

Greenback sticking to its downward trend

Highlights

- The U.S. dollar index should lose a little bit more ground.
- The euro is cashing in on greenback pessimism.
- The pound should continue to weaken against the euro.
- The yen's structural weakness remains intact.
- Factors behind the loonie's rise are still positive.
- World demand will remain favorable to commodity linked currencies.

Editorial

The greenback's generalized downward trend continues. The U.S. dollar index weighted against the major currencies has lost nearly 10% since the year opened, to hit the lowest level ever recorded (graph 1).

Graph 1 – The U.S. Dollar Index at a historic low



Sources: Federal Reserve Board, Datastream and Desjardins, Economic Studies

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At these levels, the U.S. dollar is evolving well below its long-term trend and could bounce back at any time. In particular, net non-commercial positions on futures are extremely negative. This means that investor pessimism regarding the greenback is a little overstretched, a situation that has always coincided with a break in the trend (graph 2 on the next page). However, the American economy remains weak compared to its peers, and the greenback is likely to lose a little more ground by the end of the year.

THE ONGOING REAL ESTATE CORRECTION IS STILL AT THE ROOT OF THE PROBLEMS

Difficulties remain mainly concentrated in the United States where the real estate correction continues. Housing starts fell for a third consecutive month in September to their lowest

François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

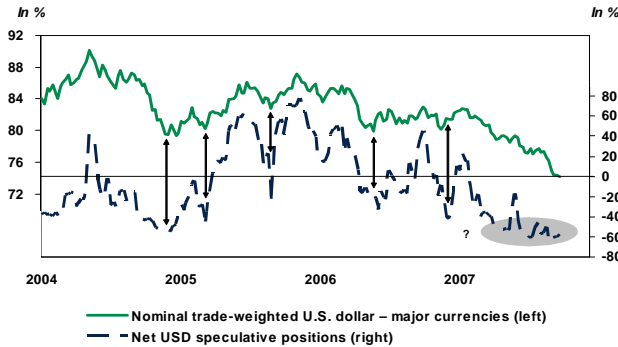
Mathieu D'Anjou
Economist

Martin Lefebvre
Senior Economist

Hendrix Vachon
Economist

514-281-2336 or 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

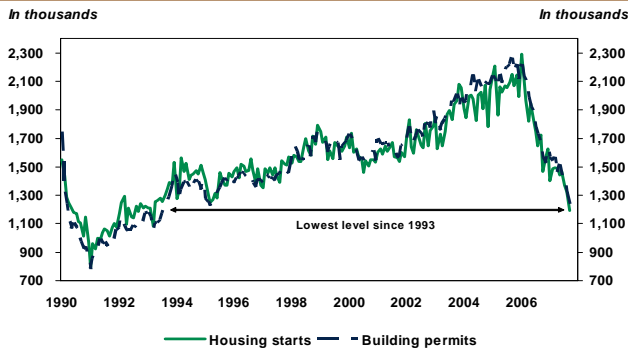
Graph 2 – The market is very pessimistic about the greenback



Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

level since 1992 (graph 3). During the same month, U.S. homebuilder confidence, as estimated by the National Association of Home Builders index, fell to its lowest point since the index was constituted in 1985. This is reflected in an almost nationwide decline in building permit applications. Temporary rebounds in housing construction could occur by the end of the year, but nothing is pointing to any substantial turnaround by the downward trend that has been in place for the last few quarters.

Graph 3 – Housing starts and building permits are down again



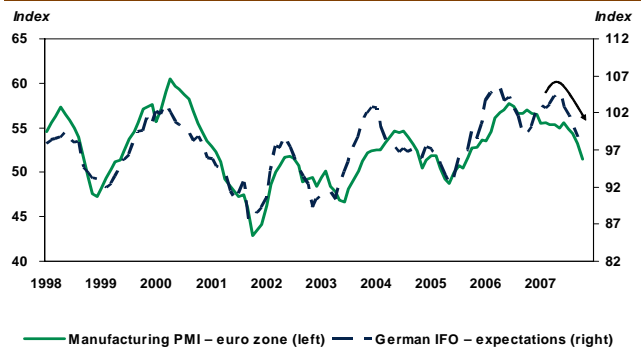
Sources: Census Bureau and Desjardins, Economic Studies

What's more, though tension was eased by upward revisions to U.S. job creation in August and stronger-than-forecast retail sales in September, a number of factors have revived investors' fears. In addition to the housing market problems, statements by the U.S. Federal Reserve's current and former Chairs, Ben Bernanke and Alan Greenspan, to the effect that credit conditions would continue to put the brakes on economic growth were amplified by disappointing financial results from the banking sector. The markets immediately fully priced in a cut to the federal funds rate for the next Fed meeting on October 30 and 31, giving further fuel to the greenback's weakening.

THE EURO WILL CONTINUE TO PROFIT FROM THE GREENBACK'S DOWNWARD TREND

The Euroland currency reached a peak of almost US\$1.43 in October, and everything suggests it is heading for new peaks. With tightening credit conditions and generalized resurgence by risk on the markets, the European Central Bank seems to be in less of a hurry to raise the cost of money in the euro zone. It should be said that there are some signs of a coming economic slowdown. The combined PMI manufacturing and services index has been decelerating since January, and Germany's IFO index has clearly crested (graph 4).

