FX Forecasts

Desjardins Economic Studies
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Has the U.S. dollar peaked?

HIGHLIGHTS

- Given the forces currently driving the U.S. dollar, we do not expect substantial gains in the near term. The greenback should resume its climb in 2015, when U.S. monetary firming will be clearly in sight.
- The Canadian dollar should benefit from easing global uncertainties in a few months. We remain particularly confident about the U.S. economy, which should generate ripple effects for Canada's economy. Oil prices should also rise by the end of the year; this will help the loonie return to US$0.90 (CAN$1.11/US$).
- The economic outlook for the euro zone is much less favourable than for the United States, suggesting that future monetary policy might not favour the euro.
- Although we still expect the pound to come back up in the coming quarters, we have downgraded our targets for this currency while we have postponed our forecast for the first British key rate increase to the second quarter of 2015.

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Editorial

Over the last three months, geopolitical and economic uncertainties have escalated, and monetary policy expectations have diverged, taking the U.S. dollar close to levels seen during the 2008 financial crisis and the 2010 European sovereign debt crisis (graph 1). Its climb seems to have ended in October, however, and the greenback lost a little ground, even though overall uncertainty remains elevated. There is reason to wonder what determinants could power an additional rise by the U.S. dollar, and which scenario is most likely now.

Graph 1 – The U.S. dollar has closed in on the levels reached during previous times of high tension

*Weighted U.S. dollar average against the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc
Sources: Bloomberg and Desjardins, Economic Studies

SOFTER WHEN DOUBT INVOLVES THE U.S. ECONOMY

The U.S. dollar is the main international safe-haven, and it usually rises during times of intense uncertainty. There are some exceptions to this rule, however, as shown by the greenback's movement in October.

In prior months, the bad news and uncertainty mainly stemmed from Europe and Asia. The United States was posting a string of positive statistics and investors increasingly anticipated the onset of monetary firming by

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the Federal Reserve (Fed) next year. The situation changed when doubts emerged about the U.S. economy's ability to stay on track against the backdrop of a slowing global economy. These doubts increased sharply on October 15, following the release of disappointing figures for U.S. retail sales and the Empire index of manufacturing activity in the state of New York. If investors see the U.S. economy as slowing, a lot fewer of them will expect monetary firming, and in turn, the greenback will lose one of the main pillars that have been supporting it in recent months.

For the U.S. dollar to remain strong, confidence in the U.S. economy has to be maintained. Here, we remain relatively optimistic about the future in the United States. Several other indicators are offsetting the weakness in retail sales and some other statistics. Jobless claims recently hit a 14-year low, while industrial production rebounded and consumer confidence grew. Added to this is the drop by fuel prices, which should help to stimulate consumption in the next few months.

THE SITUATION ABROAD IS STILL A MAJOR VARIABLE

Much of the U.S. dollar's movement cannot be explained by national factors, however. In October, the European Central Bank disappointed by unveiling few new details about its securities purchase policy, helping drive the euro up against the greenback. Analysis cannot focus solely on the Fed, but must look at all central banks to see if divergences will emerge in the coming quarters. The best scenario for the U.S. dollar would if several central banks had to either sit on their hands longer or announce additional easing measures; both outcomes would contrast with what is expected from the Fed.

We must also see how the level of uncertainty outside the United States evolves in the next few months. If the bad news keeps mounting, U.S. consumer and business confidence could eventually be affected and hurt U.S. economic growth. Financial strains could also emerge again and erode credit conditions. In these scenarios, the U.S. dollar's potential for appreciation would be heightened by its safe-haven role, but also reduced by changes to monetary policy expectations. The best scenario for the greenback would be for some uncertainty to persist, without threatening the U.S. economy. Greater intervention from foreign central banks would probably keep investor concern from intensifying.

GEOPOLITICAL UNCERTAINTY

The geopolitical uncertainty arising from this year's multitude of conflicts has helped the U.S. dollar, but this variable is harder to predict. The conflict in Ukraine and the fight against the Islamic State (IS) are the two main issues here. The war against IS could last months or even years. The markets could seesaw in response to terrorist threats and fluctuations in energy prices. At the same time, though, a solution to the conflict in Ukraine could be found shortly. As winter looms, several nations in Europe have an interest in seeing Russian natural gas flow without a hitch, and it would be hard for Russia to cope with a drop in its revenues.

