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# Macro Market Insights

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**Robert Levy**
MA (Economics)
Director
**rlevy@bordergold.com**
**(604) 535-3287**
**www.bordergold.com**

## Looking at the Loonie

It's hard to avoid the topic of the beleaguered Canadian dollar given the swift move down we have seen against its US counterpart over the last six weeks. Just six weeks ago the Loonie was much stronger, roughly trading around 97.50 Cents US before the Bank of Canada abandoned what many referred to as their hawkish bias on their second most recent policy announcement. And by removing that reoccurring implication that the next move in interest rates was going to be higher and just simply waiting for the economy to pick up some steam, economist and investors took the withdrawal of that hawkish tone as an indication that next move in interest rates could just as likely be to the downside.

But rest assured, a move lower in interest rates is not in the cards from the Bank of Canada in the months ahead, and the despite the toll its taking on the dollar, we won't see the bank change step. In fact, this most recent downturn in our currency is one of the most natural trade boosters we could receive. But there is no question that the Canadian economy is struggling to achieve the economic growth forecasts that many had been optimistically hoping for earlier in the year. However, it is still nowhere near sluggish enough for the central bank to re-enter (or arguably remain in) a sustained period of emergency level record low interest rates. And quite simply, it is the inability for the Bank of Canada to raise interest rates due to the inherent weakness in the economy, and that is the main factor driving the Loonie lower.

There are also two fundamental reasons though we are seeing weakness in our currency. The first has to do with the lack of inflation. Most recent data highlights the price level advanced by an annualized rate of a mere seven tenth of a percent in October. And the lack of inflation in the economy has two very simple implications. One is that low inflation levels are associated with more muted periods of economic growth. The second and relating to the lower levels of economic expansion is that the economy struggles to create jobs. But when you have the Canadian economy still averaging over 13,000 jobs created a month, it's not yet a worry. For any serious credibility given to a downward move in interest rates, job growth would seriously have to dissipate.

The second reason we are seeing the dollar trade lower is to do with a deteriorating balance of trade. Particularly, the weakening demand we are seeing in the resource sector is equating to a waning demand to purchase those commodities. And as that sector of the economy has proven to be so pro cyclical with GDP growth, it can be expected that when the resource sector picks up again, and it will, we will see a renewed demand that is very supportive of the Canadian currency.

While examining the fundamental factors impacting the Canadian dollar these last few months, if these volatile financial markets over the last few years have illustrated anything, fundamentals, albeit important, can very much be trumped by the sentiment of investors. And the fact that Canada was the least dirty shirt among the worlds developed economies was what elevated our Canadian dollar above parity. In fact, beyond the fundamentals, the Canadian dollar almost carried an elite status because of the relative strength of our financial institutions following the worst recession since the Great Depression. In the moment though, the story is very much about the regained strength of the US dollar. Pair that with a central bank abandoning their hawkish views and we will see the premium in our currency dissipate.