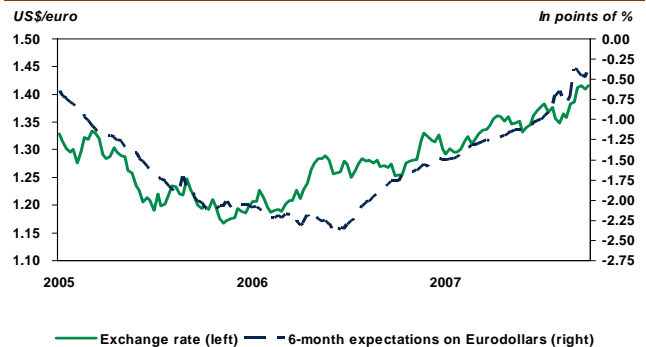
Graph 4 – Economic expansion should decelerate in the euro zone



Sources: Datastream and Desjardins, Economic Studies

However, the inflation pressure underlying the domestic economy remains strong (the jobless rate is historically low, there is record growth by the money supply, etc.), and markets have not completely ruled out monetary firming. In any event, the interest rate spread has narrowed somewhat and the expected U.S. rate cuts should allow the euro to cross the US\$1.45 mark by the end of the year (graph 5).

Graph 5 – The expected narrowing of the spread between European and U.S. interest rates favours the euro



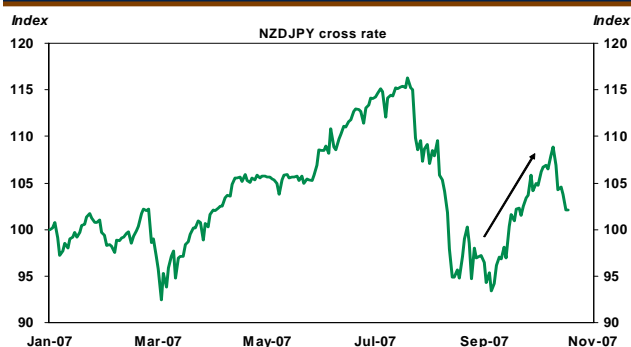
Source: Desjardins, Economic Studies

THE YEN WILL CONTINUE TO TRADE IN A STRONGER RANGE

The resurgence by risk that followed August's liquidity crisis helped to bolster the yen. However, the Japanese currency's gains against the greenback were much smaller than the gains made by the other major currencies. This shows that the yen's structural weakness is intact. The Japanese economy retreated in the second quarter, and the information available to date shows that we cannot expect real GDP to rebound sharply in Q3. Moreover, the country continues to grapple with a persistent deflation problem, which makes it hard for monetary authorities to justify raising key interest rates.

Under these circumstances, despite a general revaluation of the risk, the carry trade situation (the yield obtained from foreign investments financed by borrowing yen) remains favourable. What's more, a number of popular cross rates involving carry trades, including the NZD/JPY rate, have come back from the low point in the crisis (graph 6).

Graph 6 – Carry trades looking alive again



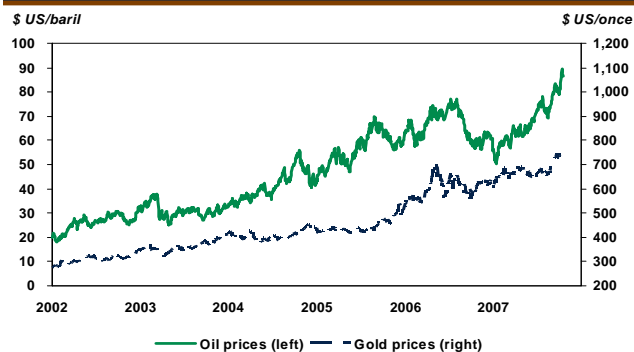
Source: Desjardins, Economic Studies

THE LOONIE'S DETERMINANTS CONTINUE TO BE POSITIVE

The Canadian dollar's parity with the greenback is now well entrenched. In October, the dollar was trading on average at over US\$1.00, and the trend remains positive. Since the beginning of the year, the loonie has gained over 20% against the greenback, and everything suggests that, before the end of the year, it will reach the US\$1.0443 peak that dates back to April 25, 1974.

All of the loonie's determinants are positive. In addition to the greenback's downward trend, metals and oil prices, which reached new highs in October (graph 7) should continue to rise. While the risks are now tilted more to the downside, global demand for commodities remains strong, which should continue to offer the loonie solid support.

Graph 7 – Prices of some raw materials have hit new peaks



Source: Desjardins, Economic Studies

What's more, the situation does not seem propitious for an imminent change in the country's monetary policy. The Bank of Canada (BoC) remains visibly torn between the positive impacts of strong global demand and high commodities prices on Canadian demand, on the one hand, and, on the other, the moderating effects on net Canadian exports of the darkening economic outlook in the United States and the strong loonie. The BoC judges that the risks to the inflation projection are relatively balanced, although there is perhaps a tilt to the downside. In particular, it seems concerned about the effects a type 2 loonie appreciation (i.e., appreciation that is not associated with heightened demand for Canadian products) could have on aggregate demand and inflation.

"The recent round of appreciation has been abnormally quick and doesn't seem to be related to the domestic factors that would normally lead to that sort of rapid appreciation."

Governor David Dodge, Bank of Canada
 Washington, October 21, 2007

For now, information is still too scanty and caution is called for. We continue to expect the present status quo to continue. As a result, the spread between Canadian and U.S. interest rates should continue to narrow until the end of the year, a situation that is favorable to the loonie.