That said, other conflicts could emerge in the coming quarters and affect the U.S. dollar. The Ebola epidemic requires a close watch. However, for the U.S. dollar, this is simply noise surrounding a trend that is primarily dictated by economic and financial factors.

MORE GAINS SOUND UNLIKELY IN THE NEAR TERM

Given the forces currently driving the U.S. dollar, we do not expect substantial gains in the near term. First, it will probably be several months before investors start to more seriously bet on monetary firming in the United States. Second the central banks that should take further action do not seem to be in a rush to announce additional measures. This includes the ECB, the Bank of Japan and the People's Bank of China. Global uncertainty could therefore remain very high for some time, failing some pleasant surprises from the economy. The greenback should still resume its climb in 2015, when U.S. monetary firming will be clearly in sight.

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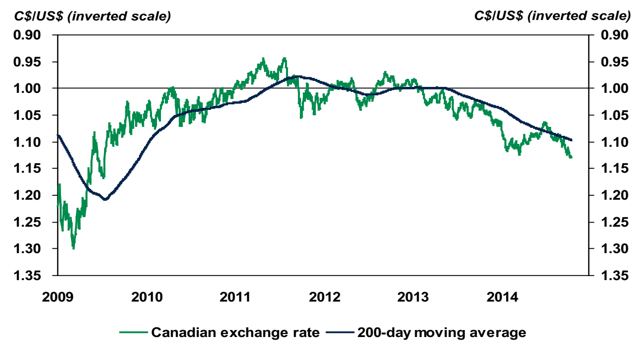
CANADIAN DOLLAR (CAD)

Back to square one

- The Canadian dollar managed to make its way back up after a difficult start to the year, but it seems to be starting all over. Once again, the Canadian dollar is trading below US$0.90 and it even hit a five-year low on October 15, at US$0.8784 (CAN$1.1384/US$).
- From a technical standpoint, the recent correction has of course weakened its momentum, but investors still held off reversing their positions. While the net balance of positive speculation has dropped back into negative territory, at its current level, it is still well above the lows generally seen since 2013. We could therefore conclude that many investors remain skeptical as to ongoing loonie depreciation.
- Some of the Canadian dollar's weakness is due to the greenback's strength. Until September, however, the Canadian currency had fared better than several other major currencies, including the euro, the yen and the pound. The other main factor in the loonie's depreciation is the drop by oil prices, primarily since the start of October. In the last few weeks, even though the U.S. dollar has seemed weaker against several major currencies, the Canadian dollar has continued to depreciate in tandem with falling crude prices.
- Several national factors merit some attention. The rising inflation rate has gotten a lot of focus since last spring; it has now stabilized, and the slide by oil prices could even drag it down in the short term. The Canadian economy also grew less quickly than expected in July, forcing a downward revision to the growth forecast for the third quarter. That being said, the overall portrait of Canada's economy remains fairly positive, as exports continued to climb. The long-awaited rebalancing of Canada's economic growth may very well have begun, but demand from the United States and the rest of the world will still be needed. This is currently a source of great uncertainty.

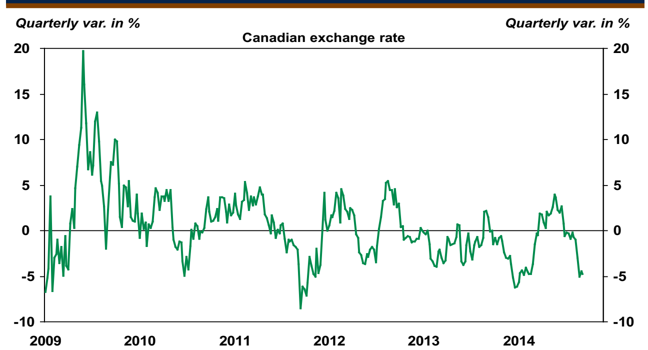
Forecasts: The Canadian dollar should benefit from easing global uncertainties in a few months. We remain particularly confident about the U.S. economy, which should generate ripple effects for Canada's economy. Oil prices should also rise by the end of the year; this will help the loonie return to US$0.90 (CAN$1.11/US$) and probably go even higher over the longer term.

