

Risk aversion at the forefront!

HIGHLIGHTS

- For the near future, prudence is in order: renewed risk aversion and the severity of the worldwide recession are compatible with a strong dollar.
- It is also too early for any structural depreciation by the yen.
- The euro down trend, recorded since the end of 2008, is running out of steam, but the European Central Bank's monetary policy is clearly inadequate.
- The Bank of England's vigorous action means we can expect the pound to stabilize or even rebound, particularly against the euro.
- Despite the upheaval, the loonie is keeping its head high. In the near term, if oil prices slide below December's low, this would make the USD/CAD test the end of the year's triple top. However, current crude prices seem oversold and any improvement to the economy will result in putting the loonie back on track for growth.
- Major efforts to kick start the economy could help the Australian dollar.

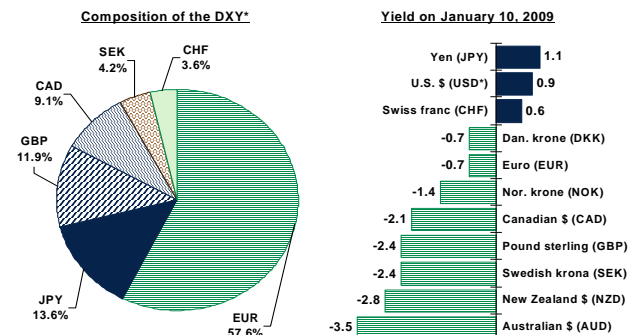
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Editorial

For a moment, the financial and economic tensions seemed to have eased. In January, the market swallowed the 600,000 some job losses (widely expected) without a hiccup, believing this would make the Obama administration do everything it could to get an economic recovery plan out quickly. It did not take long for things to sour, rapidly bringing the risk aversion theme back to the surface. On one hand, Washington's partisan bickering suggests that we will not be seeing the green in a hurry. On the other, the plan put out by new Treasury Secretary Tim Geithner on February 10 is ambitious but vague, which was a bitter disappointment for the markets. On that day alone, the New York Stock Exchange lost 4.6%. The currencies that are correlated with risk aversion have appreciated, while the European currencies and currencies linked to commodity prices have been hurt (graph 1).

Graph 1 – Risk-correlated currencies appreciated on February 10



* U.S. dollar spot index.
Sources: Bloomberg and Desjardins, Economic Studies

Judging from the resistance zone that is shaping up, the next few months could prove to be black or white for the greenback (graph 2). Of course, the current situation is not as dire as the days that followed the Lehman Brothers collapse; any easing could trigger a downward adjustment by the U.S. dollar.

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Graph 2 – U.S. dollar: up or down?



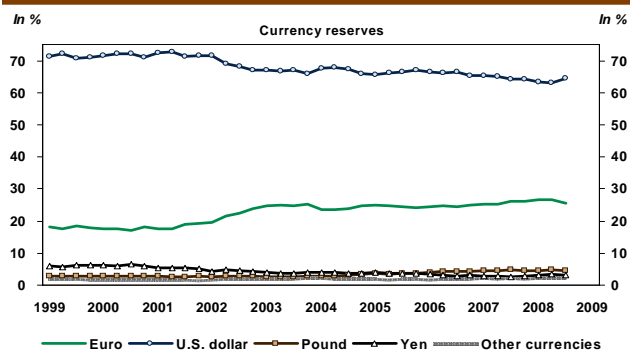
* U.S. dollar spot index.
Sources: Datastream and Desjardins, Economic Studies

However, Washington's equivocations (which could delay the economic recovery plan) or a failure by the Geithner plan (which could postpone the hoped-for improvement to the banking system) would have the potential to maintain the appeal of safe haven securities.

RISK AVERSION REMAINS THE FLAVOUR OF THE DAY

Under these conditions, caution is in order for the near term. As a reserve currency, the American dollar should remain popular (graph 3). The repatriation of capital to the United States and the central banks' appetite for Treasury securities are in keeping with a strong dollar.

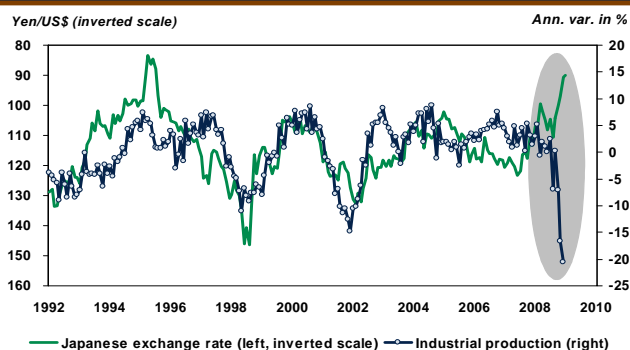
Graph 3 – An up trend began recently for the dollar's share in foreign exchange reserves



Sources: International Monetary Fund and Desjardins, Economic Studies

It is also too early for any structural depreciation by the yen. Although its economy is being pummelled by the worldwide recession, carry trades are still being unwound, to the yen's benefit (graph 4).

Graph 4 – The yen's strength does not reflect the Japanese economy's fundamentals

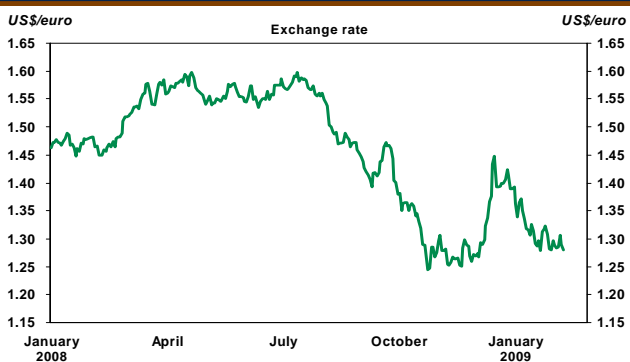


Sources: Datastream and Desjardins, Economic Studies

EUROPEAN CURRENCIES ARE STILL BEING AFFECTED

The euro down trend, recorded since the end of 2008, is running out of steam (graph 5), but the European Central Bank's monetary policy is clearly inadequate. In contrast, the Bank of Sweden realized that the situation is critical and has lowered its key rate by 275 basis points since December. Further key interest rate cuts are likely on the way in the euro zone by mid-2009, but policy makers' stubborn denial of the major risks to growth and the deflationary forces that are in place are unfavourable to the euro.