François Dupuis
 Vice-President and Chief Economist

Martin Lefebvre
 Senior Economist

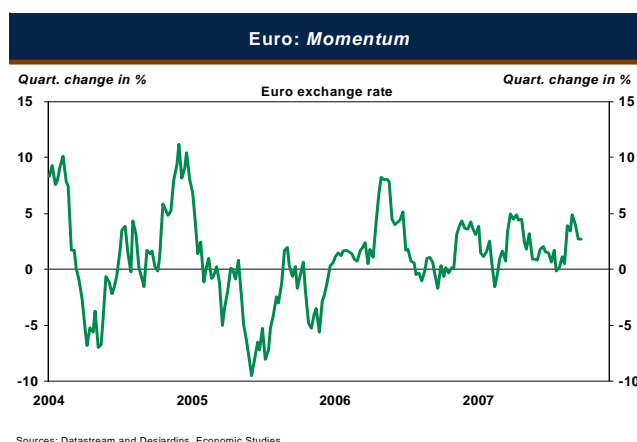
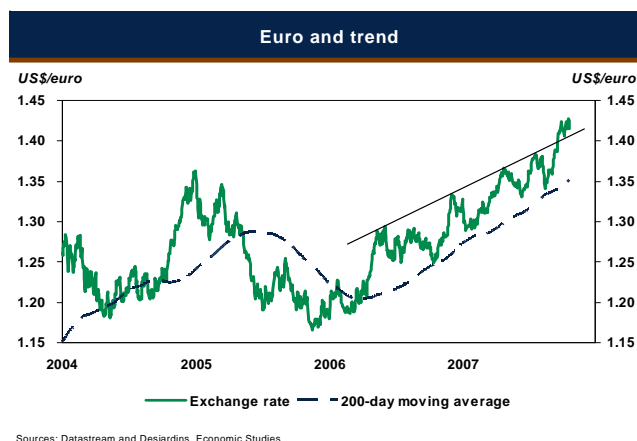
EURO (EUR)

The euro benefits from pessimism surrounding the greenback

- The euro is still on a rising trend. After some softness following mid-August's liquidity crisis, Euroland's currency has benefited from pessimism about the U.S. economy, crossing US\$1.40 to reach a new peak, US\$1.43, in October.
- Technically, the currency is ripe for a correction. Market sentiment has peaked, euro momentum is high and speculative positions are teeming. However, given the pessimism about the greenback, the timing does not yet seem right for betting against the euro.
- In the near term, the euro's outlook remains positive. The U.S. real estate market's struggles are back in headlines and the markets expect the U.S. Federal Reserve (Fed) to continue with monetary easing in the next six months. Conversely, in the euro zone, although the situation is not as propitious for continuing with monetary firming, the markets have not completely dropped the idea that the European Central Bank (ECB) will raise its key rate later this year or in early 2008.
- In the longer term, however, we anticipate a euro correction. The U.S. slowdown will have an inevitable downward impact on Euroland's growth. Several indicators are already showing that real GDP growth should slow in the next few quarters. Firmer growth in the United States combined with changes in investor perceptions of the ECB will trigger a euro correction as of Q1 of 2008.

Forecasts

The euro should maintain its momentum in the near term. If the Fed lowers federal funds in October or December, the euro is likely to go over US\$1.45 by the end of the year.



BRITISH POUND (GBP)

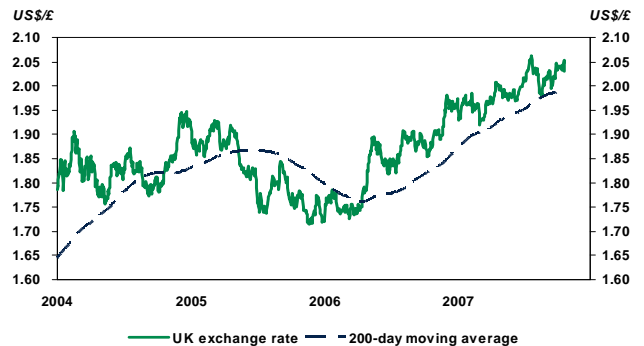
The pound should keep falling against the euro

- The pound sterling did not move much in October, oscillating in a tight band around US\$2.04.
- With little movement, and little market enthusiasm about the pound, Britain's currency should evolve closer to its long-term trend until the end of the year.
- In the near term, there is little prospect of gains for the pound. For now, the British economy is still resilient. Retail sales were surprisingly lively in September and real GDP posted an annualized 3.2% gain for the third quarter, its eight straight quarter above growth potential. However, cresting by home price increases signals that a slowdown by consumer spending is to be expected. What's more, the reverses experienced by Northern Rock, a major British mortgage lender, showed that the U.K. was not immune from the credit crisis.
- For now, the Bank of England (BoE) judges it is too early to quantify the potential impact of tightening credit conditions, but one member (8 vs. 1) voted for an immediate rate cut in October. Inflation has fallen faster than forecast, giving the BoE more leeway if the need to kick-start the economy emerges. In our view, it is too early to lower rates. Unless there is a clear slowdown in American growth, U.K. key rates may only be cut for the first time in early 2008.

Forecasts

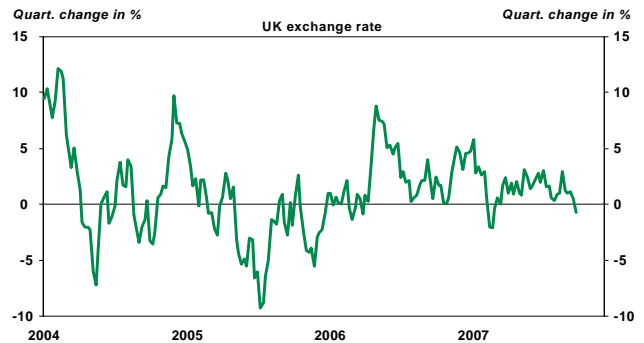
The pound should be steady against the greenback in the short term. Under these circumstances, we continue to lean toward the EURGBP improving to close to 0.71 by the end of the year.

