

A Dollar Tug of War

A little over a year ago when the world was discussing the realms of currency wars and central banks purposely imposing policy in order to devalue their exchange rates with trading partners, it was the policy makers that argued that their approach was directed domestically, and a weaker currency was simply an indirect consequence. As long as the policy intent was not, for example to weaken their currency, or to better the country's respective terms of trade by cheapening their exports, it was deemed acceptable.

Today, however, we are seeing the other side of that coin as western central bankers once again look out for their respective countries best interest, and in an uncoordinated approach adjust their monetary policy and stimulus. And it's the worlds emerging economies, who were the engine of growth for the global economy as it climbed back from the worst recession since the Great Depression, that are feeling the pain.

It was only by coincidence, not by design, that central bankers around the world coordinated policy in order to spur economic growth. It prompted fears of currency wars or a "race to the bottom" in terms of devaluing their exchange rate. I think it's clear now that did not yet happen. But if the tremors we are witnessing in currency markets over the last few days have illustrated anything, it's that nothing destabilizes risk assets like the boisterous equity markets of 2013, more than uncertainty and instability in foreign exchange markets. And that's exactly what's to come as the world's central banks once again operate in this unilateral non-structured fashion.

Over the course of the last week we saw action from central banks all over the world in attempts to stabilize their financial sectors. As the markets perceive the United States and the US Federal Reserve to be tightening their policy by altering their stimulus and decreasing their bond purchases by a successive \$10 billion per month, the emerging market economies have no

choice but to follow suit. It's simply a stronger dollar attracting capital and foreign investment back towards the US, and other advanced economies. In the last week, countries like Turkey have had to raise their key policy interest rate from 7.75 percent to 12 percent in an emergency meeting. Although not as drastic, South Africa and India raised their rates also. And this doesn't discredit that the home grown problems some of these countries already face may be the root cause of their suffering; moreover, a strengthening US dollar only acts to exacerbate their problems.

It's almost paradoxical though how emerging economies through the efforts of the G20 were relied upon to fuel a recovery for the industrialized nations of the world. Many countries saw their exchange rates significantly strengthen against the US dollar, with Brazil being the textbook example as the Real appreciated by as much as 48 percent. No questions this strangled their export sector, especially given they represent resource based open economies which thrive on strong international markets. But now, a rift if being created as no consideration is yet to be given from the western world. A dollar tug of war is creating a global imbalance. And what's surprising is that with a strengthening dollar, we are seeing the rebirth of the safe haven characteristics of gold.

Only in periods of extreme turmoil do we see gold and the US dollar trade higher in tandem. And that's not to suggest that we have entered a period of extreme turmoil, but it certainly shows the potential for gold. To some extent it's argued the industrialised nations can immune themselves from an emerging market crisis; nonetheless, periods of economic uncertainty have always been favourable for gold. That's when insurance is needed more than ever. Alternatively, a weak US dollar also bodes well for the yellow metal. I don't want to attempt to forecast a crisis, but this tug of war, juggling act, or whatever we want to call it is what will see gold bottom in 2014.

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