate*** *was 2.2 percent for the week ending December 14, unchanged from the prior week's unrevised rate. The advance number for seasonally adjusted* ***insured unemployment*** *during the week ending December 14 was 2,923,000, an increase of 46,000 from the preceding week's revised level of 2,877,000. The 4-week moving average was 2,836,750, an increase of 39,500 from the preceding week's revised average of 2,797,250.'*

On a Year-On-Year comparison, the Unemployment Insurance Data, Seasonally Adjusted, was down about 7.65 percent, according to **TARGET**'s calculations. As for the four-week, Moving Average, it was down about 4.40 percent.

All good stuff! But …

The Decline of Confidence

The US is the world's de facto banker, with the US dollar, being the world's currency, or, in jargon of economists, the US dollar is the Reserve Currency of the world.

This is easily provable because nearly everything that is bought or sold, internationally, is denominated in US dollars, from condoms to crude oil to real estate to strategic commodities.

There has to be one currency that the world can point to as being the medium of exchange that can be trusted and in which it can be accepted with confidence for international payments.

Without confidence in the US dollar, the world would be in a very difficult situation: In fact, such a situation would trigger a crisis, unheralded in the annals of history.

This confidence in the US greenback, as the US dollar is sometimes referred, is responsible, among other things, for encouraging the sovereign funds of a number of well-heeled countries to purchase long-term securities in various US, Government-backed commercial notes, such as Treasury Bills.

The PRC, today, is the largest single creditor of the US, holding about eight percent, or about $US1.20 trillion, of the total country's public debt.

In January of 2011, foreign individuals, foreign corporate entities and countries' sovereign funds owned about $US4.45 trillion of the total debts of the US, or about 47 percent of public debt ($US9.50 trillion) and about 32 percent to the country's total debts of about $US14 trillion.

The US debt ceiling, today, is being capped at about $US17.10 trillion. When it was just $US12.31 trillion in 2009, it represented about 73 percent of the Gross Domestic Product (the gross national product, excluding the value of net income earned abroad).

This previous, capped-debt ceiling figure of $US12.31 trillion was twice that of 2007.

As is only too obvious, should the largest single economy of the world be seen to be unable, materially, to manage its financial affairs in an orderly fashion, an immediate erosion of confidence in the US dollar could well follow.

And this would be disastrous, not just for the US, but also for the entire world.

In 2008, the Bank of International Settlements went on record, stating:

> *'Foreign investors in US dollar assets have seen big losses, measured in dollars, and still bigger ones, measured in their own currencies. While unlikely, indeed highly improbable for public sector investors, a sudden rush for the exits cannot be ruled out, completely.'*

In 2007, Kuwait discontinued pegging its currency to the US dollar, preferring a basket of currencies so as not to be dependent on the world's Reserve Currency. The Government of Syria followed suit a fortnight later.

The US Government must, as a matter of extreme importance, maintain the confidence of the world in order to ensure the sanctity of the Reserve Currency that must be recognised as the safest of all currencies.

It was only last year that Brazil, when its government was starting to lose confidence in the US dollar, demanded to be paid in gold for its exports of crude oil.

The Obama Administration – or the next Administration, whatever its colours might be – must rein in the present situation where the country's continuous spending of much more than it earns (which is highly inflationary).

As was noted, late last year, there was a question of the US Government, being in a position without the necessary wherewithal to meet a financial commitment in respect of the interest factor on some Treasury Bills.

Deficit spending can go only so far, and, then, quite a number of intelligent people might well start to lose faith in the financial ability of The Land of The Free and The Home of The Brave.

Should such a scenario occur, in part or in whole, sovereign funds might well start to withdraw investments; and this could well be catastrophic for whoever is sleeping in the White House.

Not only that, but the entire world would be rocked by the problems, confronting the largest single economy of the world.

Even today, many economists cringe when viewing the huge financial deficit that is confronting the US Government.

Mr Paul Adolph Volcker, a very well-respected, US economist, who was the Chairman of The Fed under Presidents Jimmy Carter and Ronald Reagan from August 1979 to August 1987, has suggested that, within the next 18 months or so, the penny is likely to drop in the US.

As the days pass by, another aspect of the US economy is that, every time The Fed engages in further, so-called, '*quantitative easing*' – buying up the country's debts by speeding up the printing of more greenbacks in order to satisfy the tens of billions of US dollars that are required to meet the purchase prices of domestic debts – it exacerbates the current situation since, in effect, like it or not, it is creating hyperinflation:

Inflation that is growing at a very high rate in a very short space of time.

Before this situation gets completely out of control whereby international confidence starts to be eroded, action of a definitive nature must be taken at the top of the political pile in Washington, D.C..

But the problem here could well be that President Barrack Hussein Obama and/or his successor may be incapable of fully understanding the importance and gravity of the macroeconomic matters, confronting the nation, and, therefore, unlikely to know what would be the appropriate action to take.

To do nothing would be catastrophic; to do the wrong thing would be calamitous.

This is a terrible affliction that the US could well be facing.

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