British pound and trend



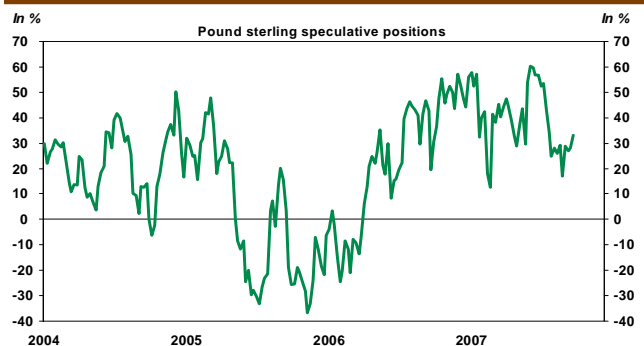
Sources: Datastream and Desjardins, Economic Studies

British pound: Momentum



Sources: Datastream and Desjardins, Economic Studies

British pound: net speculative positions



Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

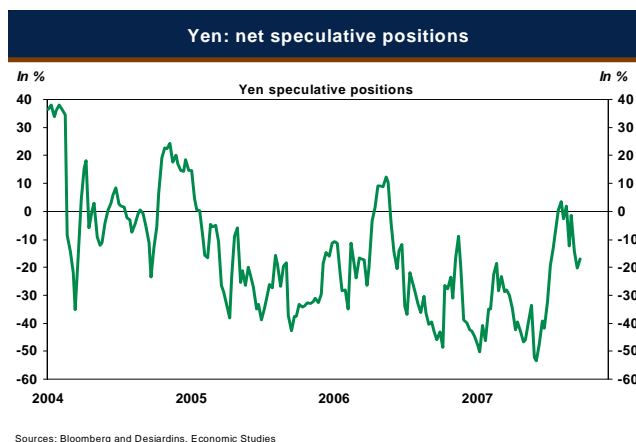
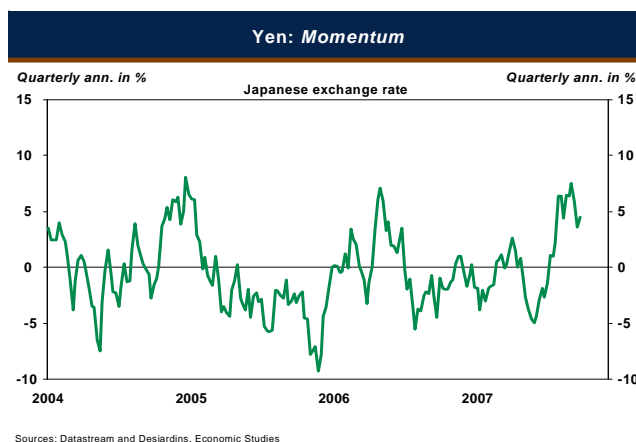
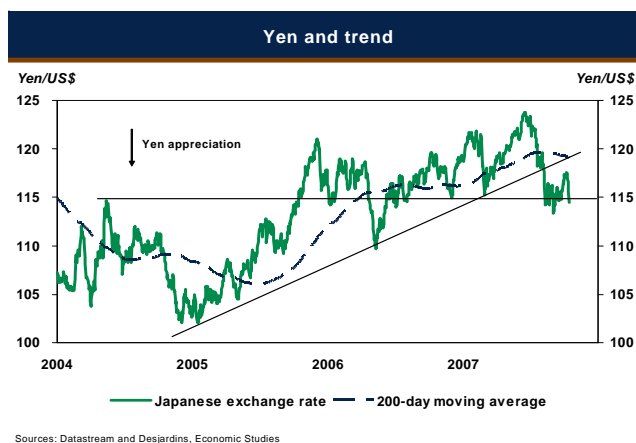
YEN (JPY)

The currency's structural weakness is still with us

- The yen has appreciated by close to 7.5% against the greenback since mid-June. At best, Japan's currency will succeed in consolidating its gains by year's end, but the currency's structural weakness continues.
- The liquidity crisis and resurgence by risk allowed the yen to cross a major technical barrier in mid-August, and appreciate to levels around 115 yen/\$US. However, pessimism about the yen is growing again and the rising movement is beginning to run out of steam.
- Note that the U.S. Federal Reserve's 50 basis point cut to federal funds on September 18 was well received by the markets, which have begun to take risks again, pushing speculative exchange transactions to rise.
- Japan's economy is also still dragging its heels. Economic growth is anaemic and the price indexes continue to send mixed signals regarding inflation. In our view, the Bank of Japan should postpone rate increases to next year. Under the circumstances, interest rate expectations will remain against the yen, although 50 basis points in federal funds cuts are expected in the next six months.

Forecasts

In the short term, the pressure on the yen is to the downside. Bad news from the U.S. will be viewed as an increase in risk, which will play against Japan's currency as it is very dependent on carry trades. Popular cross rates have quickly regained strength, putting them in a precarious position. With home prices cresting in New Zealand, the NZDJPY cross rate seems especially vulnerable to a correction.



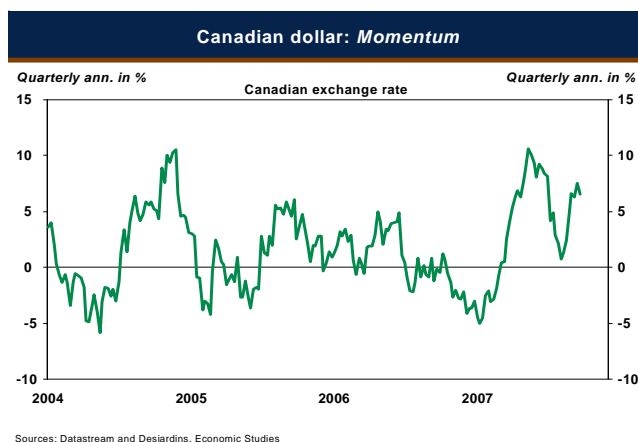
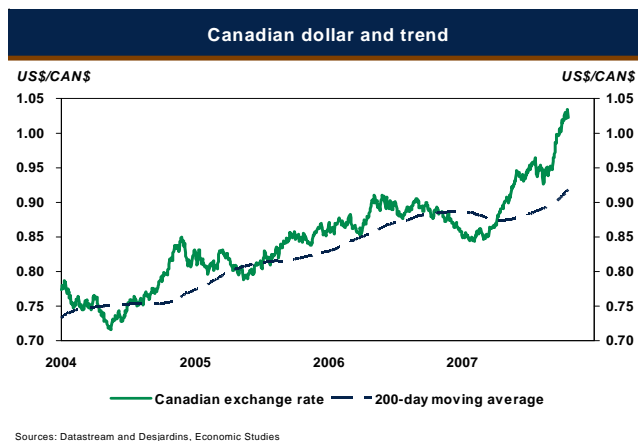
CANADIAN DOLLAR (CAD)