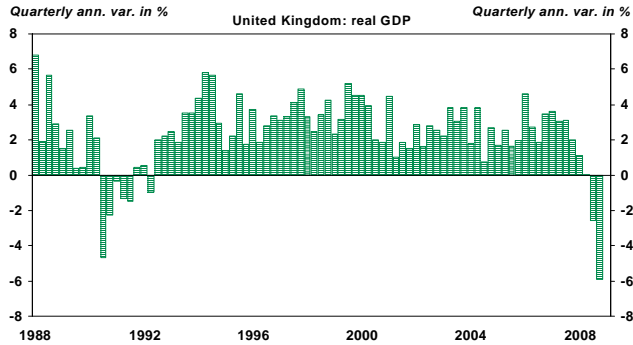
Graph 5 – The euro seems to be stabilizing



Sources: Datastream and Desjardins, Economic Studies

The fate of the pound sterling could be different. The economic situation is a very tough one: the United Kingdom is heading for a worse recession than 1990 (graph 6). However, British monetary authorities' quick adjustments have been well received by the markets. In addition to the 400 basis points in key rate cuts ordered by the Bank of England (BoE) since October of 2008, which put the rate at a historic low,

Graph 6 – On the way to a recession worse than 1990

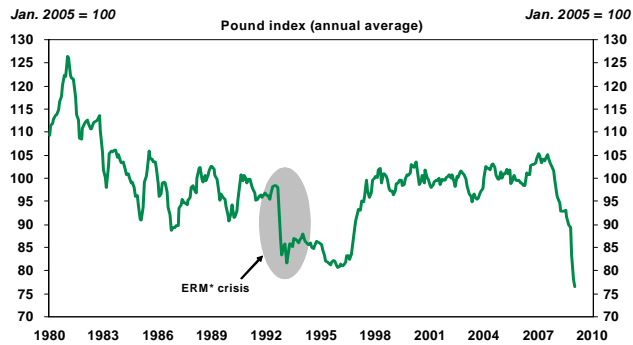


Sources: Office for National Statistics and Desjardins, Economic Studies

1.0%, the committee has opened the door to non-traditional policies. According to the February Inflation Report, the BoE has substantially downgraded its outlooks for growth and inflation, with the risks still broadly tilted to the downside. Inflation is expected to drop to 0.5% in the second half of 2009, and remain there for the next two years. Like the Federal Reserve, this should allow the BoE to lower its key rate to “zero”. According to BoE Governor Mervyn King, Britain’s economy is in the grips of a deep recession. This is more than enough justification to take measures to increase nominal spending by expanding the money supply.

Paradoxically, the BoE’s energetic action should allow the pound sterling to stabilize and even appreciate shortly, especially against the euro. Clearly, the recent pessimism regarding the pound was exaggerated, and oversold levels were pointing to an impending rebound (graph 7).

Graph 7 – The pound sterling over corrected recently

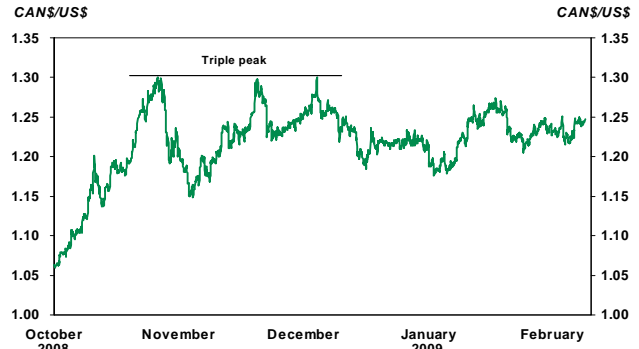


* Exchange Rate Mechanism. Sources: Bank of England and Desjardins, Economic Studies

THE CANADIAN DOLLAR REMAINS FIRM

Despite the choppy waters, the loonie is doing admirably in keeping its head above water. After testing CA\$1.30 three times, the USD/CAD pair has fluctuated between CA\$1.18 and CA\$1.27 (graph 8).

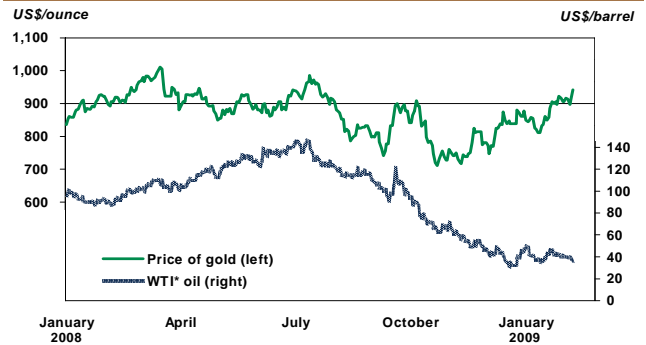
Graph 8 – The loonie is keeping its head above water



Sources: Datastream and Desjardins, Economic Studies

This partially reflects the fact that oil prices may have reached a trough and gold prices are climbing (graph 9). However, the economy is visibly deteriorating, and the pressure on the currency is still to the downside. Despite the Bank of Canada’s optimism about the economic recovery, it seems clear that further rate cuts will be needed in the near future.

