FX Forecasts
Desjardins Economic Studies
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Despite another pause in the U.S. dollar's rise, the outcome for the year remains quite positive for this currency

HIGHLIGHTS

- The U.S. dollar's period of appreciation should extend through next year at least, provided the U.S. economy continues to improve and differences in monetary policies intensify.
- The Canadian dollar should benefit from easing global uncertainty in the coming quarters. We also expect oil prices to go back up, which will help the loonie return to US$0.90 (C$1.11/US$) in 2015.
- In the short term, the euro will be greatly influenced by the European Central Bank's (ECB) decision at its December 4 meeting. Over the longer term, ongoing ECB asset purchases over the next few years, with the Federal Reserve likely to begin monetary firming in mid-2015, suggest the euro will trend down for some time.
- Some of the pound's recent decline seems exaggerated, and we expect the pound to appreciate gradually over the coming quarters. The economic outlooks remain favourable for the United Kingdom and the Bank of England does not have a lot of leeway.

Contents

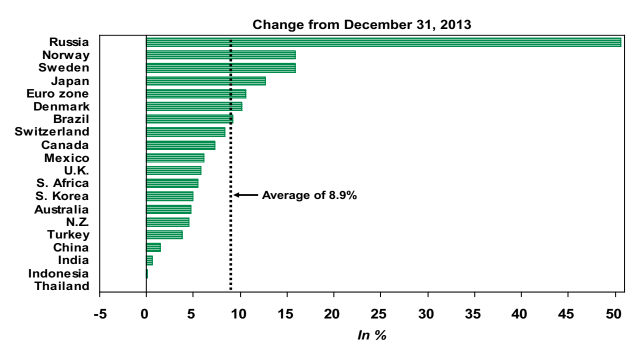
Editorial

Our first issue of the year for *FX Forecasts* was titled "2014: Year of the greenback?" From the start of the year, the planets seemed poised to align to support the U.S. dollar, with the U.S. economy's expected improvement and looming divergences in monetary policy. After several false starts, the greenback finally surged, mainly between July and September. Another push came in late October and early November; since then, however, the trend has flattened. After its performance over the last few months, some consolidation seems normal, barring any unexpected major developments. In any case, this does not change the U.S. dollar's already extraordinary results for 2014.

TOTAL DOMINATION

Boosted by the Federal Reserve's (Fed) decision to end its securities purchases, as well as the improvement in the U.S. economy, the greenback is posting gains against most of the major currencies in advanced and emerging nations (graph 1). European currencies were particularly affected by disappointing economic growth and inflation in the region, which prompted the European Central Bank to relax

Graph 1 – U.S. dollar's gains against major advanced and emerging nation currencies



Sources: Datastream and Desjardins, Economic Studies

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its monetary policy a few times. Currencies such as the Swiss franc and Danish krone, whose values are pegged to the euro, automatically followed this movement. The yen's depreciation is comparable to the European currencies, except that it mainly occurred in the fall, when the Bank of Japan announced new easing measures and signs that Japan was falling back into recession materialized.

The U.S. dollar's gains against emerging currencies were more timid, the exceptions being the Russian rouble and Brazilian real, among others. Remember that most emerging currencies had already slid considerably in 2013, which left little room for further steep drops in 2014, especially since the economies in these countries generally stabilized or even improved. The rouble is being hurt by the uncertainty arising from the Ukraine conflict, sanctions imposed on Russia by Western nations and falling oil prices. For the real, its depreciation is mainly linked to Brazil's continued poor economic performance, but also weak commodity prices.

MORE MIXED FIGURES IN THE UNITED STATES

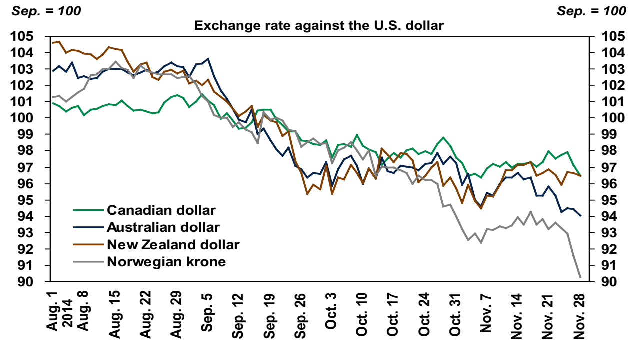
Recently, economic data for the United States has been rather mixed, which has helped to curb the greenback's rise. Following the good figures for employment, GDP and regional activity indicators, consumer confidence, consumer spending and income have been all been short of expectations. Even jobless claims disappointed: after dropping to 278,000 in late October, they rose back to 313,000.