The loonie's determinants continue positive

- The Canadian dollar continues to defy gravity. Since the year began, the loonie has gone up 20% against the greenback, and 11.5% against the euro.
- Technically, the enthusiasm for Canada's dollar seems to be stretched to its utmost. Following a soft period early this year, the loonie's sharp appreciation has now put the currency well above its long-term trend. Net positions on non-commercial CAD contracts, a measure of market speculation, have never been this high. Movement on the currency has started up again and is nearing levels that are compatible with a period of consolidation or even correction.
- That said, the current circumstances suggest that the loonie should easily shatter the record of US\$1.0443 it set on April 25, 1974. For one thing, the real estate correction should prod the U.S. Federal Reserve to further ease its monetary policy, which will keep the greenback on its downward trend. For another, strong global demand should continue to impact energy and non-energy materials prices. Oil prices went to over US\$90/barrel in mid-October and, with winter on its way, nothing suggests prices are getting ready to drop back below US\$70 any time soon. The same goes for metals. Of course, the U.S. slowdown is not certain, but Asian demand is still very strong, which is compatible with continued price growth.
- In the longer term, the loonie appears to be subject to a correction. We believe that the slow improvement to the U.S. economic situation, profit taking and easing tensions on oil prices in early 2008 will encourage the market to reposition itself and put the Canadian dollar back on its long-term path.

Forecasts

The currency is ripe for a correction, but, in our view, it is risky to bet against the market at this point. We are revising our year-end target to US\$1.04. This will not keep the loonie from crossing US\$1.05 or higher in the meantime.



AUSTRALIAN DOLLAR (AUD)

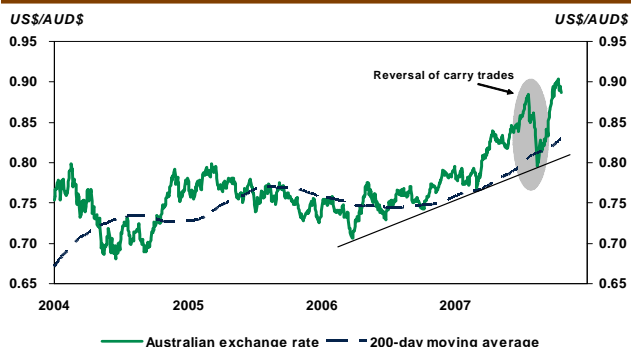
Global demand will continue to favour commodity currencies

- Despite the correction triggered by resurgent risk and the temporary reversal of carry trades in mid-August, the AUD is still on a rising slope. Australia's currency jumped almost 12% in the last two months, taking back all of the losses posted in the aftermath of the liquidity crisis.
- The AUD's rising trend is holding, but its strong surge in recent weeks puts it in a correction situation. The momentum has not yet taken it to "critical" levels. However, speculation is on fire, sending the signal that the AUD could correct in the near future. That said, any correction will be temporary.
- The fundamentals are good, which should allow the AUD to start back up again by the end of this year and next year. On one hand, election year could result in tax cuts, a situation that would be favourable to increased consumer spending. On the other, the Reserve Bank of Australia chose to opt for prudence in September and keep the status quo. However, home prices are still going up and monetary firming should start up again by the end of this year, or early next year.
- Moreover, Australia continues to benefit from China's proximity and the strong demand for commodities. To this effect, record gold prices will continue to offer good support to the Australian dollar.

Forecasts

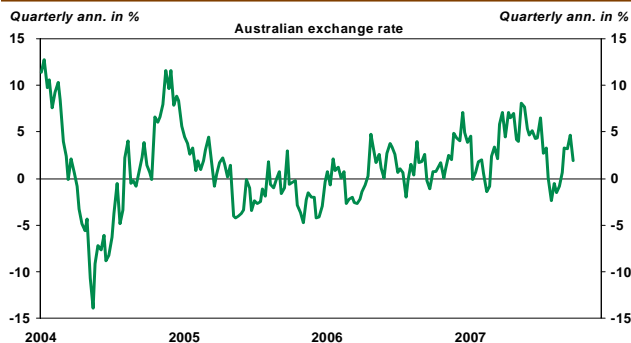
At US\$0.90, parity could be achieved by mid-2008. The Australian dollar won't be hard hit as much as other commodity linked currencies.

Australian dollar and trend



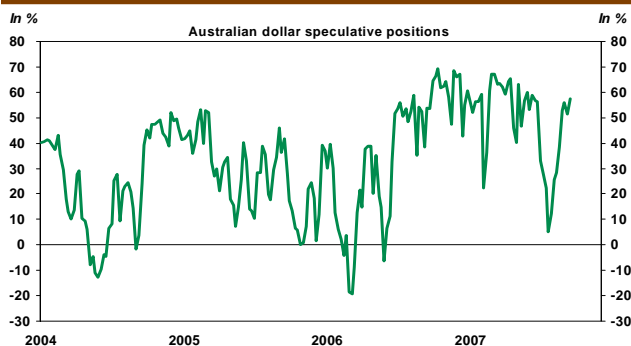
Sources: Datastream and Desjardins, Economic Studies

Australian dollar: Momentum



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Australian dollar: net speculative positions