Canadian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

Canadian dollar: momentum



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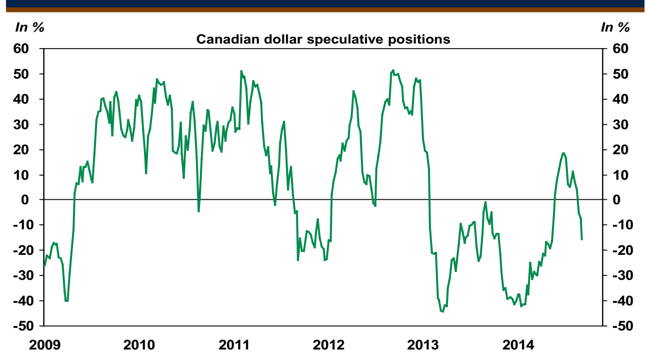
Canadian dollar: net speculative positions



Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

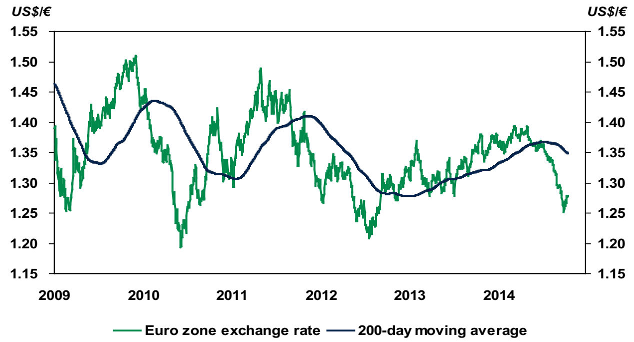
EURO (EUR)

The euro should continue to consolidate

- The euro stabilized just below US$1.30 following the September 4 meeting of the European Central Bank (ECB). However, in mid-September, it started to fall steeply again when disappointing new economic statistics, especially from Germany, fuelled fears of a third recession in the euro zone. After hitting US$1.25 on October 3, however, the euro started to climb, nearing US$1.28, when the ECB disappointed investors and panic in the financial markets opened the door to a postponement of key rate hikes in the United States.
- The last few months have shown how important monetary policy is to movements by the EUR/USD pair. Remember that the euro was oscillating around US$1.40 at the start of May, and that the downtrend started when the ECB clearly indicated its intention to ease its monetary policy in order to combat soft inflation. The ECB then took action in June and September, cutting its key rates and announcing easing measures, as encouraging economic statistics from the United States opened to door to the Fed beginning its monetary firming relatively early in 2015.
- As the economic outlook continued to deteriorate in the euro zone, some investors hoped that the ECB would consider massive purchases of sovereign bonds at its October 3 meeting. They were disappointed, as the ECB announced nothing new, and even provided fewer details than expected on the asset-purchasing programs. This and the growing dissent among ECB leaders showed the markets that there was little chance of sovereign bond purchases in the euro zone. The euro's rebound was also helped by falling inflation expectations in the United States; this could concern the Fed and even open the door to a fourth quantitative easing program (QE4) if the situation were to keep eroding. This explains why the euro has done well lately, despite a financial environment that should have favoured safe havens and new fears about Greece and the stability of Europe's financial system.

Forecasts: The euro could appreciate further in the short term if investors really begin to bank on a QE4 in the United States. For now, however, this scenario seems unlikely. The economic outlook for the euro zone is much less favourable than for the United States, suggesting that future monetary policy might not favour the euro. We therefore still expect the euro to remain close to current levels in the next few months, before resuming its downtrend in 2015.