All the same, we cannot conclude this is a new trend, as only some figures have been more disappointing. The U.S. dollar's period of appreciation should extend through next year at least, provided the U.S. economy continues to improve overall and differences in monetary policies intensify. Furthermore, other disappointments could again strike Europe and Japan, undermining those regions' currencies. Some emerging nations will also continue to bear watching.

THROWING OIL INTO THE MIX

The sharp slide in oil prices has had its own effects on currencies. Among other things, the Canadian dollar and Norwegian krone have dropped faster over the last few months, in tandem with falling black gold prices. However, it is interesting to note that Canada's dollar still fell less than other, comparable currencies tied to commodity prices (graph 2). The Australian dollar seems to have been affected primarily by the ongoing slide in iron ore prices, while the New Zealand dollar was penalized by the Reserve Bank of New Zealand's more dovish tone.

Graph 2 – The Canadian dollar is still doing better than other commodity currencies



Sources: Datastream and Desjardins, Economic Studies

The U.S. dollar is instead rather indirectly impacted by lower oil prices. Weaker gasoline prices, and lower energy prices overall, generate deflationary pressure, leading some to believe that the Fed could push back the onset of monetary firming. If the Fed does not raise its interest rates in 2015 as expected, there will be fewer differences between the trajectories of monetary policy in the United States, Japan and the euro zone, which will limit the greenback's potential gains. That being said, we expect oil prices to climb back in 2015, and even if prices remain lower for longer, the beneficial effect that this could have on the economy should bring its own inflationary pressures.

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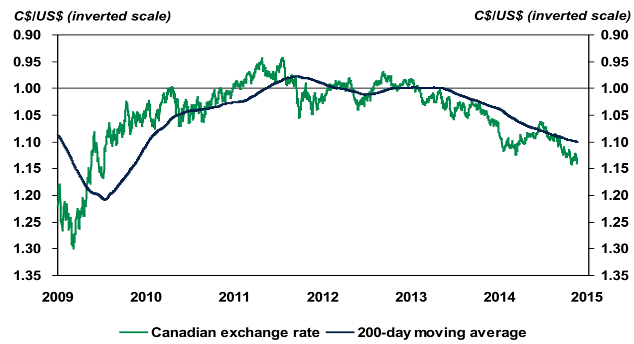
CANADIAN DOLLAR (CAD)

Hit by falling oil prices

- The Canadian dollar lost more altitude in late October and early November, in tandem with the continued slide in oil prices, bringing it to its lowest point since July 2009, US$0.8724. However, solid economic data from Canada, including an upside surprise from the inflation rate, helped to limit loonie's decline. Remember that last spring, inflation growth had had a big positive impact on the Canadian dollar by encouraging investors to revise their expectations about Canada's monetary policy.
- From a technical standpoint, the longer-term trend remains negative for the currency, though momentum recently improved. Investors are also slow to take more short positions. The net balance of speculative positions is still well above the lows frequently seen in 2013 and early 2014.
- Positive developments by some fundamental variables have not yet managed to convince investors to bet on a rise in the dollar. However, Canada's economy is doing rather well, as shown by the latest indicators. The long-awaited scenario of a bigger contribution to economic growth from international trade is materializing. Canadian exports are getting a boost from improved U.S. demand, among other things. The solid U.S. figures are therefore less likely to bring the loonie down against the greenback.
- However, a number of factors could cause some hesitation. For example, non-residential investment is still showing no lasting acceleration, due to the many risks threatening global economic growth. The Bank of Canada (BoC) also seems quite wary of these risks, which is helping to curb monetary firming expectations. Finally, the drop in oil prices is still playing against the currency and could also become an additional source of discouragement for some investments.

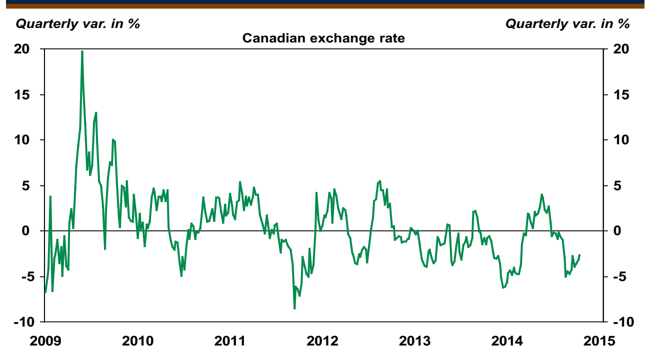
Forecasts: The Canadian dollar should benefit from easing global uncertainty in the coming quarters. We remain particularly confident about the U.S. economy, which should generate positive ripple effects for Canada. Furthermore, the BoC could have to adjust its stance in the wake of the recent changes to inflation and growth. Lastly, we expect oil prices to go back up, which will help the loonie return to US$0.90 (C$1.11/US$) in the coming months.

Canadian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

Canadian dollar: momentum



Sources: Datastream and Desjardins, Economic Studies

Canadian dollar: net speculative positions

Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

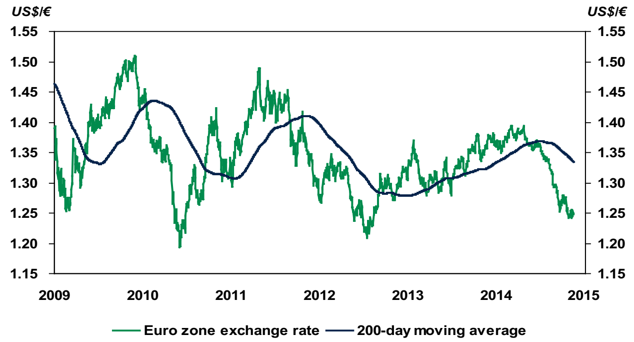
EURO (EUR)

The euro could continue to trend down

- After climbing close to US$1.28 in mid-October, the euro resumed its downtrend, recently nearing US$1.24. This currency has dropped to its lowest point since summer 2012, a time when investors feared for the euro zone's survival. Once again, the matter of monetary policy is behind the common currency's recent movements.
- The European Central Bank (ECB) did not announce any new measures in early October, giving the euro a bit of momentum. Then, speculation that the stock market's retreat and inflation expectations could convince the Federal Reserve (Fed) to extend its third quantitative easing program (QE3) continued to favour the euro. However, it quickly became apparent that these speculations were groundless; instead, the Bank of Japan caused some surprise by announcing that it would accelerate its financial asset purchases. This, combined with the confirmed ending of QE3 and a relatively optimistic statement from the Fed, led to another surge of the U.S. dollar against European and other currencies. Finally, ECB President Mario Draghi's dovish remarks prompted investors to again bank on new unconventional measures in the euro zone.
- Until just recently, the ECB seemed inclined to wait for the series of measures announced last summer to have an impact before contemplating further monetary easing. However, President Draghi upped the ante in his November 21 speech, saying that the ECB would "do what we must to raise inflation and inflation expectations as fast as possible." The ongoing, very low inflation and struggle to purchase enough financial assets through the programs already in place could also convince the ECB to announce new measures, such as purchasing corporate bonds, at its December 4 meeting. The ECB's decision may be strongly influenced by the new inflation forecasts. In terms of growth, the most recent figures do not seem to suggest that the situation is deteriorating further, as real GDP grew slightly faster than expected in the third quarter. However, dissent between ECB leaders still seems too strong to immediately go ahead with massive sovereign bond purchases.

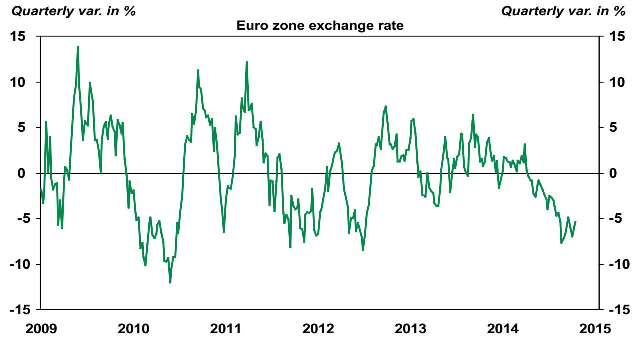
Forecasts: In the short term, the euro will be greatly influenced by the ECB's decision at its December 4 meeting. Over the longer term, ongoing ECB asset purchases over the next few years, with the Fed likely to begin monetary firming in mid-2015, suggest the euro will trend down for some time.