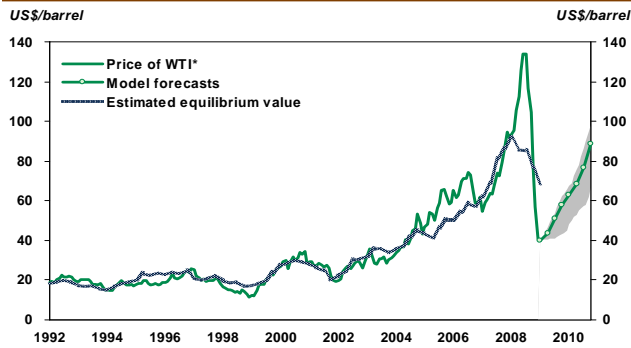
Graph 9 – Oil prices are stabilizing and gold maintains its momentum



* West Texas Intermediate. Sources: Datastream and Desjardins, Economic Studies

Over the longer range, our econometric models are unequivocal. First, oil prices are currently at oversold levels (graph 10). As a result, any improvement in the economic context or expectations of recovery could translate into a sizeable rebound by crude prices.

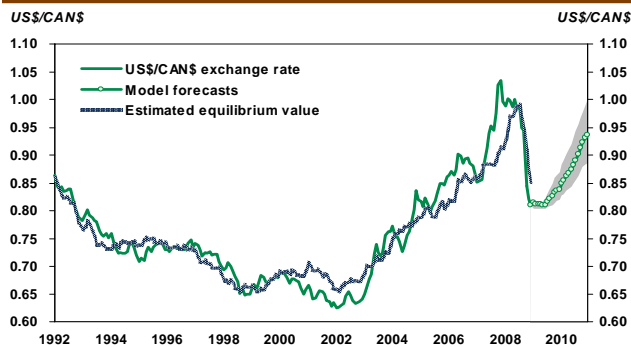
Graph 10 – An economic recovery would drive oil prices up sharply



* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

As energy and non-energy commodity prices are dominant factors in our model for the Canadian exchange rate, this could put the loonie back on track for sustained growth as of the second half of the year (graph 11).

Graph 11 – The loonie should get a boost from commodity prices' expected appreciation



Sources: Datastream and Desjardins, Economic Studies

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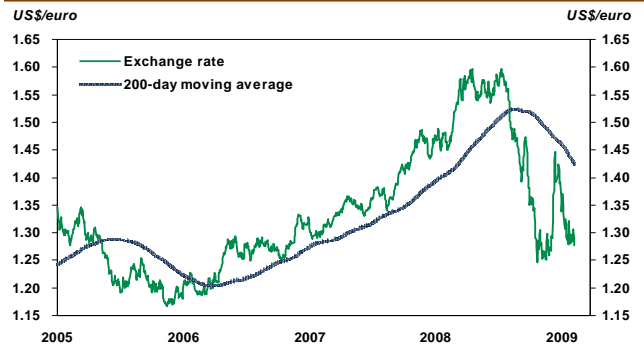
EURO (EUR)

The European Central Bank's hesitations are not helping the euro

- The euro has been relatively stable since mid-January, fluctuating between US\$1.27 and US\$1.34. The recent movements by Euroland's currency primarily seem to be a reflection of how investors feel about the U.S. dollar, as the euro is the main alternative to the greenback.
- Although the euro is well below its 200-day moving average, market indicators do not point to any imminent technical rebound. Strongly negative in the final months of 2008, the euro's momentum and speculative positions have come back to almost zero.
- Already in recession since Q2 of 2008, the euro zone's economy still appears to be sinking, a development that does not favour the euro. The real GDP thus contracted by 4.6% in the fourth quarter of 2008, the biggest decline since the currency area was created. Although some confidence and activity indicators appear to be starting to stabilize, they are still very low, promising further substantial declines in activity in the first half of 2009. Increasingly, the economic problems are also affecting the labour market: the jobless rate went from a low of 7.2% in March 2008 to 8.0% in December. The downturn in economic activity combined with the collapse in commodity prices pulled the annual inflation rate down to 1.1% in January, according to the flash estimate.
- Although it has evident leeway, the European Central Bank (ECB) decided to take a pause in February and keep its key rate at 2%. However, the ECB removed the comment that inflation risks are "broadly balanced" from its bulletin and clearly left the door open for a 50 basis point cut in March. However, for now, it refuses to anticipate zero rates. Although higher interest rates are usually good for a currency, it is dangerous for the ECB to stay "behind the curve", as this could prolong the recession.

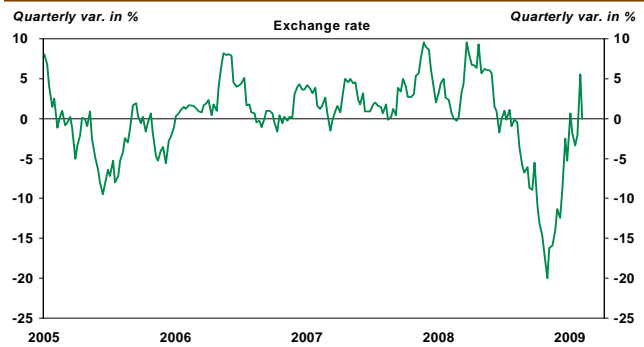
Forecasts: Movement by Euroland's currency will continue to be heavily influenced by U.S. dollar movement. The euro is currently weakened by the economic difficulties and the ECB's hesitation; it could test last October's low at US\$1.23 if the greenback rises again. Some internal tensions and concerns about some zone countries' budget situations could also hurt the currency. Over the medium range, the euro could appreciate as we are expecting the greenback to pullback.