Euro and trend



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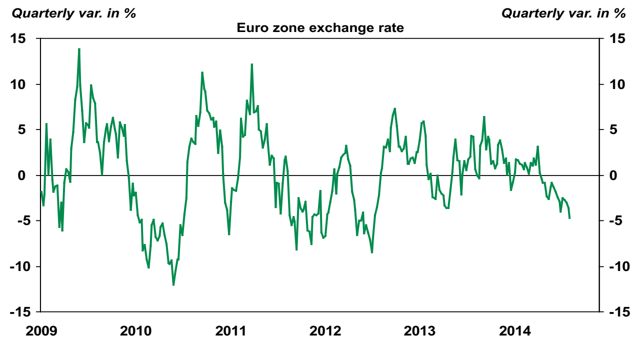
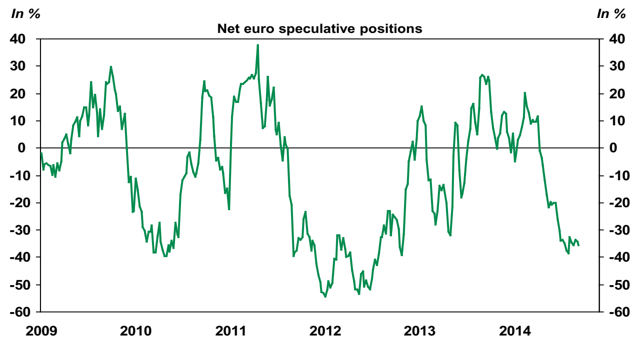
Euro: momentum



Sources: Datastream and Desjardins, Economic Studies

Euro: net speculative positions



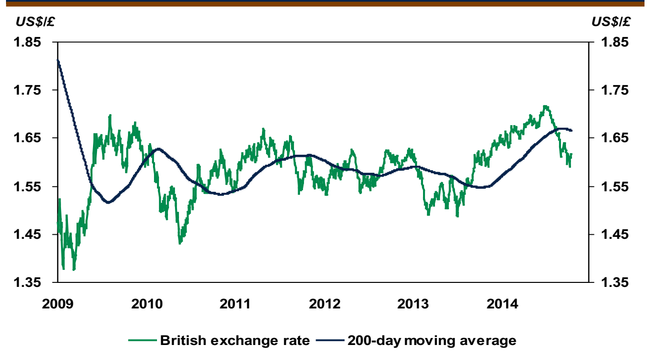
Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

BRITISH POUND (GBP)

The outlook for the pound is a little less favourable

- After a short sigh of relief following the No side's victory in the Scottish referendum, the pound quickly started to trend down against the greenback again, temporarily dropping below US$1.60. Until early October, the pound's retreat was largely a reflection of the greenback's strength; the EUR/GBP pair fell below 0.77 pound at the end of September. Unlike the euro, the pound did not rebound in October, recently taking the EUR/GBP pair above 0.79 pound.
- Although Britain's economy continues to do fairly well, we cannot overlook the risks that the euro zone, its main trading partner, could slide into a recession in the near future. The pullback by inflation, which fell to 1.2% in September, will also prompt the Bank of England to be quite cautious before initiating monetary firming, especially as low oil prices could bring additional disinflationary pressure. **Although we still expect the pound to come back up in the coming quarters, we have downgraded our targets for this currency while we have postponed our forecast for the first British key rate increase to the second quarter of 2015.**

British pound and trend



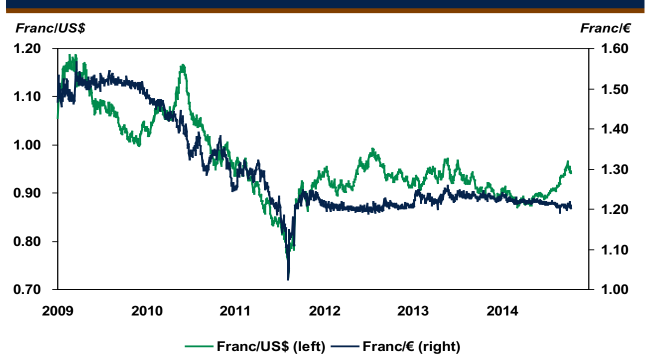
Sources: Datastream and Desjardins, Economic Studies

SWISS FRANC (CHF)

The Swiss National Bank will prevent further appreciation of the franc

- Like the euro, the Swiss franc dropped against the greenback until the start of October, before rebounding recently. The USD/CHF pair brushed 0.97 francs at the start of the month, then fell back to around 0.94 francs. After climbing to about 1.214 francs at the end of September, the EUR/CHF pair recently slid back to 1.206 francs, with the strains in the financial markets boosting demand for safe-haven securities like the Swiss franc. The franc could have risen further against the major currencies if not for the Swiss National Bank's (SNB's) determination to defend its floor rate of 1.20 francs per euro. Given the very low outlook for inflation and an erosion of the growth outlook for the euro zone and Switzerland, the SNB says it is prepared to buy unlimited quantities of currency and take additional measures immediately, such as instituting negative key rates, to keep the franc from rising further. **We therefore still expect the franc to edge down against the euro.**