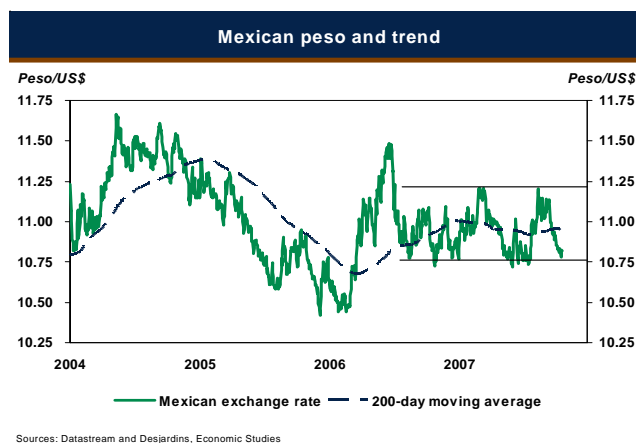


Sources: Datastream and Desjardins, Economic Studies

MEXICAN PESO (MXN)

The greenback is ripe for a rebound

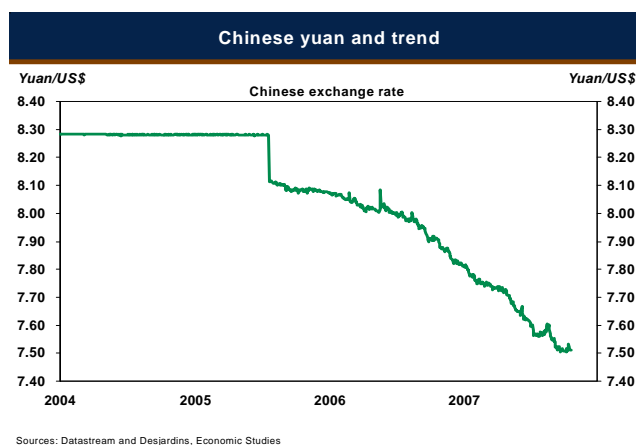
- The Mexican peso appreciated to a two-month peak in mid-October, as the central bank's inflation concerns prodded the markets to expect a return by monetary firming by year's end.
- However, economic expansion is still anaemic, and Mexico's extensive dependence on its northern neighbour suggests that the MXN's gains will be limited. Many Mexican construction workers who participated in the U.S. real estate boom are now without jobs. Mexican exports will also be hit by the current American slowdown.
- In these conditions, the peso should continue to evolve in a narrow range, between US\$10.75 and US\$11.25.



CHINESE YUAN (RMB)

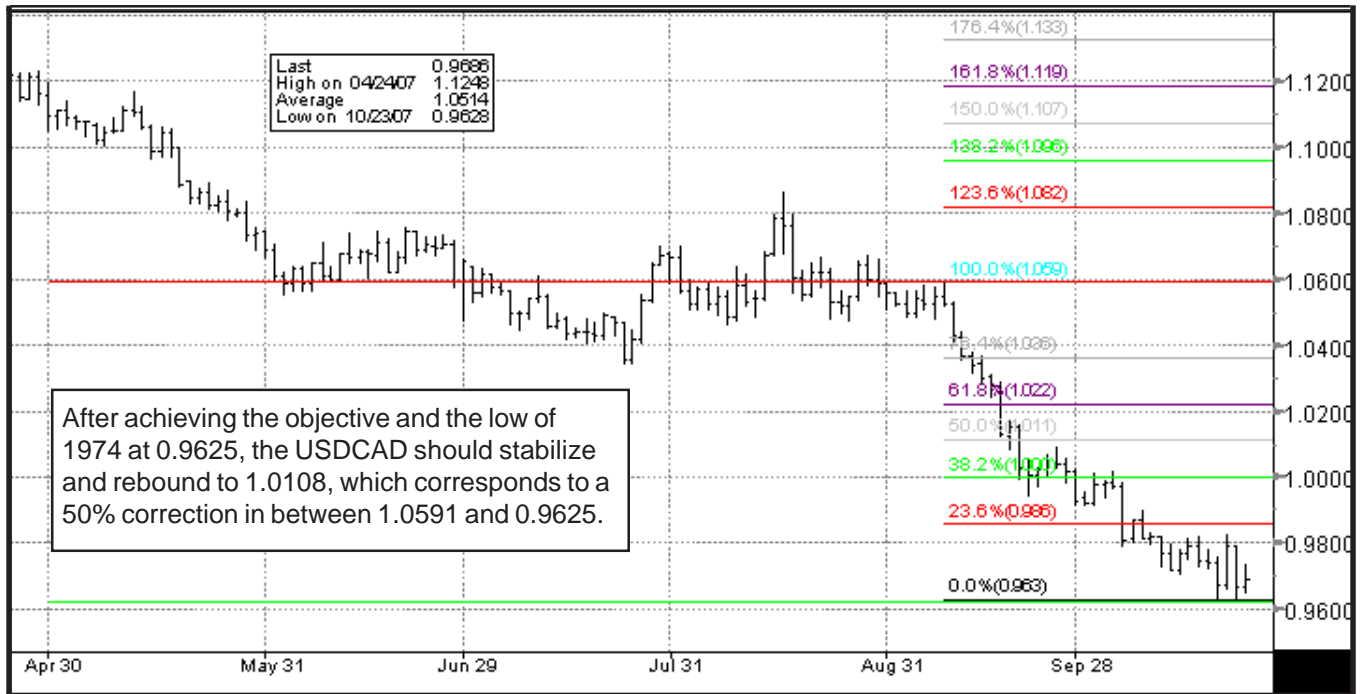
It is in China's interest to let the yuan float more freely

- China's currency appreciated at a slightly faster pace against the greenback in the last few months, bringing its total gains since the July 2005 revaluation to 10.2%. However, the greenback's decline means that the RMB is weak against the major currencies, and the effective exchange rate is steady.
- International pressure for faster RMB appreciation is strong. The Chinese current account explosion and massive influx of foreign capital are causing reserves to keep growing at a fiery pace. This means that the RMB is clearly undervalued in relation to the Chinese economy's fundamentals.
- At this rate, and with monetary policy that is not very efficient, in our opinion, the People's Bank of China will have no choice but to allow the currency to float in 2008.

