

## A Dose of Reality

2014 so far hasn't really panned out as many had anticipated. While financial markets, particularly equities have seen the volatility that many analysts called for, the year of a strong greenback (US dollar) corresponding to a strong US economy is yet to develop. For this reason it is interesting to think back to some of the more high profile forecasts for 2014, and then weigh them with how the economy has fared thus far.

The key themes for Canada in 2014 were that the Canadian dollar was going to continue to decline and settle in the mid to high 80 cent range. While the dollar tested 4 year lows, the story lately has actually been of the apparent strength and resilience of the Canadian dollar.

Along with the loonie, commodities were certainly not in favour in the beginning of this year following many of the world's natural resources entering bear market territory in 2013. And despite the story of extreme slack in the global commodity markets from waning demand and excess supply, it has actually been the rebound in energy and precious metal prices that has the TSX up close to 9 per cent year to date.

Even though it was the natural resource theme that carried this country through the global recession that began six years prior, growth in the economy will begin to be more broad based as the year progresses. There is no doubt though that natural resources will remain centerfold to Canada's economy. Moreover, when it is accompanied with government policy that promotes growth in international commerce, Canada is really then set to prosper.

The most welcomed government policies have been the free trade pacts and agreements going into place with South

Korea, the Eurozone, and the current negotiations involving 11 nations in the Trans Pacific Partnership. This is where the focus of Canadian business should lie in promoting relationships that see more of our goods and services offered outside this country. Removing barriers to increase the size of a marketplace in which we can compete gives us this opportunity.

Needless to say, this doesn't omit that we remained challenged with some structural problems here at home. Bank of Montreal Chief Economist Douglas Porter estimates that for the 12 years spanning 2002 to the end of 2013, unit labour costs in Canada rose 98 percent versus a mere 10 percent gain in the United States. As Canadian labour costs increased significantly relative to the States, breaking down Canada's gains reveals 28 per cent was attributed to weaker productivity versus 70 per cent being due to a strengthening loonie. As a strengthening dollar no doubt held back Canadian manufacturers, examples like the Canadian auto industry seeing zero new investment dollars in 2013 serve sobering reminders of where innovation is needed, especially when the fate of a currency is subject to market forces.

And with the dollar, Bank of Canada policy becomes an important factor. Like the US Federal Reserve though, as the economy gains strength and more stability, monetary policy will play a much smaller role with central bankers returning to the shadows. It is simply our central banks wish to see our economy return to normality, and with that the active role they have played will slowly subside. And as the US economy rebounds, the forecasts for a weaker loonie and stronger growth on the back of our neighbours to the south will ensue.

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