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A Diminishing Reach

There is a stark difference in the financial world today than a few year's prior. Unsettling news in foreign counties does not seem to have the same effect as it once did. Especially in light of Federal Reserve meeting minutes released this week that highlight the extraordinary efforts of the US central bank domestically and an extreme period of economic uncertainty back in 2008. There was a level of fragility in the North American economies that saw increased volatility from incidents all over the world that not always directly influenced them. Today, however, Western economies have almost rebalanced themselves, and have created a buffer from chaos elsewhere.

This is also a direct effect of weak US foreign policy, as the current administration seems to lack the wherewithal to have a presence or stance on global issues. This is what Harvard Economic Historian Niall Ferguson refers to as "geopolitical strategic tapering." Objectively speaking, the days of the US acting as a world policeman seem rather distant. If the line in the sand Obama drew for Syria and the regimes use of chemical weapons is not proof enough, then we simply can look to events unfolding in Kyiv, Ukraine. The lack of interest the US shows in Kyiv provides us with example number two. Granted some might argue that Syria and Ukraine should not be concerns of US foreign policy, there are events unfolding elsewhere in the world, like China, that is of pertinent relevance.

It's long been discussed that for a middle class to rise in China, their economy must shift from one that is savings based to more consumption based. This premise is not new. But in accordance with China achieving that, their economy is simply slowing down. The only question is will they suffer a bubble popping crash or something more gradual. This poses a problem for the US. Right at a time when the US Federal Reserve is withdrawing their support for US treasuries, the world's biggest consumer of US debt is (a) not growing as fast, and (b) is looking to decrease their savings rate. Therein lays one of many threats to the long term strength and viability of the US dollar.

The World Gold Council released data this week on consumption levels for gold in the fourth quarter of 2013, and what was most interesting (given their bias and strong roots to the mining community) were the consumption levels in gold in 2013. Despite gold prices having their second worst year since 1971, demand for gold coins and bars increased by 28.3 percent in 2013. India and China alone now account for 54.6 percent of worldwide demand for coins, bars, and jewellery. Overall demand from China by best estimates averaged over 100 tonnes per month for all of 2013, which is something not ever seen out of India, the world's previous largest buyer. As China takes over the top spot as the world's largest consumer of gold, their central bank is even believed (as there is no hard data) to have added to their reserves for the first time since 2009.

Gold is the de facto hedge for the US Dollar. And given the emergence of a stronger US private sector, the prospects for gold do not seem as favourable in this current environment in the near term. It is why consensus for the metal is for further weakness through 2014; albeit, I have argued any further move down will be short-lived. China's data showing an increase in gold holdings is a long term play. It always has been. Moreover, as we are reminded every day, the role of the United States in this all too important global economy is slowly diminishing, and that is why the world's largest holder of US debt is increasing their hedge.

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