Euro and trend



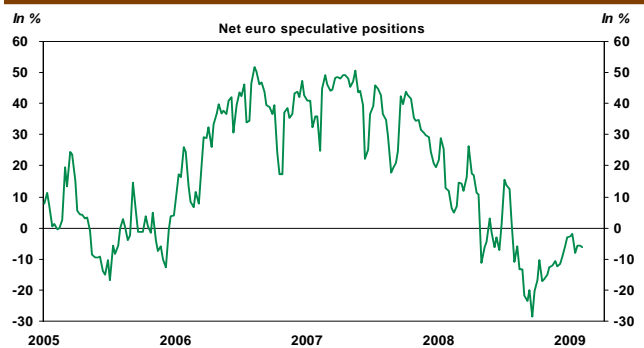
Sources: Datastream and Desjardins, Economic Studies

Euro: momentum



Sources: Datastream and Desjardins, Economic Studies

Euro: net speculative positions



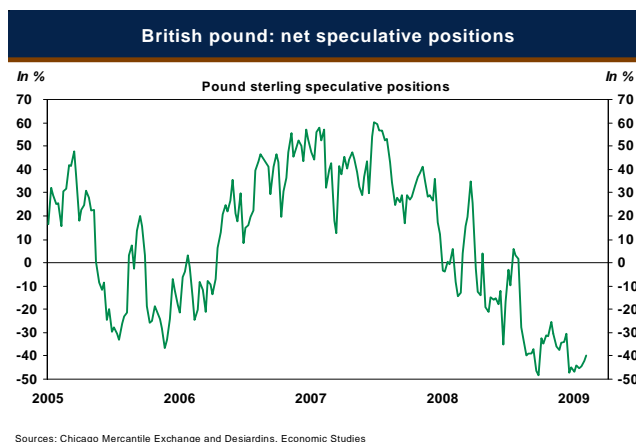
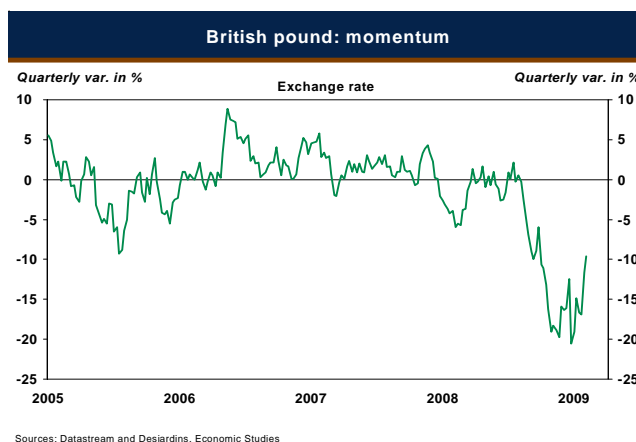
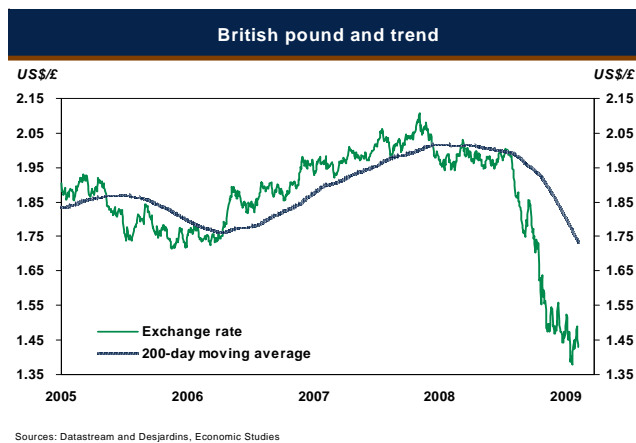
Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

BRITISH POUND (GBP)

Will the pound keep rising?

- The pound has undergone substantial fluctuations in the last few weeks. Fears surrounding the banking sector and nationalization risks have notched up following the news of the Royal Bank of Scotland's record loss. Combined with a bigger-than-forecast pullback of Britain's economy in the last quarter of 2008, this made the pound tumble to US\$1.35 on January 23, a low that dates back over 20 years. The fears of nationalization eased when Barclays announced that it would not need additional assistance from the government. Another 50 basis point cut to the U.K.'s key rate, welcomed by the markets, and some slightly less negative economic statistics even helped the pound come back temporarily to around US\$1.50.
- Market indicators show that the currency is still oversold. Its momentum is still in negative territory, although much less so than at the end of 2008, and net speculative positions continue to be extremely negative. Note that, in the second half of 2008, the pound's tumble was especially brutal, which now opens the door to a sizeable technical rebound.
- However, the fundamental factors could still hurt the pound over the next few months. The recession in the United Kingdom has now been made official and it seems it will be a very painful one. In the fourth quarter of 2008, the real GDP posted its biggest contraction in over 25 years and all signs are that activity will continue to decline sharply. In this context, annual inflation, which fell from a peak of 5.2% in September 2008 to 3.1% in January, should keep coming down. Britain's key rate should thus go to zero in the next few months, as the Bank of England (BoE) is already preparing to take non-traditional measures, like the Federal Reserve. The markets seem to like the BoE's clear wish to do everything it can to support Britain's economy more than the ECB's hesitations, and the pound has appreciated against the euro recently.

Forecasts: The pound will continue to react to developments regarding the health of Britain's financial system. In our view, there is little risk that the banking problems will bring on a major currency crisis akin to the one that recently occurred in Iceland, given the British economy's size and the pound's broad credibility. The most likely scenario is that the pound will fluctuate close to where it is now for several months; this level already reflects the British economy's problems. After that, it should begin a lasting rise against the greenback and euro, as the effects of economic stimulus plans begin to be felt and the financial strains wane.