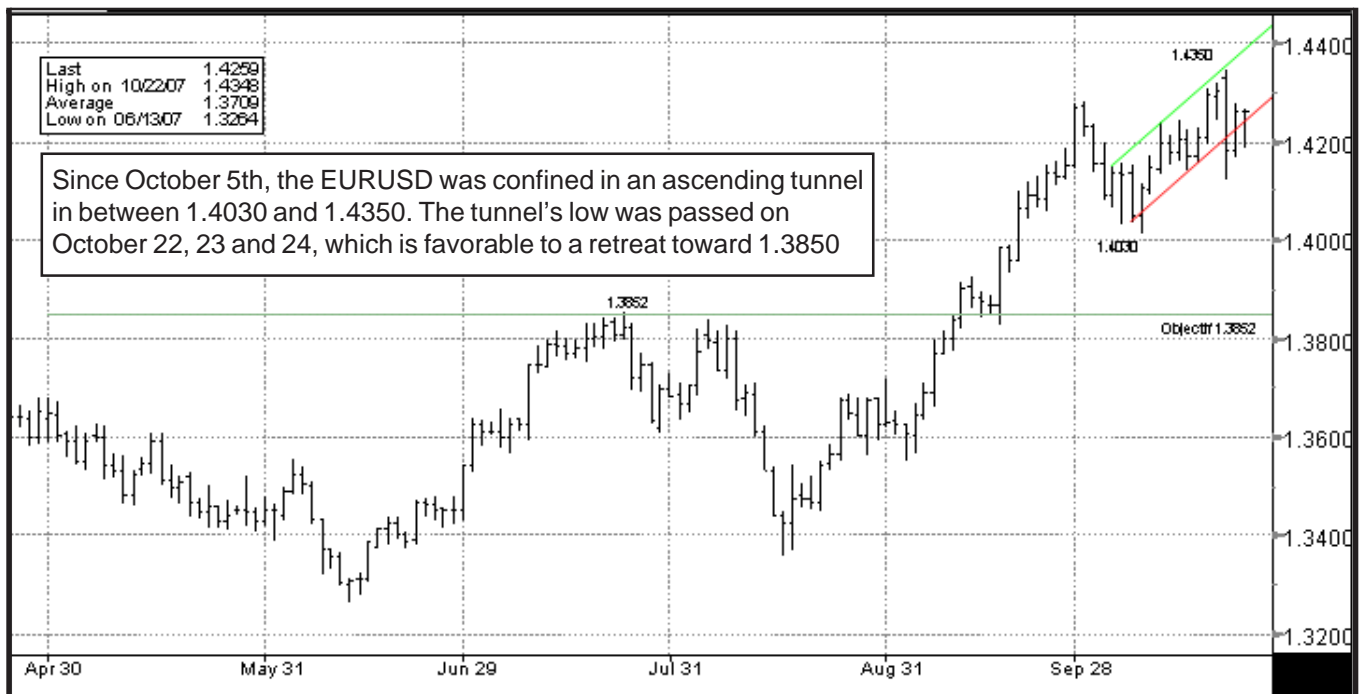


TECHNICAL ANALYSIS

USDCAD

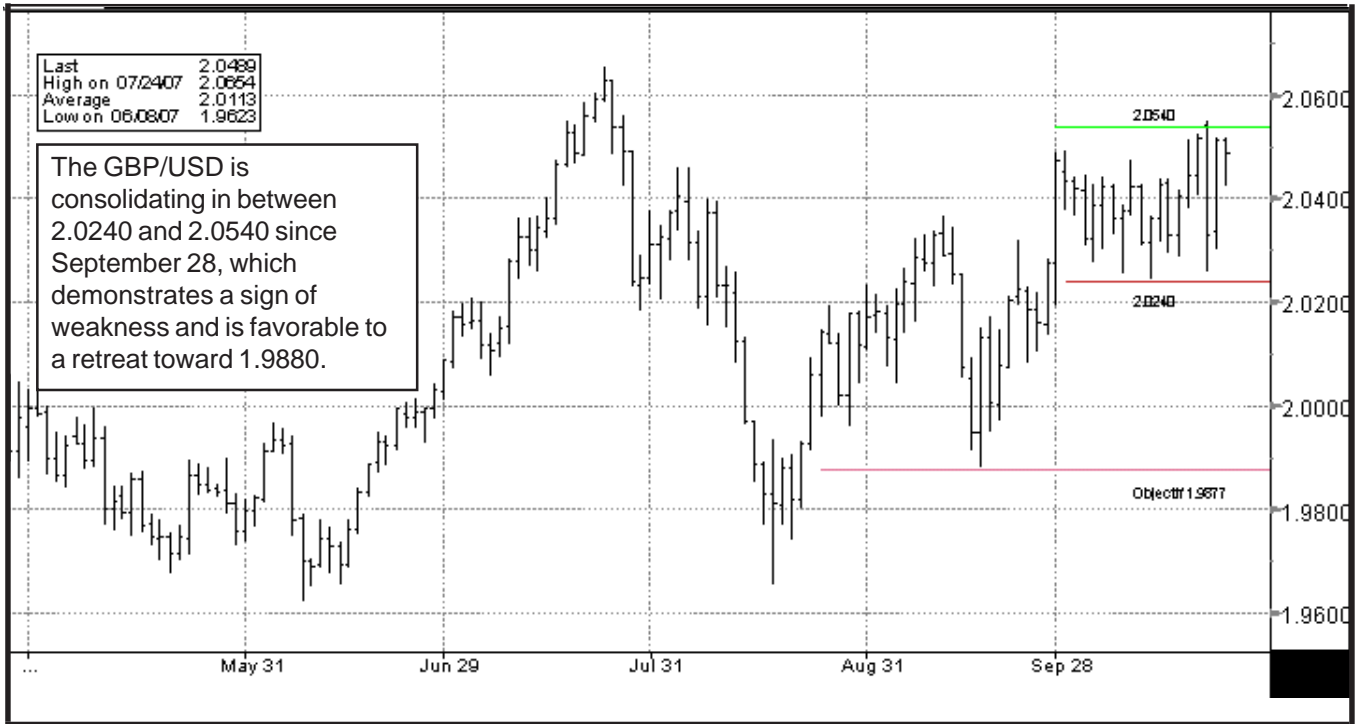


EURUSD



TECHNICAL ANALYSIS

GBPUSD



JPYUSD



Currency markets

Country – Currency*	Spot price		Previous data			Last 52 weeks		
	Oct/24	-1 month	-3 months	-6 months	-1 year	Higher	Average	Lower
North America								
Canada – dollar	0.9712	1.0010	1.0383	1.1218	1.1292	1.1860	1.1036	0.9647
Canada – (CADUSD)	1.0297	0.9991	0.9632	0.8915	0.8856	0.8432	0.9062	1.0366
Mexico – peso	10.8321	10.9333	10.7789	11.0045	10.8513	11.2456	10.9301	10.6975
South America								
Argentina – peso	3.1788	3.1463	3.1340	3.0813	3.0888	3.1838	3.1025	3.0488
Brazil – real	1.8020	1.8660	1.8446	2.0381	2.1464	2.1834	2.0174	1.7916
Asia								
China – yuan renminbi	7.4948	7.5100	7.5635	7.7269	7.9050	7.9060	7.6906	7.4948
Hong Kong – dollar	918.00	921.05	914.10	927.25	958.50	958.50	931.02	913.75
India – rupee	7.7510	7.7755	7.8227	7.8164	7.7813	7.8299	7.8008	7.7507
Japan – yen	39.5145	39.5255	40.1455	40.8305	45.2005	45.2965	42.2009	39.1250
South Korea – won	114.19	114.92	120.19	118.55	119.43	123.82	118.76	113.39
Europe								
Denmark – krona	5.2268	5.2954	5.3806	5.4631	5.9385	5.9385	5.5592	5.2122
Euro zone – US\$/€	5.4305	5.5172	5.7416	5.9440	6.6706	6.6706	6.0218	5.3549
Norway – kroner	2.0469	2.0221	2.0614	2.0028	1.8719	2.0614	1.9804	1.8719
Russia – ruble	24.8916	25.0135	25.3885	25.7141	26.9185	26.9185	25.9314	24.8308
Sweden – krona	6.4645	6.5176	6.6599	6.7435	7.3318	7.3318	6.8659	6.4123
Switzerland – swiss franc	1.1731	1.1734	1.2045	1.2027	1.2687	1.2687	1.2169	1.1666
United Kingdom – US\$/£	1.4229	1.4092	1.3824	1.3622	1.2546	1.4280	1.3412	1.2546
South Pacific								
Australia – (USDAUD)	1.1071	1.1523	1.1345	1.2080	1.3183	1.3183	1.2243	1.1063
New Zealand – (USDNZD)	1.3243	1.3392	1.2432	1.3459	1.5156	1.5260	1.3916	1.2415

* In comparison with the U.S. dollar, unless otherwise indicated.

Note: Currency table base on previous day closure.

Currency markets: History and forecasts

End of period	2006		2007				2008			
	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
American dollar										
Canadian dollar (USDCAD)	1.1179	1.1654	1.1535	1.0651	0.9944	0.9615	1.0000	1.0204	1.0000	0.9756
Euro (EURUSD)	1.2667	1.3186	1.3311	1.3506	1.4222	1.4500	1.4000	1.3600	1.3200	1.3100
British pound (GBPUSD)	1.8723	1.9589	1.9673	2.0080	2.0471	2.0000	1.9800	1.9600	1.9500	1.9300
Yen (USDJPY)	118.03	119.03	117.67	123.20	114.80	114.00	112.00	110.00	108.00	106.00
Australian dollar (AUDUSD)	0.7461	0.7889	0.8090	0.8503	0.8885	0.9200	0.9200	0.9400	0.9200	0.9000
Mexican peso (USDMXN)	10.99	10.80	11.04	10.81	10.94	10.75	10.90	11.00	11.25	11.35
Chinese yuan (USD RMB)	7.91	7.81	7.73	7.61	7.51	7.40	7.18	7.00	6.00	#REF!
Effective dollar* (73 = 100)	81.83	81.41	80.53	78.65	74.38	74.23	73.57	72.91	72.26	72.00
Canadian dollar										
American dollar (CADUSD)	0.8945	0.8581	0.8669	0.9389	1.0056	1.0400	1.0000	0.9800	1.0000	1.0250
Euro (EURCAD)	1.4161	1.5367	1.5355	1.4385	1.4143	1.3942	1.4000	1.3878	1.3200	1.2780
British pound (GBPCAD)	2.0931	2.2828	2.2694	2.1387	2.0357	1.9231	1.9800	2.0000	1.9500	1.8829
Yen (CADJPY)	105.58	102.14	102.01	115.67	115.44	118.56	112.00	107.80	108.00	108.65
Australian dollar (AUDCAD)	0.8341	0.9194	0.9332	0.9056	0.8836	0.8846	0.9200	0.9592	0.9200	0.8780
Mexican peso (CADMXN)	9.83	9.27	9.57	10.15	11.00	11.18	10.90	10.78	11.25	11.63
Chinese yuan (CAD RMB)	7.08	6.70	6.70	7.15	7.55	7.70	7.29	7.04	7.00	6.15

f: forecasts

* Trade-weighted against major U.S. partners.

Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies