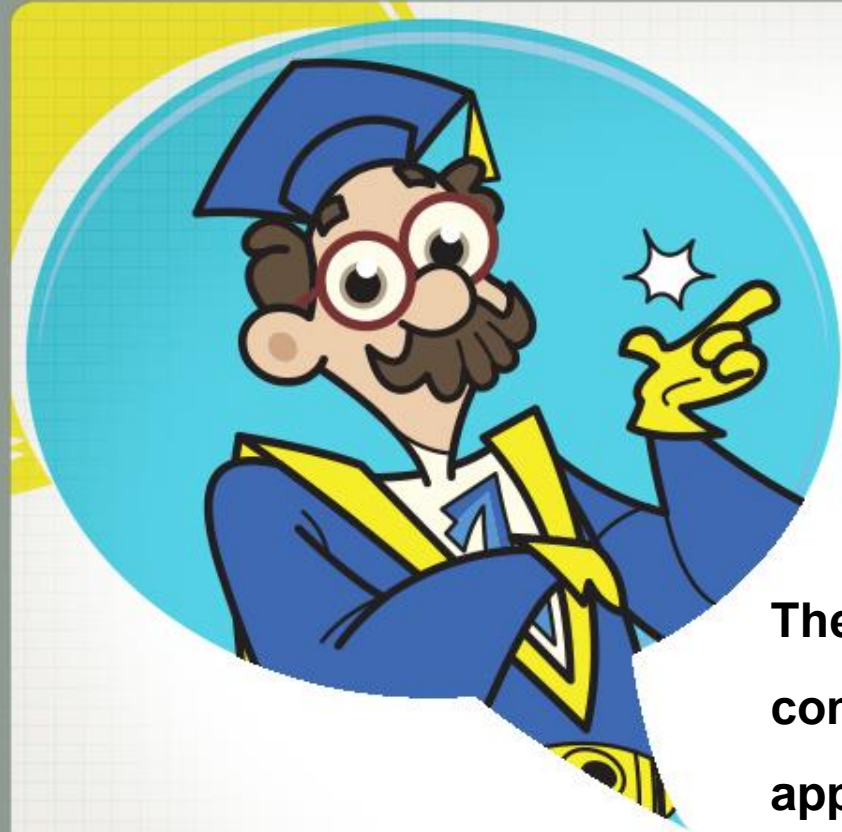


QUANTITATIVE EASING



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QUANTITATIVE EASING

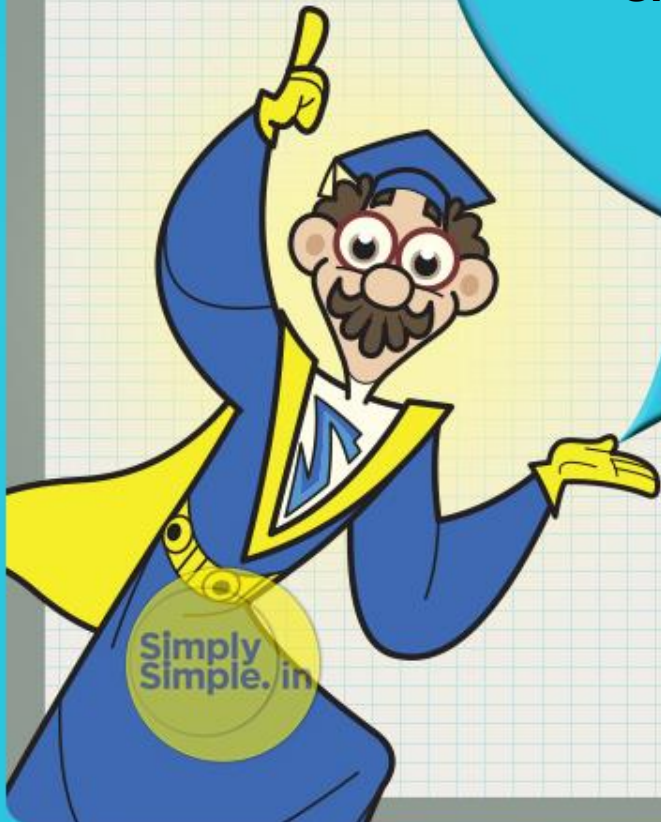


The word “Quantitative Easing” more commonly known as “QE” has been appearing in the media on account of QE 1 and then the QE 2 by the Federal Reserve to revive the US economy.



QUANTITATIVE EASING

What is this QE all about?
To understand let's look at a
simple story.



QUANTITATIVE EASING

Let's say there was a prosperous village - Sukhsagar. Most of the villagers were into agriculture. Their lands were fertile and the farmers were happy. The village had good schools, shops, entertainment hubs, hospitals, municipality etc.

Then one day, a pundit, who enjoyed the confidence of the villagers, visited the village. The villagers believe that the pundit was blessed with the knowledge of the future and could predict their future.



QUANTITATIVE EASING

One evening, the pundit called an urgent meeting of the villagers to tell them about their future. This kind of meeting had been a regular feature in the village and most people attended it because the pundit's prediction often was accurate.



QUANTITATIVE EASING

While addressing the villagers, the pundit dropped a bombshell. He told the villagers that the future appeared very dark. He expected that the villagers would soon lose their jobs and source of livelihood. Their incomes would vanish. Therefore, time had come for them to store all that they had so that they could overcome the bad times.



QUANTITATIVE EASING

The petrified villagers acted upon his instruction without any further delay. They began to save their money like there was no tomorrow. The villagers were in a state of shock. It appeared like the smiles had been erased from their faces. People stopped spending money and just focused on saving.



QUANTITATIVE EASING

They were in no mood to visit the entertainment hub. Nobody visited the market to buy anything. Markets wore a deserted look. Even people stopped visiting the hospital except for emergencies. The fear of losing their jobs and source of income was sucking out every aspect of happiness from their lives.



QUANTITATIVE EASING

The demand for all goods and services nosedived. The producers of goods felt the pain and reduced prices to get some hold of their lives. But the demand simply did not lift up. Clearly, negative sentiments had come to enshroud the entire village and led to a standstill of economic activity.



QUANTITATIVE EASING

One day, a government official passed through the village and wondered to himself how Sukhsagar village turned into Dukhsagar village. He talked to the village elders to understand. After listening to them, he understood that the fear of the future had got to them. He made an attempt to dissuade their fears by informing them that there was no imminent danger of bad times befalling on them.



QUANTITATIVE EASING

But the villagers continued to embrace fear. After all they had more faith in the Pundit than the government official. The official had realized that the villagers themselves were making things bad. Seeing that his advice was falling on deaf ears, he invited another learned person to address the villagers. But all his efforts were in vain.

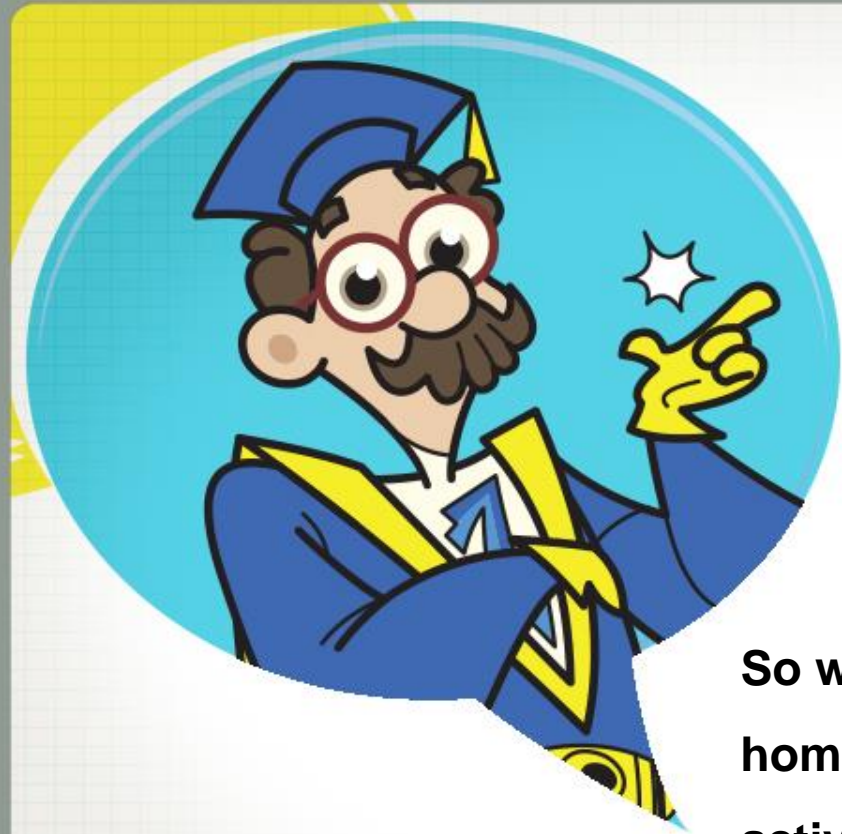


QUANTITATIVE EASING

Soon the villagers started suffering. Although they had money stocked up in their houses, it meant little. The producers of goods and services due to the demand slump had either closed shop or left the village. So now there was even a shortage of goods. This meant that even though there was no demand, the prices had stopped falling.



QUANTITATIVE EASING



So while everyone had money in their homes, there was no economic activity. Without economic activity the markets had dried up just like a car would get stalled without petrol.



QUANTITATIVE EASING

Just as the engine of the car can run dry and come to a standstill, so did the markets in the village in the absence of money that did not reach the markets even though there was plenty of money in the homes of the villagers. This is just like saying that there is a lot of petrol in the pump but not a drop in the car's engine.



QUANTITATIVE EASING

There was only pain and misery left in the village. Although there was no external threat to their jobs but the peculiar behavior of the villagers to save money and stop buying goods and services was turning out to be the cause of job losses. So in a sense, the behavior of the villagers was making their nightmare come alive.



QUANTITATIVE EASING

The government official was afraid that the villagers would destroy themselves if they continued on this path. So he thought of an idea to release the village from this grip of negativity. He made an unprecedented announcement to jolt the villagers into action.



QUANTITATIVE EASING

The key parts of his announcement were

- 1) Money would be made available to everybody at 0% interest.
- 2) As much money that would be needed would be provided.
- 3) The villagers could pay off their debts over time.
- 4) The government would buy off all the debt that others owed them which meant the villages would be only indebted to the government and no-one else going forward.



QUANTITATIVE EASING



This announcement worked like magic for the villagers.



QUANTITATIVE EASING

The assurance of easy money made them realize that it was futile to hoard money in their homes. The announcement encouraged them to buy goods and services from the market. This led to an increase in the demand for goods and services.



QUANTITATIVE EASING

Soon, the producers of other goods and services who had fled from the village started to return in large numbers.

The entertainment hub also sprung into action. The economic engine sputtered back into action just as a car engine would when supply of fuel resumes. The sentiments of the villagers took a U turn from negativity to positivity and Dukhsagar once again turned into Sukhsagar.



QUANTITATIVE EASING

This process of releasing money into the hands of people to revive sentiment and getting people to actively participate in economic activity is what is popularly known as, “Quantitative Easing”. Quantitative easing literally means easing (or increasing) the supply of money in the economy. This is done by printing additional currency.



QUANTITATIVE EASING

The cheap money released becomes an incentive for the people to consume and invest. While consumption increases, the demand for goods and services infuses life to the production process, investment provides the credit to build manufacturing capacity for goods and services so that the rise in demand does not lead to high inflation.



QUANTITATIVE EASING

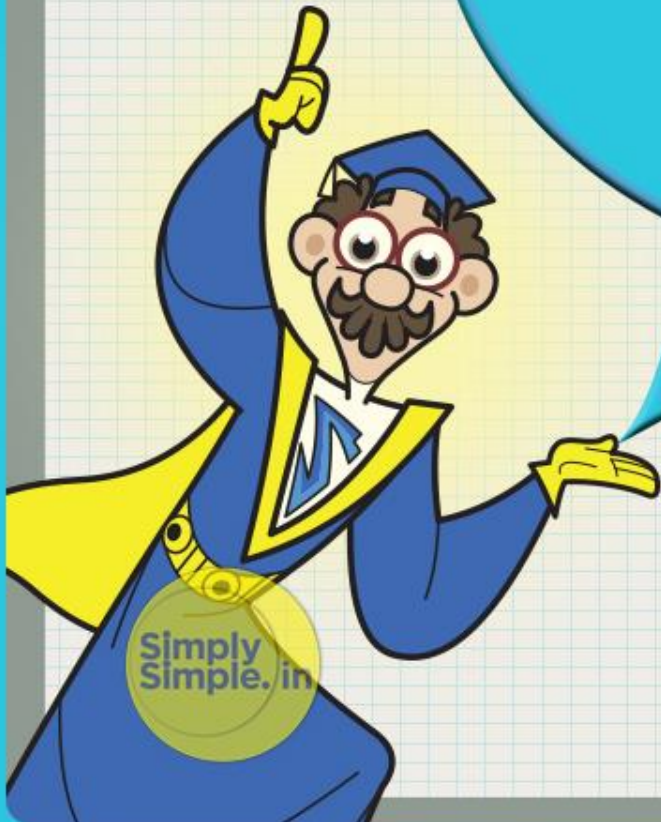


Thus changing sentiments is a self fulfilling prophecy that helps the economy to gain momentum and sustains itself. The moment sentiments change, people are inclined to hoard less and inject more money into the economy. The infused money acts as the lubricant for the economy to chug along smoothly.



QUANTITATIVE EASING

Hope this story has helped clarify
QE (Quantitative Easing)



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