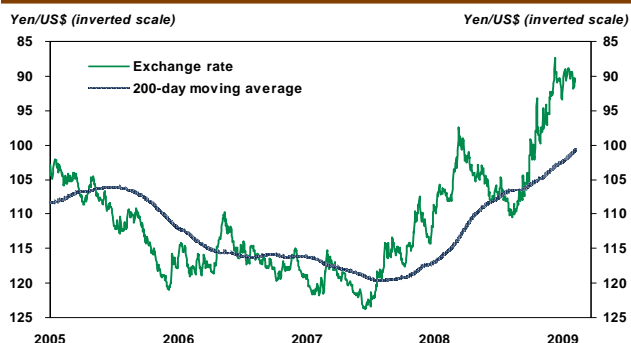
YEN (JPY)

Still too early for the economy's weakness to catch up to the yen

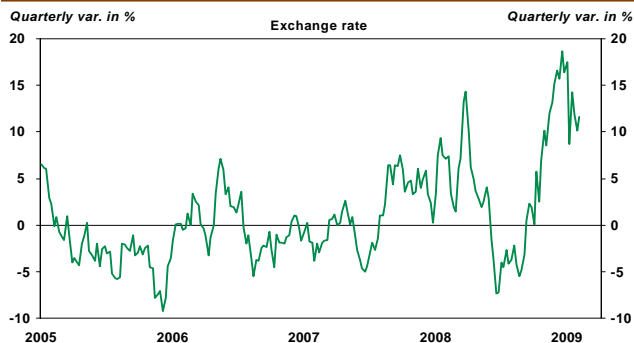
- Japan's exchange rate abruptly shot over 92 yen/US\$ last week as the markets were stimulated by expectations of a new bank rescue plan in the United States. True moderation by risk would, in fact, allow the yen to get back to values that are more in keeping with Japan's economic struggles. Since the year began, Japan's exchange rate has for the most part remained under the 90 yen/US\$ mark, without going back under the 14-year low of 87.15 yen/US\$ reached on December 17, 2008.
- Market indicators were already pointing to a potential short-term yen correction. Momentum and net speculative positions are still high but do not suggest another big correction. With risk aversion likely to rebound and carry trades still being unwound, this should provide some support to the yen before it records true depreciation to reflect the soft Japanese economy.
- The results for Q4's national accounts will be out next week and should once again show that the world's second largest economy is sinking. Annualized growth of -11.7% is expected. For the last two months of 2008 alone, industrial production posted a decline of 17.3%. The economic problems mainly come from deterioration by foreign trade as a result of soft global demand and an overpriced yen. Domestic demand is also showing some worrisome symptoms with a rising jobless rate and low consumer and business confidence levels.
- The drop in commodity prices and a teetering economy are creating a clearly disinflationary climate in Japan. Continuing its descent of the last few months, the annual inflation rate was 0.4% in December; it was just 0% if energy and fresh food prices are excluded. Slight deflation is expected to return in the next few months. In this context, the Bank of Japan (BoJ) should keep its key interest rate at 0.1% for some time to come. In keeping with the Federal Reserve's interventions, the BoJ is also resorting to non-traditional tools such as buying commercial paper.

Forecasts: The yen's recent correction attests to a reduction in markets' perceived risk and gloomy statistics on Japan's economy. In the near term, however, perceived risk should remain volatile and the exchange rate may very likely go back to its previous low before depreciating further.

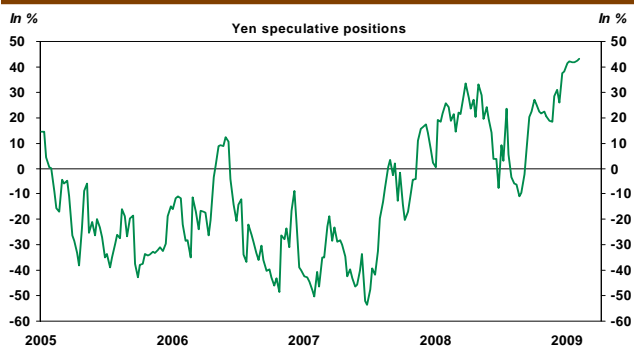
Yen and trend



Yen: momentum



Yen: net speculative positions

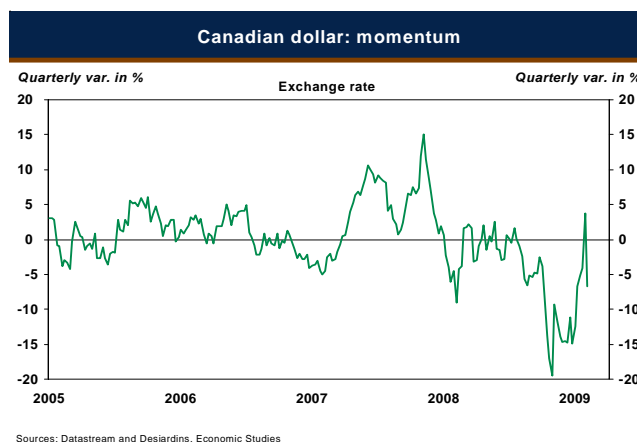
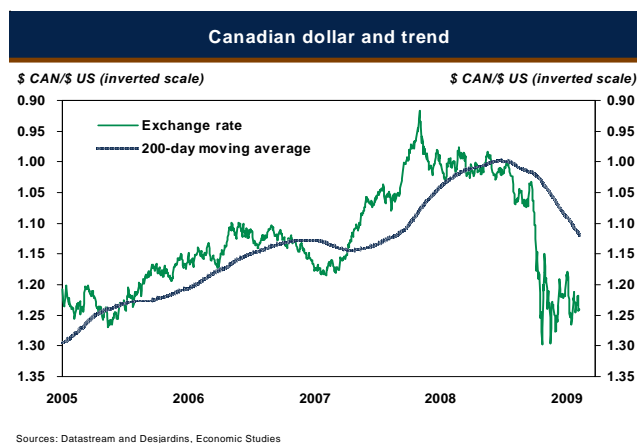


CANADIAN DOLLAR (CAD)

Pressure on the loonie is still downward

- After having closed in on the triple top of CA\$1.30 reached at the end of 2008, the USD/CAD pair fell off somewhat, reflecting the stabilization of crude prices, a surge by gold prices and easing financial strains. Risk aversion is still the dominant theme in the financial markets which, combined with the deteriorating Canadian economy, will keep downward pressure on the loonie.
- On a market basis, short speculative positions are slowly mounting, but they are still below levels that had previously been compatible with substantial appreciation by the loonie. This is backed by weak momentum, which suggests that stabilization will continue in the near future.
- Overall, the economy's fundamentals are unfavourable to the loonie. Of course, oil prices seem to have bottomed out, suggesting that the USD/CAD pair will have trouble crossing CA\$1.30 on a sustainable basis. However, the short-term economic situation is rapidly worsening and Canada's relative position is deteriorating.
- Job losses accelerated sharply in January, going to 126,000 positions, and everything suggests that the job market will be feeling the effects of the recession into the second half of 2009. Under these circumstances, the jobless rate could go up to 9%, which would maintain consumers' current pessimism. Moreover, the decline in the terms of trade, totalling 14% since July, will result in a substantial decline in the country's income and, as a result, limit our ability to support real domestic spending. Parallel to that, foreign trade is still eroding. The trade balance went into deficit in December, on a decline in both its value (drop in prices) and volume (drop in global demand in the United States and elsewhere).
- It seems that further rate cuts will have to be ordered to rein in the ongoing downturn. The Bank of Canada says that it "retains considerable policy flexibility, which we will use as required."

Forecasts: In the short term, the Canadian dollar is at risk. A return toward the CA\$1.30 peak by the USD/CAD pair is still possible. A deterioration in the financial context and resurgence by risk would be bad for the loonie. Expectations of an economic recovery in the second half of the year could result in a rebound by commodity prices, which would be favourable to getting the loonie back on track for growth.



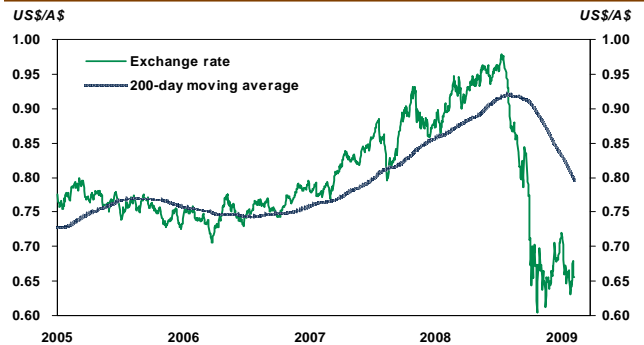
AUSTRALIAN DOLLAR (AUD)

Major efforts to kick start the economy have been announced

- The last few weeks have been studded with news of major monetary and budget policy measures to stave off a recession in Australia and secure sustained medium term growth. The markets seem to like it: the Australian dollar, which had recently fallen to US\$0.6249, had been driven over US\$0.68 before coming back closer to US\$0.67. The movement also received a hand from the decline in market strains due to the rosy outlook expected from a new U.S. banking sector rescue plan.
- On a market basis, net speculative positions and momentum indicate less risk of a short-term correction. The currency is only expected to show lasting appreciation in the context of real easing of financial strains which would allow carry-trade positions to be re-established and commodity prices to rise. High gold prices are something else and cannot make the Australian dollar go up on their own.
- Australia's economy is being hit by the drop in global demand for base products, as well as their low prices. However, they are not expected to recover until mid-year, and the risks are even leaning toward a later rebound. Moreover, the drop in household and business confidence is a concern, as are the sharp declines in wealth and credit. To support the economy, the government recently announced an ambitious \$42B plan, in addition to the \$10.4B plan deployed in October 2008. These amounts, which correspond to more than 4% of Australia's GDP, will help reduce the tax burden on consumers and business; a substantial portion will also be used for infrastructures.
- The monetary authorities have not been sitting on their hands in the face of the risks weighing on the economy, either. Another 100 basis point cut to the key interest rate was announced on February 3, putting the monetary easing ordered since last September at 400 basis points. At 3.7%, the inflation rate is higher in Australia than in other industrialized countries, however. The exchange rate's depreciation is not making things easier, as it is driving up import prices. Opting to prevent rather than cure, the Reserve Bank of Australia could announce more key interest rate cuts.

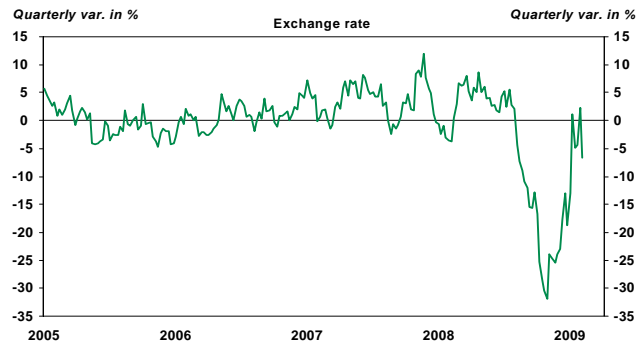
Forecasts: Weak commodity prices and financial strains that are still strong despite some signs of easing do not allow us to anticipate new momentum for Australia's dollar in the next few months. Economic recovery efforts should bear fruit over the medium range.

Australian dollar and trend



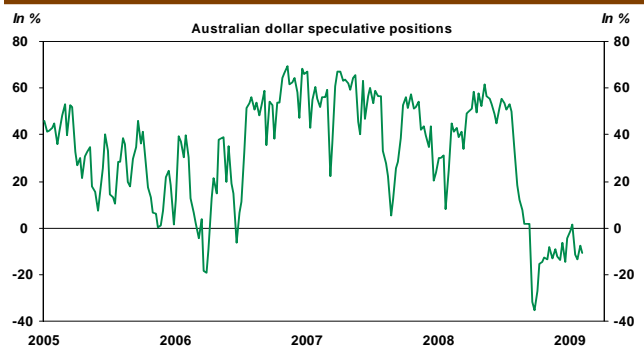
Sources: Datastream and Desjardins, Economic Studies

Australian dollar: momentum



Sources: Datastream and Desjardins, Economic Studies

Australian dollar: net speculative positions

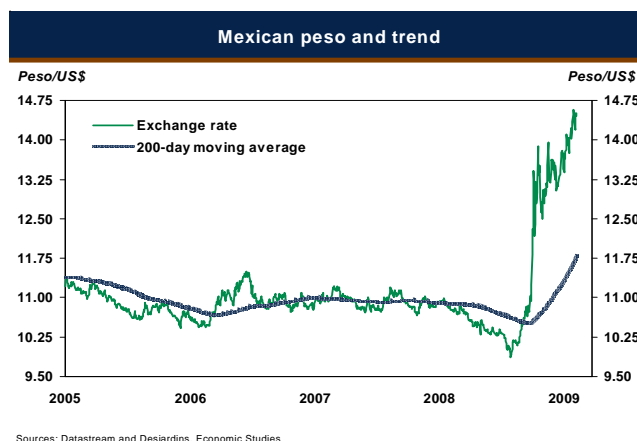


Sources: Datastream and Desjardins, Economic Studies

MEXICAN PESO (MXN)

The peso sags further

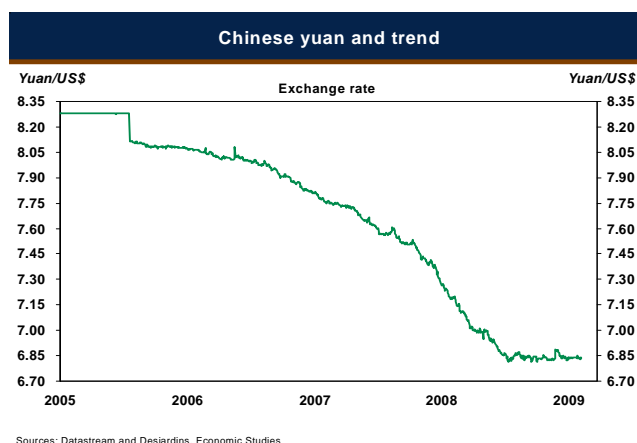
- The peso has been under the gun since the year began, reflecting the deterioration in the American economic situation and its impacts on Mexico. The USD/MXN pair crossed a new peak, going over 14.50 pesos on February 3.
- As expected, Mexico's central bank lowered its key rate by 25 basis points. This is the first cut in three years, as monetary authorities are now putting more focus on the risks to growth than on inflation pressures. High inflation is still a problem, but the rapidly deteriorating global economic situation is worrisome. To deal with it, the government should set up another recovery plan, which could total as much as 1% of Mexico's GDP.



CHINESE YUAN (CNY)

No yuan appreciation in sight until the economy perks up

- The yuan has been holding close to US\$6.85 since last summer, as the tough economic and financial situation does not allow China to move ahead with exchange rate adjustments without doing further harm to its economy.
- For the first time since 2001, the annual change in China's GDP was less than 7% for the fourth quarter. Exports have recorded their first decline in almost eight years; we must go all the way back to 1999 to see industrial production growth that is this low. Inflation has also nosedived, going from 8.5% in April of 2008 to 1.5% in January. Measures to support the economy have been announced, including interest rate cuts, lower mandatory reserve rates for financial institutions and an economic stimulus plan valued at about US\$600B.
- The international community, especially the United States, is still pleading for a stronger yuan, but it would be surprising if Chinese authorities were to give in to these demands in the near term. Moreover, China's foreign reserves are growing at a slower pace, indicating that it takes less effort to keep the yuan low.



TECHNICAL ANALYSIS

USD/CAD

The pair has been trapped in a triangle pattern since last October. As long as it is trading above 1.1465, it should go over 1.3020 to reach 1.40. This movement should be followed by a slide below 1.14.



EUR/USD

The upward correction could come to an end at 1.4719. If so, the pair should continue its descent in the next few weeks, going below 1.2328 to return to 2005's lows, between 1.1640 and 1.20. The RSI's (oscillator trough) recent break below its support at 28 also suggests that buyers are lacking conviction about the pair.



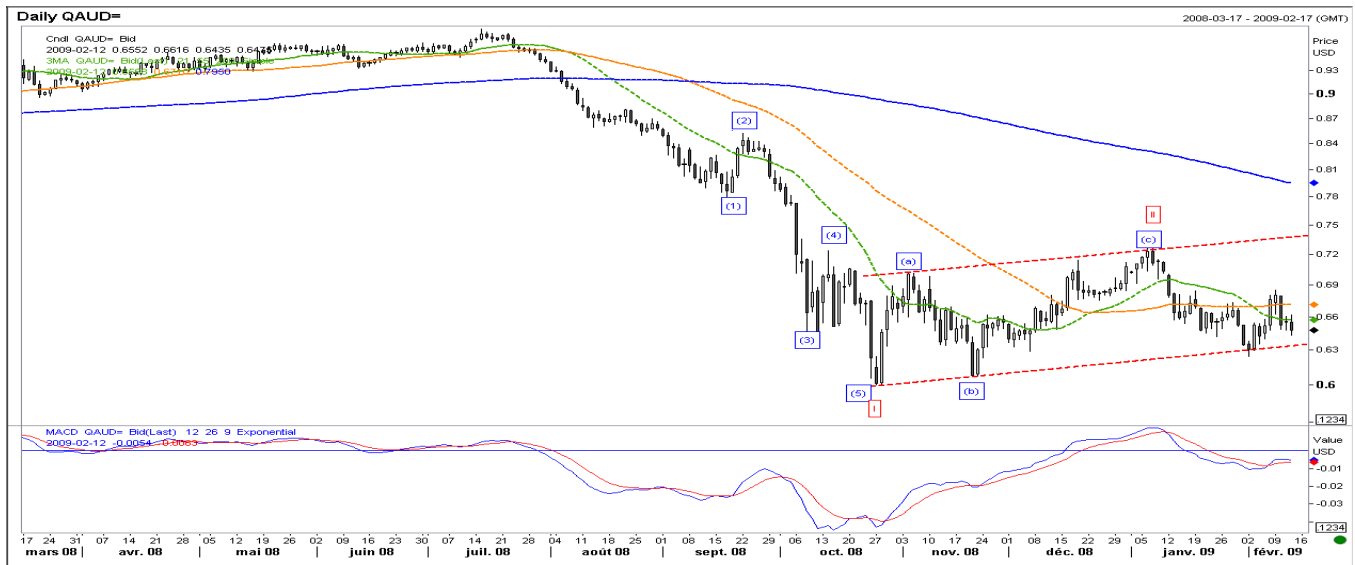
USD/JPY

Stock market stability has kept Japan's currency from gaining more ground against the American dollar in the last few weeks. Despite this, the pair is on a bear trend below 100, but a rally to 95 is possible in the short term to finish an upward correction. Watch for a break below 80 by the S&P500 to anticipate the pair's decline.



AUD/USD

The five-wave descent from July to October of 2008 confirms that the main trend is bearish. The slight rally since October is corrective and a breach of the latest low at 0.6011 would confirm that the medium-term down trend has returned.



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Table 1
Currency market

Country – Currency*	Spot price	Percentage return since					Last 52 weeks		
	Feb. 12	1 month	3 months	6 months	1 year	Higher	Average	Lower	
North America									
Canada – dollar	1.2497	3.79	1.61	17.54	25.36	1.3001	1.0930	0.9737	
Canada – (CADUSD)	0.8002	-3.65	-1.58	-14.92	-20.23	1.0270	0.9149	0.7692	
Mexico – peso	14.5845	6.07	10.98	43.71	35.69	14.5845	11.5271	9.9169	
South America									
Argentina – peso	3.4963	1.33	5.75	15.25	10.52	3.4988	3.2009	3.0130	
Brazil – real	2.2878	-1.48	-0.03	41.05	31.41	2.5935	1.8990	1.5590	
Asia									
China – yuan renminbi	6.8378	0.00	0.10	-0.42	-4.91	7.1987	6.9053	6.8119	
South Korea – won	1,404.25	3.35	3.29	35.72	48.52	1,517.35	1,149.84	936.40	
Hong Kong – dollar	7.7521	-0.03	0.02	-0.72	-0.61	7.8146	7.7808	7.7500	
India – rupee	48.7305	-0.06	-1.00	15.26	23.10	50.2585	44.5382	39.5805	
Japan – yen	90.83	1.66	-4.06	-16.91	-15.37	110.54	101.34	87.36	
Europe									
Denmark – krona	5.7788	3.64	-3.35	15.54	13.00	5.9827	5.1640	4.6644	
Euro zone – (EURUSD)	6.8248	-2.81	-4.28	27.15	24.43	7.2360	5.8244	4.9583	
Norway – kroner	1.4254	-3.96	-5.27	-25.03	-27.29	2.0309	1.7914	1.3669	
Russia – ruble	34.7612	11.72	26.15	43.25	41.21	36.3167	25.8845	23.1169	
Sweden – krona	8.3639	3.92	2.93	32.87	29.69	8.4546	6.7997	5.8368	
Switzerland – swiss franc	1.1670	4.57	-1.07	7.34	6.07	1.2247	1.0867	0.9860	
United Kingdom – (GBPUSD)	1.2776	-4.31	2.02	-14.31	-12.45	1.5979	1.4527	1.2449	
South Pacific									
Australia – (AUDUSD)	0.6558	-3.64	2.93	-24.73	-27.45	0.9786	0.8063	0.6036	
New Zealand – (NZDUSD)	0.5224	-8.92	-6.11	-24.64	-33.84	0.8175	0.6704	0.5018	

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

Note: Currency table base on previous day closure.

Table 2
Currency market: history and forecasts

End of period	2008		2009				2010			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
American dollar										
Canadian dollar (USDCAD)	1.0630	1.2189	1.2987	1.2500	1.1628	1.1364	1.1111	1.0870	1.0526	1.0000
Euro (EURUSD)	1.4047	1.3901	1.2500	1.2200	1.2500	1.3000	1.3250	1.3580	1.3910	1.4240
British pound (GBPUSD)	1.7825	1.4378	1.4500	1.5000	1.5500	1.6000	1.6500	1.7000	1.7500	1.8000
Yen (USDJPY)	106.00	90.74	90.00	95.00	102.00	100.00	105.00	108.00	100.00	98.00
Australian dollar (AUDUSD)	0.7700	0.6500	0.6700	0.7200	0.7500	0.7800	0.8000	0.8400	0.8700	0.9000
Mexican peso (USDMXN)	10.80	12.50	12.20	12.00	11.50	11.00	11.00	11.00	11.00	11.00
Chinese yuan (USDCNY)	6.82	6.82	6.80	6.80	6.70	6.60	6.40	6.25	6.00	6.00
Effective dollar* (73 = 100)	76.13	79.41	82.00	81.00	79.00	77.00	77.00	75.00	73.00	72.00
Canadian dollar										
American dollar (CADUSD)	0.9407	0.8204	0.7700	0.8000	0.8600	0.8800	0.9000	0.9200	0.9500	1.0000
Euro (EURCAD)	1.4931	1.6943	1.6234	1.5250	1.4535	1.4773	1.4722	1.4761	1.4642	1.4240
British pound (GBPCAD)	1.8947	1.7525	1.8831	1.8750	1.8023	1.8182	1.8333	1.8478	1.8421	1.8000
Yen (CADJPY)	99.71	74.44	69.30	76.00	87.72	88.00	94.50	99.36	95.00	98.00
Australian dollar (AUDCAD)	0.8185	0.7923	0.8701	0.9000	0.8721	0.8864	0.8889	0.9130	0.9158	0.9000
Mexican peso (CADMXN)	10.16	10.26	9.39	9.60	9.89	9.68	9.90	10.12	10.45	11.00
Chinese yuan (CADCNY)	6.42	5.60	5.24	5.44	5.76	5.81	5.76	5.75	5.70	6.00

f: forecasts; * Trade-weighted against major U.S. partners.

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