Euro and trend



Sources: Datastream and Desjardins, Economic Studies

Euro: momentum



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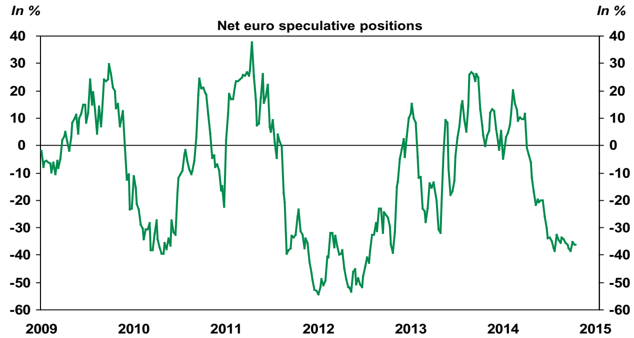
Euro: net speculative positions



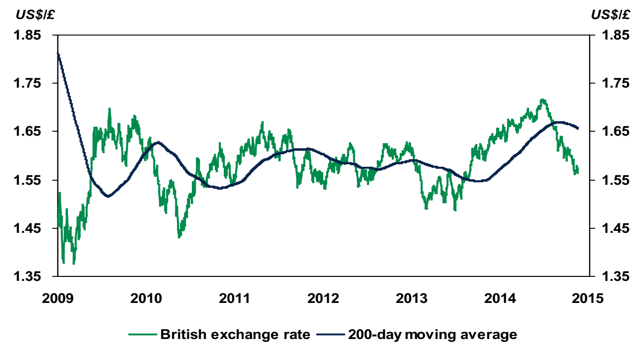
Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

BRITISH POUND (GBP)

The Bank of England's concerns are hurting the pound

- After remaining relatively stable in October, the pound again lost ground against the greenback in November, hitting its lowest point in over a year, at around US$1.56. In addition to the U.S. dollar's generalized gains, the pound was hurt by the Bank of England's (BoE) worried tone during the November 12 presentation of the *Inflation Report*.
- Given the recent soft inflation and economic difficulties in the euro zone, Governor Carney clearly signalled that he was contemplating later firming for Britain's monetary policy. It now seems more likely that the BoE will wait until Q3 2015 before raising its key rates, just after the Federal Reserve. Some investors are even banking on rate hikes not coming until 2016 for the United Kingdom, which has magnified the pound's slide. However, the economic outlooks remain favourable for the country and the BoE does not have a lot of leeway, especially since earnings seem to be starting to accelerate. **Some of the pound's recent decline thus seems exaggerated, and we expect the pound to appreciate gradually over the coming quarters.**

British pound and trend



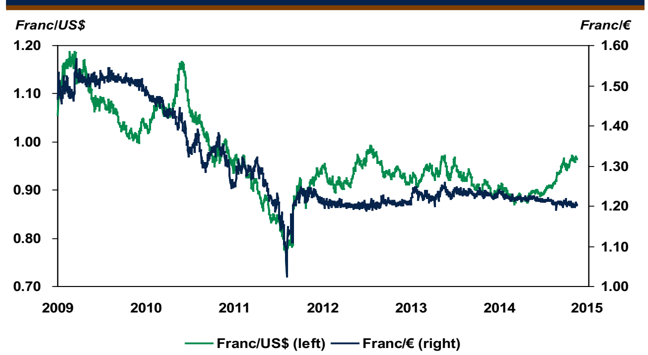
Sources: Datastream and Desjardins, Economic Studies

SWISS FRANC (CHF)

Investors continue to test the Swiss National Bank

- Unsurprisingly, the Swiss franc continued to follow the euro's movements quite closely. The USD/CHF pair thus generally increased over the last few weeks, now oscillating around 0.965 francs, which is close to its highest point in the last year. However, the EUR/CHF pair attracted all of the attention, recently falling to around 1.201 francs, which is very near the 1.20 franc/€ floor rate established by the Swiss National Bank (SNB). Even though some Swiss figures have been encouraging recently, we can assume that it is primarily expectations of new unconventional measures in the euro zone that are putting downside pressure on the EUR/CHF pair. The late-November referendum, which threatened to limit the SNB's capacity to act by forcing it to buy gold instead of euros, also hurt the franc recently. **Now that the referendum proposal has been rejected, the EUR/CHF pair should move away from the floor rate.**

Swiss franc



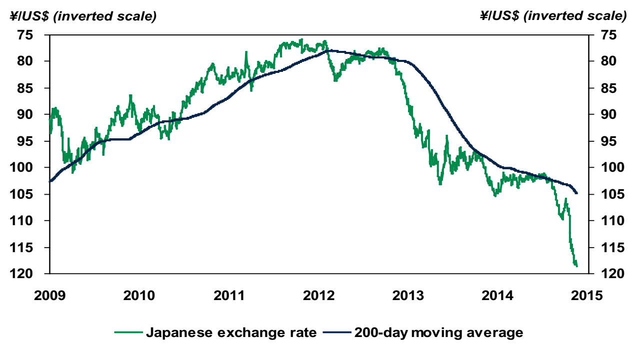
Sources: Datastream and Desjardins, Economic Studies

YEN (JPY)

Lively depreciation is back

- The yen has lost around 8% of its value since the end of October, and exchange rates recently hit a seven-year peak of ¥118.98/US$. The Bank of Japan's (BoJ) surprise decision to increase its securities purchases triggered this movement. Monetary easing was expanded to prevent another slide by inflation, as Japan's economy is showing signs of flagging. After rising 6.7% in the first quarter and falling 7.3% in the spring, real GDP contracted 1.6% over the summer. Consumption grew a modest 1.5% and investment fell again. Note that the latest GDP numbers had not yet been released when the BoJ increased its purchases, suggesting that it could still announce additional easing.
- From another angle, the yen is still being penalized by unfavourable interest rate spreads and carry-trade transactions, which involve investing in currencies offering higher returns against low-return currencies. **After consolidating for short time, the yen should continue to depreciate in 2015, heading for ¥125/US$.**

Yen and trend



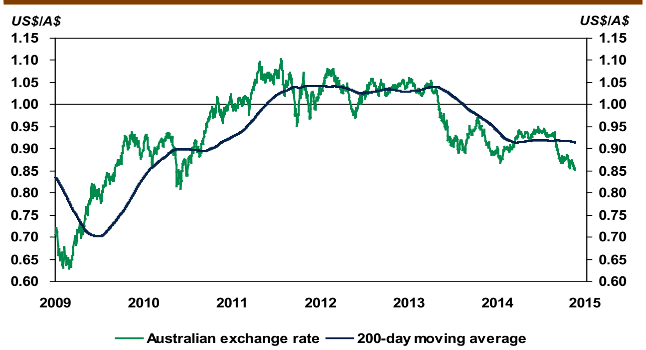
Sources: Datastream and Desjardins, Economic Studies

AUSTRALIAN DOLLAR (AUD)

The Reserve Bank of Australia reiterates that the currency is overvalued

- Australia's dollar recently hit its lowest point since July 2010, at US$0.8416. The Australian economy has lost some of its appeal in recent years, as investment in the natural resource sector has slowed. Add to this the economic uncertainties in many countries that import commodities, such as China and Japan, as well as the larger price drops for the main resources exported by Australia (iron ore and coal). Despite the dollar's depreciation in the last few months, the Reserve Bank of Australia (RBA) still maintains that the currency is overvalued and that its value does not sufficiently reflect the drop in prices for commodities produced in Australia.
- On the other hand, the currency is supported by higher interest rates in Australia than in other advanced nations and by carry-trade transactions. Without any concrete monetary intervention, the RBA may struggle to bring its currency down in a lasting fashion. **We predict a limited appreciation by the Australian dollar, as global fears will likely decrease next year and commodity prices may rise slightly.**

Australian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

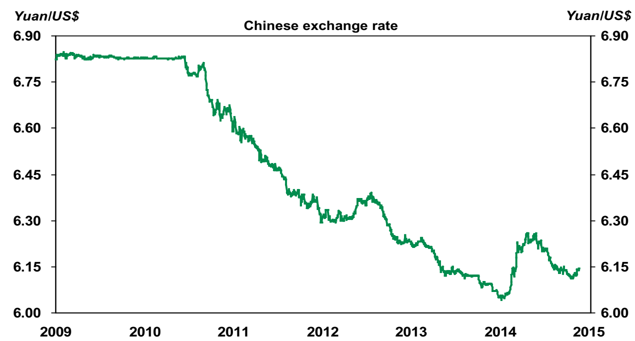
EMERGING CURRENCIES

The People's Bank of China announced interest rate cuts

CHINESE YUAN (CNY)

- The monetary authorities have recently allowed the yuan to depreciate. The exchange rate is currently close to 6.14 yuan/US$, similar to September's levels. This change of course is consistent with the decision to cut interest rates for the first time since July 2012. Several elements support this caution from monetary authorities. Primarily, economic growth remains slow, with annual real GDP growth of just 7.3% for the third quarter, the slowest advance since winter 2009. Major changes are taking place in China, as investment should make a waning contribution to growth, with consumption taking a larger share. **The yuan's gains for 2015 look to be limited, and the 6.00 yuan/US$ mark will be hard to reach.**

Chinese yuan and trend



Sources: Datastream and Desjardins, Economic Studies

MEXICAN PESO (MXN)

- Despite easing strains in financial markets, the Mexican peso continued to depreciate against the greenback. The USD/MXN pair recently hit 13.90 pesos, its highest point since summer 2012. The greenback's strength is largely responsible for the recent rise of the USD/MXN pair. Falling oil prices, political problems in Mexico and some disappointing economic data also hurt the peso. By recently downgrading its growth forecast for next year, the Bank of Mexico signalled that it does not plan to raise its key rates soon. **However, production and automobile exports jumped to historic peaks in October, which suggests that outlooks for the economy and the Mexican currency are still rather good.**

Mexican peso and trend

Sources: Datastream and Desjardins, Economic Studies

BRAZILIAN REAL (BRL)

- The real depreciated in the wake of Dilma Rousseff's re-election as president of Brazil. All the same, she offered an olive branch to investors by announcing a change of leadership at the Ministry of Finance. The exchange rate, which had hit 2.62 reals/US$ in mid-November, fell to 2.50 reals/US$ when a media leak revealed that Joaquim Levy, from the finance sector, had been chosen to kick-start the economy and clean up public finances. Brazil also suffers from high inflation, amplified by the currency's depreciation. The Bank of Brazil must therefore continue its monetary firming, which complicates the economy's recovery. **Outlooks for the real remain negative in the short term.**

Brazilian real and trend

Sources: Datastream and Desjardins, Economic Studies

Table 1
Currency market

	Spot price	*Percentage return since*				*Last 52 weeks*		
Country – Currency*	Nov. 28	1 month	3 months	6 months	1 year	Higher	Average	Lower
Americas								
Argentina – peso	8.5280	0.3294	1.5057	5.6099	39.3464	8.5280	7.9159	6.1200
Brazil – real	2.5761	4.1249	14.4580	14.8638	10.8288	2.6088	2.3284	2.1959
Canada – dollar	1.1403	2.0130	5.0147	4.9616	7.7181	1.1414	1.0964	1.0579
Canada – (CAD/USD)	0.8770	-1.9733	-4.7753	-4.7270	-7.1651	0.9453	0.9121	0.8762
Mexico – peso	13.8998	3.0527	6.0362	8.0725	6.2043	13.8998	13.1768	12.8363
Asia and South Pacific								
Australia – (AUD/USD)	0.8511	-3.8936	-9.0340	-7.8511	-6.4851	0.9498	0.9082	0.8511
China – yuan renminbi	6.1432	0.4891	0.0057	-1.7725	0.8330	6.2594	6.1512	6.0412
Hong Kong – dollar	7.7549	-0.0342	0.0613	0.0155	0.0310	7.7693	7.7546	7.7500
India – rupee	62.2100	1.6703	2.8264	5.5391	-0.1156	63.1050	60.9475	58.2850
Japan – yen	118.6400	9.6944	14.3904	16.4907	15.9500	118.6400	104.5125	100.9900
New Zeland – (NZD/USD)	0.7853	-0.8481	-6.3217	-7.5546	-3.2747	0.8821	0.8335	0.7692
South Korea – won	1,108	5.5457	9.2276	8.4790	4.3808	1,115	1,049	1,008
Europe								
Denmark – krona	5.9788	2.2673	5.7605	8.8598	9.0604	6.0101	5.5671	5.3568
Euro zone – (EUR/USD)	1.2467	-2.2004	-5.3812	-8.3177	-8.3311	1.3933	1.3409	1.2413
Norway – kroner	7.0312	6.3352	13.7882	17.6671	15.4814	7.0312	6.2050	5.8995
Russia – ruble	49.4725	16.4442	34.5394	43.0327	49.1933	49.4725	36.5171	32.5735
Sweden – krona	7.4596	1.6980	6.9907	12.2851	13.9898	7.4657	6.7668	6.3285
Switzerland – swiss franc	0.9635	1.8176	5.3005	7.2820	6.3172	0.9694	0.9082	0.8712
United Kingdom – (GBP/USD)	1.5661	-3.0760	-5.5515	-6.2582	-4.1966	1.7170	1.6541	1.5645

* 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	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
American dollar											
Canadian dollar	(USD/CAD)	1.0310	1.0623	1.1050	1.0671	1.1199	1.1236	1.1111	1.1236	1.1111	1.0870
Euro	(EUR/USD)	1.3536	1.3780	1.3782	1.3691	1.2632	1.2500	1.2400	1.2200	1.2100	1.2000
British pound	(GBP/USD)	1.6194	1.6563	1.6672	1.7099	1.6212	1.5800	1.5900	1.6000	1.6200	1.6300
Swiss franc	(USD/CHF)	0.9052	0.8908	0.8869	0.8900	0.9534	0.9600	0.9700	0.9900	1.0000	1.0100
Yen	(USD/JPY)	98.23	105.32	103.22	101.33	109.66	118.00	118.00	120.00	122.00	124.00
Australian dollar	(AUD/USD)	0.9317	0.8918	0.9264	0.9432	0.8746	0.8600	0.8700	0.8700	0.8800	0.8900
Chinese yuan	(USD/CNY)	6.1215	6.0540	6.2172	6.2038	6.1385	6.1400	6.1200	6.1000	6.0700	6.0500
Mexican peso	(USD/MXN)	13.09	13.04	13.06	12.97	13.43	13.70	13.55	13.65	13.50	13.35
Brazilian real	(USD/BRL)	2.2297	2.3423	2.2627	2.2022	2.4507	2.5500	2.5200	2.6000	2.5000	2.4000
Effective dollar*	(1973 = 100)	75.19	76.44	76.86	75.91	81.30	82.80	82.80	83.80	84.00	84.00
Canadian dollar											
American dollar	(CAD/USD)	0.9700	0.9414	0.9050	0.9372	0.8929	0.8900	0.9000	0.8900	0.9000	0.9200
Euro	(EUR/CAD)	1.3955	1.4638	1.5229	1.4610	1.4147	1.4045	1.3778	1.3708	1.3444	1.3043
British pound	(GBP/CAD)	1.6695	1.7594	1.8421	1.8245	1.8155	1.7753	1.7667	1.7978	1.8000	1.7717
Swiss franc	(CAD/CHF)	0.8780	0.8386	0.8027	0.8341	0.8513	0.8544	0.8730	0.8811	0.9000	0.9292
Yen	(CAD/JPY)	95.28	99.14	93.41	94.96	97.91	105.02	106.20	106.80	109.80	114.08
Australian dollar	(AUD/CAD)	0.9605	0.9473	1.0237	1.0065	0.9795	0.9663	0.9667	0.9775	0.9778	0.9674
Chinese yuan	(CAD/CNY)	5.9377	5.6989	5.6267	5.8140	5.4813	5.4646	5.5080	5.4290	5.4630	5.5660
Mexican peso	(CAD/MXN)	12.70	12.27	11.82	12.15	11.99	12.19	12.20	12.15	12.15	12.28
Brazilian real	(CAD/BRL)	2.1628	2.2049	2.0478	2.0638	2.1883	2.2695	2.2680	2.3140	2.2500	2.2080

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