Swiss franc



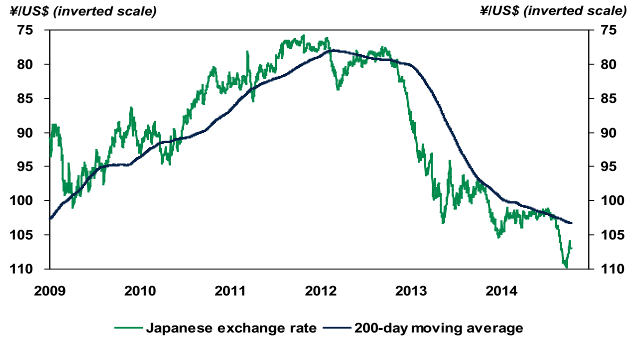
Sources: Datastream and Desjardins, Economic Studies

YEN (JPY)

Short-lived depreciation

- Japan's exchange rate hit 110 yen/US$ in early October, a rate that hasn't been seen in nearly six years. The yen managed to resist the greenback's strength earlier this summer, but renewed fears worldwide and a series of disappointing statistics in Japan ended up changing the game. More recently, the yen has stated to appreciate again against the greenback. This new change of course seems to mesh with the worries that have also affected the U.S. economy, giving the yen new value as a safe haven.
- All the same, the outlook remains negative for the yen. Japan's economy fell dramatically after April's sales tax hike. Though a rebound is expected for the third quarter, it does not promise to be enough to offset the previous slide. Inflation also remains an issue. Excluding the volatility associated with food prices, energy prices and the sales tax increase, the Bank of Japan is still far from its 2% target. **Monetary easing measures must therefore continue to allow the exchange rate to return to 110 yen/ US$.**

Yen and trend



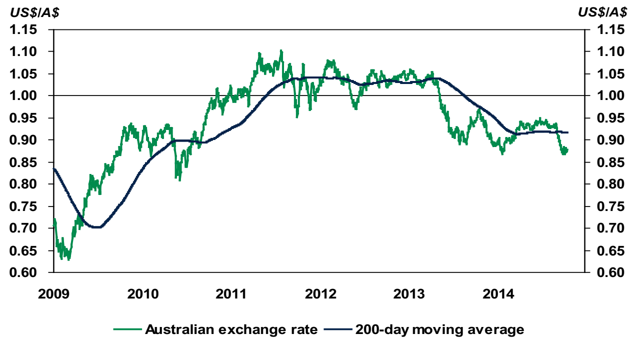
Sources: Datastream and Desjardins, Economic Studies

AUSTRALIAN DOLLAR (AUD)

A difficult month for commodity currencies

- The Australian dollar hit its lowest point in four years at US$0.8642 in early October, before stabilizing around US$0.8750. In addition to the impact of the U.S. dollar's appreciation, the Australian dollar is being hit by falling prices for many natural resources. Changing Chinese demand is also an important issue for Australia, which exports much of its iron ore and coal to that country.
- Australia's economy slowed due to weaker investments in the resources sector. Some restructuring is necessary to ensure healthy, long-term growth, but that will take several quarters to materialize. The weaker currency could help to support some sectors that must contribute more to growth. This is the opinion of the Reserve Bank of Australia, which tends to denounce the Australian dollar's strength in its statements. Despite these factors, **the Australian dollar could appreciate again in the short term, if global uncertainties die down and commodity prices climb.** However, it should not go much above US$0.90 for several months.

