

## Sell currencies of serial QE offenders

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### Fighting central banks is dangerous, writes Bill Gross

Big Macs are out, horsemeat is in ... not in burgers perhaps, but at least in the latest headlines. What is rather evident, though, is that my favourite valuation metric for currencies – the relative pricing of Big Macs in individual countries – is being subordinated to the willingness and ability of central banks to print money.

But I get ahead of myself. Why do currencies go up and down relative to each other? Economists would argue that ever since President Richard Nixon took the dollar off the gold standard in 1971 – and certainly even before – a currency's price was a function of several factors.

First, but not necessarily foremost, was its purchasing power parity (PPP), or its price in terms of what it could buy. Big Macs, for instance. Today, a Big Mac costs \$7.84 in Norway while only \$1.67 in India. If Big Macs were all the world produced or consumed, the krone should go down and the rupee should go up in order to rectify the imbalance.

Second, and third, however, are trade and investment flows between countries. Real growth, fiscal surpluses or deficits, return on investment, haven status and other factors combine to produce a flow of money into and out of a country, changing its price in the process. Add to that a speculative component, typified by George Soros's bet against the pound in the early 1990s, and you have a decent head start in determining the value of an individual country's currency.

Now, however, much of that is subordinated to policy makers in the form of capital controls, policy rates, and the biggest bazooka of them all – [quantitative easing](#) policies that surreptitiously increase the quantity of dollars, euros or yen relative to each other.

Newspapers, and even G20 summary statements, refer to this development as “[currency wars](#)”. The global economy, the phrase suggests, is using QE policies as currency bullets, with the central bank that can print the fastest being the ultimate winner in a race to the currency bottom.

The insinuation is undoubtedly true, although the assumption that any individual country or currency can win this war is rife with historical refutation.

Granted, in the 1930s the countries that devalued against gold first and by the most escaped the depths of depression before any of the others. Similarly, the devaluations by Asian countries against the dollar in the late 1990s rather successfully shifted growth in their favour for years to come, relative to developed countries.

But today's quantitative easing policies – at least in G-10 countries – are not really currency wars against each other. Instead, they are rather uniform expressions of artificial asset pricing and financial repression in a rather obvious attempt to reflate their respective economies.

The “war”, if it can be labelled that, is a war against stagnant growth and high unemployment. The weapons, instead of early 20th century machine guns and devaluations against a continuing gold standard, are central bank purchases of sovereign debt – modern-day drones whose target is an artificially low interest rate that hopefully will lead to asset market appreciation and real growth in quick order.

How should an investor respond? Respect the drone, I suppose, and don’t fight the central bank in the immediate term.

In currency terms, one has only to observe the 15 per cent depreciation of the yen against the dollar and its 20 per cent depreciation versus the euro without a shot even being fired. Japan’s Prime Minister Shinzo Abe has one-upped Federal Reserve Chairman Ben Bernanke simply with a promise to print.

Instead of Big Mac prices, then, or money in/money out trade and investment flows, investors and market speculators should analyse promises, observe QE purchases as a percentage of gross domestic product or outstanding debt, and sell the most serial offender or obsessive-compulsive printer.

The yen is a first choice, the pound a close second based on incoming Bank of England governor [Mark Carney’s inaugural addresses](#), with the euro holding up the rear. European Central Bank President Mario Draghi may promise to support the euro, but to date that hasn’t meant printing many of them.

Once an investor has picked winners and losers based upon the increasing size of a central bank’s balance sheet, however, he or she should understand that all of these QE bullets are reflationary attempts that may produce a semblance of real growth, but rather more inflation in future years.

Unless there is a white flag or an ultimate ceasefire, money printing lowers the value of all global currencies – much like horsemeat lowers the value of any burger or shepherd’s pie.

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