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YOU CAN'T DRINK MOTHER'S MILK, FOREVER

The determination of the US Federal Reserve of January 29, 2014, appeared to have been one of the principle reasons for an international sell-off of stocks and shares on quite a number of equity markets.

Many people started to panic as soon as it became apparent that The Fed had decided to wane the US economy away from what has come to be known as '*Quantitative Easing*'.

QE – **Q**uantitative **E**asing – is defined, generally, as being an unconventional way to stimulate an economy when the usual monetary policy(ies) is proved to be ineffective. What transpires is that a central bank buys up specified amounts of financial assets from banks, private commercial entities and/or other money-lending entities and, by so doing, it tends to increase the monetary base of the country and, at the same time, lowering the yields on those financial assets that have been purchased.

In short, the central bank, obliquely, beefs up an economy by injecting cash into it.

On Wednesday, January 29, 2014, The Fed informed the world how it viewed the US economy and the action that it, now, intends to take and, by innuendo, what is likely to transpire in the near future.

Some of the statements of The Fed included:

> *'The unemployment rate declined but remains elevated. Household spending and business fixed investment advanced more quickly in recent months, while the recovery in the housing sector slowed somewhat. Fiscal policy is restraining economic growth, although the extent of restraint is diminishing. Inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable…*
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> *'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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> *'In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee decided to make a further measured reduction in the pace of its asset purchases. Beginning in February, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $30 billion per month rather than $35 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $35 billion per month rather than $40 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 ...*
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> *'If incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future*

meetings. However, asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases …'.

As far as **TARGET** () can ascertain, nothing that The Fed said could have been considered shocking and, certainly, it was well expected.

Nevertheless, Wall Street went into a panic on digesting The Fed's determinations – and down came the key indices on the world's largest equity markets.

Then, it dawned on some investors, on scanning the decision of The Fed, that the statements suggested, strongly, that a further reduction in asset purchases was on the cards in the near future.

The Fed's next **O**pen **M**arket **C**ommittee **M**eeting (**FOMC**) is scheduled for March 18 and 19, 2014, and one may expect that The Fed, at this two-day meeting, will seek to ease back on QE, even further if the situation in the US merits such a move.

One would have thought that such a move by the US Central Bank, de jure, would be welcomed because, inter alia, it means that the largest single economy of the world is truly on the mend.

However, Wall Street is quite likely to get the jitters, once again, following The Fed's announcement at the conclusion of its March FOMC.

This medium likens such heebie-jeebies to a child, being weaned off its mother's milk.

What happens on Wall Street, more often than not, has a knock-on effect, round the world, with the key indices of major equity markets, going into shallow nose-dives.

Dependence On The US Dollar

The US dollar remains, today, as the world's preferred medium of exchange. There is little to no probability of that situation, changing over the short or intermediate term.

Due in large part to the actions of The Fed, the largest single economy of the world is improving and, by all accounts, it will, from hereon in, continue to strengthen.

That being the case, one may assume that international dependence on the US dollar will not wane, but will wax, materially, in the coming months.

US Government debt has tended, for many a decade, to have been among the safest of investment assets. This is despite record-high borrowings by the US Government.

This situation is amplified in today's world when one notes how the currencies of certain emerging markets are suffering, dramatically, with the South Africa rand, the Turkish lira and the Argentine peso among some of the biggest losers on translation to the US dollar.

The economies of these three countries could well be in tsuris, during the coming months, because, among other things, their respective governments will have to pay a hefty premium in terms of their respective currencies in order to purchase foreign-made goods, all of which will have to be paid, denominated in US dollars.

Import prices will rise, to be sure, but, paradoxically, exports of goods and services from these three economies are likely to rise because, in US dollar terms, the greenback will have a greater buying power against the currencies of all of these countries.

On the flip side of the coin, however, investors, noting the ever-growing strength of the US economy, will think very carefully before putting money into emerging markets of this ilk, preferring to ride the American gravy train that appears to picking up steam.

After all, if push comes to shove, to be trite, the US dollar is, still, a better bet as a long-term investment medium of exchange than a great number of the mediums of exchange of many an emerging market.

There are, of course, exceptions to the rule and the renminbi, the official currency of the People's Republic of China, is likely to be one of those exceptions.

On this note, it appears to **TARGET** that, sooner or later, the euro and the renminbi will have to take their respective places beside the US dollar as the world's reserve currencies.

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