Australian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

EMERGING CURRENCIES

Most emerging currencies are under pressure

CHINESE YUAN (CNY)

- The yuan is one of the few currencies that have not fallen against the U.S. dollar in recent months. China's exchange policy continues to guard the yuan from market forces and volatility. The pace of yuan revaluation has slowed, however, from what it was in June and August. Monetary authorities have therefore adjusted to the higher degree of uncertainty worldwide. Even though China's economic growth slightly beat expectations lately, major changes are happening in the country, and investment should make a decreasing contribution to growth. In order to not harm exports in the short term, **it is likely that China's exchange rate will be stabilized again, until uncertainty returns to more normal levels.**

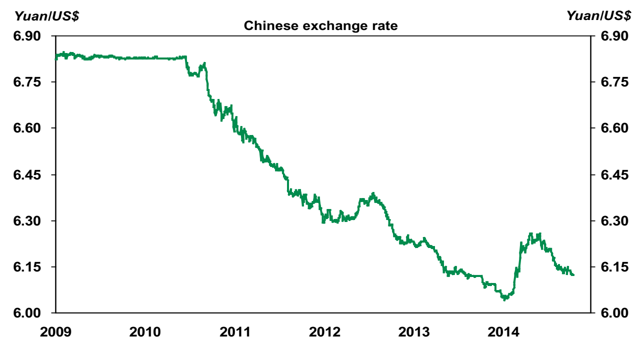
MEXICAN PESO (MXN)

- Heightened investor skittishness, which turned into panic in the first few weeks of October, did not leave the Mexican peso unscathed. The currency is down about 3.5% since the start of September, putting the USD/MXN pair over 13.60 pesos. Relatively speaking, the peso has still done a lot better than the currencies of other emerging nations, such as Russia and Brazil, which are grappling with serious economic problems. Overall, Mexico's economic statistics are still fairly encouraging and the Bank of Mexico seems at ease with its monetary policy, even though some government measures could keep inflation somewhat above the Bank's 3% target in the coming quarters. **A drop in financial market tension should help the peso in the near term.**

BRAZILIAN REAL (BRL)

- Brazil's exchange rate recently neared 2.50 reals/US$. The currency's depreciation coincides with the greenback's climb, but Brazil's precarious economic situation is magnifying the movement. South America's biggest economy is in a technical recession, as its real GDP has posted two consecutive quarterly drops. Though some of this weakness seems to be caused by the effects that the World Cup had on hours worked, the economy has still been slow for a bit more than a year. The presidential election is also contributing to volatility: the second round will be held on October 25. **We do not expect the real to recover strongly in the coming quarters.**

Chinese yuan and trend



Sources: Datastream and Desjardins, Economic Studies

Mexican peso and trend

Sources: Datastream and Desjardins, Economic Studies

Brazilian real and trend

Sources: Datastream and Desjardins, Economic Studies

Table 1
Currency market

	Spot price	Percentage return since				Last 52 weeks		
Country – Currency*	Oct. 20	1 month	3 months	6 months	1 year	Higher	Average	Lower
Americas								
Argentina – peso	8.4800	0.6528	3.9534	5.9894	44.9263	8.4850	7.6339	5.8508
Brazil – real	2.4618	3.8997	10.1181	9.5497	13.8536	2.5027	2.2989	2.1623
Canada – dollar	1.1272	3.0112	4.9486	2.5706	9.6125	1.1327	1.0871	1.0284
Canada – (CAD/USD)	0.8872	-2.9232	-4.7152	-2.5062	-8.7695	0.9724	0.9199	0.8829
Mexico – peso	13.5407	2.3017	4.5146	3.6593	5.8380	13.5625	13.1140	12.7938
Asia and South Pacific								
Australia – (AUD/USD)	0.8783	-1.6028	-6.4729	-5.8844	-9.2394	0.9708	0.9164	0.8675
China – yuan renminbi	6.1236	-0.2850	-1.3603	-1.6179	0.4388	6.2594	6.1478	6.0412
Hong Kong – dollar	7.7576	0.0826	0.0826	0.0406	0.0458	7.7693	7.7543	7.7500
India – rupee	61.2350	0.6162	1.5758	1.5590	-0.0082	63.7200	61.0191	58.2850
Japan – yen	106.9550	-1.9166	5.5460	4.4329	9.4337	109.7700	102.8770	97.2800
New Zeland – (NZD/USD)	0.7967	-1.9759	-8.4137	-7.2504	-6.2943	0.8821	0.8390	0.7763
South Korea – won	1,060	1.4504	2.9335	2.0168	-0.1060	1,085	1,046	1,008
Europe								
Denmark – krona	5.8173	0.2559	5.5168	7.6172	6.7434	5.9480	5.5180	5.3568
Euro zone – (EUR/USD)	1.2780	-0.4673	-5.3962	-7.6254	-6.6811	1.3933	1.3523	1.2511
Norway – kroner	6.5546	3.1636	5.8919	9.4166	11.1232	6.5795	6.1231	5.8930
Russia – ruble	41.0500	6.6812	16.9132	14.9312	28.9471	41.0500	35.1319	31.6820
Sweden – krona	7.1783	0.3572	4.9498	8.8042	11.9066	7.2775	6.6711	6.3189
Switzerland – swiss franc	0.9439	0.4096	4.9477	7.1579	4.6800	0.9669	0.9024	0.8712
United Kingdom – (GBP/USD)	1.6131	-1.1035	-5.4815	-4.0336	-0.3490	1.7170	1.6565	1.5919

* 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

		2013		2014				2015			
End of period		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
American dollar											
Canadian dollar	(USD/CAD)	1.0310	1.0623	1.1050	1.0671	1.1199	1.1111	1.0989	1.1111	1.0989	1.0870
Euro	(EUR/USD)	1.3536	1.3780	1.3782	1.3691	1.2632	1.2700	1.2700	1.2600	1.2500	1.2500
British pound	(GBP/USD)	1.6194	1.6563	1.6672	1.7099	1.6212	1.6300	1.6500	1.6800	1.6700	1.6700
Swiss franc	(USD/CHF)	0.9052	0.8908	0.8869	0.8900	0.9534	0.9500	0.9600	0.9700	0.9800	0.9800
Yen	(USD/JPY)	98.23	105.32	103.22	101.33	109.66	108.00	108.00	109.00	110.00	111.00
Australian dollar	(AUD/USD)	0.9317	0.8918	0.9264	0.9432	0.8746	0.8900	0.9000	0.9000	0.9100	0.9100
Chinese yuan	(USD/CNY)	6.1215	6.0540	6.2172	6.2038	6.1385	6.1000	6.1000	6.0500	6.0000	6.0000
Mexican peso	(USD/MXN)	13.09	13.04	13.06	12.97	13.43	13.25	12.80	13.00	12.90	12.60
Brazilian real	(USD/BRL)	2.2297	2.3423	2.2627	2.2022	2.4507	2.3800	2.3500	2.4000	2.4200	2.3000
Effective dollar*	(1973 = 100)	75.19	76.44	76.86	75.91	81.30	80.60	80.30	80.80	81.00	80.90
Canadian dollar											
American dollar	(CAD/USD)	0.9700	0.9414	0.9050	0.9372	0.8929	0.9000	0.9100	0.9000	0.9100	0.9200
Euro	(EUR/CAD)	1.3955	1.4638	1.5229	1.4610	1.4147	1.4111	1.3956	1.4000	1.3736	1.3587
British pound	(GBP/CAD)	1.6695	1.7594	1.8421	1.8245	1.8155	1.8111	1.8132	1.8667	1.8352	1.8152
Swiss franc	(CAD/CHF)	0.8780	0.8386	0.8027	0.8341	0.8513	0.8550	0.8736	0.8730	0.8918	0.9016
Yen	(CAD/JPY)	95.28	99.14	93.41	94.96	97.91	97.20	98.28	98.10	100.10	102.12
Australian dollar	(AUD/CAD)	0.9605	0.9473	1.0237	1.0065	0.9795	0.9889	0.9890	1.0000	1.0000	0.9891
Chinese yuan	(CAD/CNY)	5.9377	5.6989	5.6267	5.8140	5.4813	5.4900	5.5510	5.4450	5.4600	5.5200
Mexican peso	(CAD/MXN)	12.70	12.27	11.82	12.15	11.99	11.93	11.65	11.70	11.74	11.59
Brazilian real	(CAD/BRL)	2.1628	2.2049	2.0478	2.0638	2.1883	2.1420	2.1385	2.1600	2.2022	2.1160

f: forecasts; * Trade-weighted against major U.S. partners.
Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies