

# FX FORECASTS

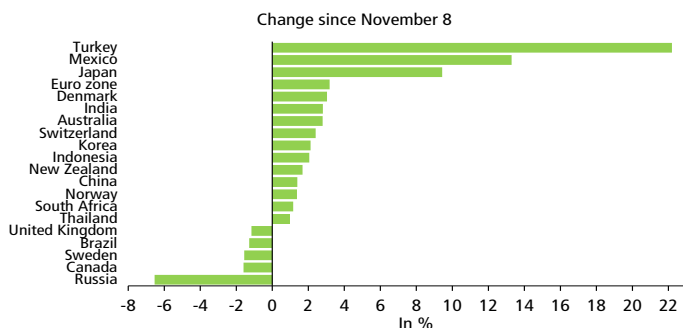
## January's currency movements will probably not be typical of the rest of the year

### HIGHLIGHTS

- ▶ Despite a recent downturn, the U.S. currency is still holding onto some gains won against most currencies since the November 8 election. There is every reason to think that these gains will increase again in the coming quarters.
- ▶ Since there is no indication of any change to the European Central Bank's monetary policy, the fate of the euro will probably continue to be greatly influenced by investor sentiment toward the U.S. dollar. Continued monetary firming in the United States and widening interest rate spreads should drive the euro back below US\$1.05 within a few months.
- ▶ Despite the loonie's recent performance, we remain pessimistic for the upcoming quarters. Our forecasts include a further widening of interest rate spreads with the United States, and limited additional gains in oil prices. The Canadian exchange rate should end 2017 in the neighbourhood of US\$0.71 (C\$1.41/US\$).
- ▶ The expected strengthening of the U.S. dollar and a clearer slowdown of the British economy should put renewed downward pressure on the pound in the next few quarters.
- ▶ The Mexican peso kept on depreciating in January, but its poor performance has been outdone by the Turkish lira.

After the U.S. dollar's sharp appreciation against many currencies last November and December, the trend reversed itself in January. Despite this recent downturn, the U.S. currency is still holding onto some gains won against most currencies since the November 8 election (graph 1). There is every reason to think that these gains will increase again in the coming quarters.

**GRAPH 1**  
The U.S. dollar has remained stronger than most other currencies since November 8



Sources: Datastream and Desjardins, Economic Studies

### The peso is no longer the most beleaguered currency

The Mexican peso kept on depreciating in January, but its poor performance has been outdone by the Turkish lira, which is suffering the effects of the numerous problems, both geopolitical and economic, that Turkey is facing. As for the peso, ongoing concerns about U.S. protectionism is the main reason weighing it down.

### CONTENTS

Highlights and editorial.....	1	British pound and Swiss franc.....	5	Emerging currencies .....	7
Canadian dollar .....	3	Yen and Australian dollar.....	6	<i>Chinese yuan, Mexican peso, Brazilian real</i>	
Euro.....	4			Tables .....	8

François Dupuis, Vice-President and Chief Economist

Mathieu D'Anjou, Senior Economist • Jimmy Jean, Senior Economist • Hendrix Vachon, Senior Economist

Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • [desjardins.economics@desjardins.com](mailto:desjardins.economics@desjardins.com) • [desjardins.com/economics](http://desjardins.com/economics)

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

IMPORTANT: This document is based on public information and may under no circumstances be used or construed as a commitment by Desjardins Group. While the information provided has been determined on the basis of data obtained from sources that are deemed to be reliable, Desjardins Group in no way warrants that the information is accurate or complete. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. Desjardins Group takes no responsibility for the consequences of any decision whatsoever made on the basis of the data contained herein and does not hereby undertake to provide any advice, notably in the area of investment services. The data on prices or margins are provided for information purposes and may be modified at any time, based on such factors as market conditions. The past performances and projections expressed herein are no guarantee of future performance. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the opinions of any other person or the official position of Desjardins Group. Copyright © 2017, Desjardins Group. All rights reserved.

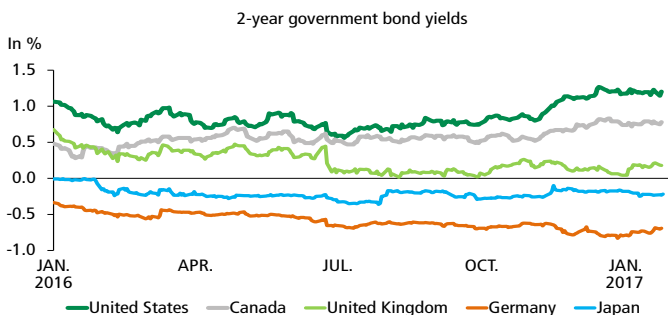
Among the currencies of the advanced economies, it is the Japanese yen that is showing the worst performance against the greenback. As is the case for many other currencies, this trend is largely due to expectations of divergence in monetary policies.

### Monetary policies will increasingly diverge

For a few years now we have been talking about divergence between U.S. monetary policy and those of many other economies. The phenomenon looks like it will become far more evident in 2017, when monetary firming is expected to accelerate in the United States.

We must therefore expect to see a few repetitions of the movements that were observed in the financial markets in November and December. Currencies are often more sensitive to changes in short-term interest rate spreads, like those between two-year bond yields. In November, the U.S. 2-year yield clearly outstripped its European and Japanese counterparts (graph 2). The Canadian 2-year yield was an exception, remaining closely correlated with the U.S. yield; this enabled the loonie to hold its own better than the other major currencies. However, the sustainability of that correlation appears questionable in the absence of monetary firming in Canada.

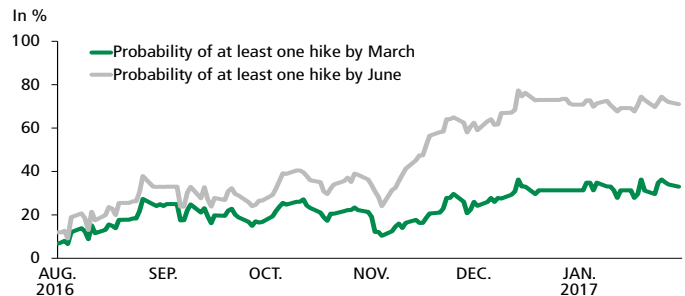
**GRAPH 2**  
Interest rate spreads are widening



Sources: Datastream and Desjardins, Economic Studies

Our scenario is banking on two interest rate hikes by the Federal Reserve (Fed) in 2017. However, the more hawkish tone adopted by several Fed leaders since the beginning of the year, combined with generally positive U.S. economic data, increases the credibility of a scenario with three rate hikes. A firming action in March would send a strong signal in that direction. For the time being, the markets do not appear to be factoring in that possibility, but things could change in the coming weeks (graph 3).

**GRAPH 3**  
Markets are estimating the probability of a rate hike by the Federal Reserve in March at around 33%



Sources: Datastream and Desjardins, Economic Studies

### Protectionism could also support the U.S. dollar

Other factors could benefit the U.S. dollar during the year. The election of Donald Trump could prove to be especially favourable for the currency, depending on what policies are adopted. For the time being, the proposed policies appear to be structured around three main focal points: deregulation, fiscal easing and protectionism.

Deregulation could have a positive impact on the currency if it facilitated business investment and accelerated economic growth. Similarly, fiscal easing could also be beneficial for the U.S. dollar, especially in the absence of an equivalent spending cut. The ensuing acceleration of the economy would add to inflationary pressures, pushing the Fed to raise interest rates faster.

Lastly, protectionism would benefit the currency by affecting the trade balance. Normally, when a country's trade balance improves and economic growth is boosted, the currency reacts positively. We can also look at this from the perspective of the currencies of countries that find themselves in the crosshairs of protectionist measures. Those currencies will tend to depreciate sharply, as is currently the case for the Mexican peso. From another point of view, a decline in global economic activity caused by protectionism could support the U.S. dollar simply because of its safe-haven status.

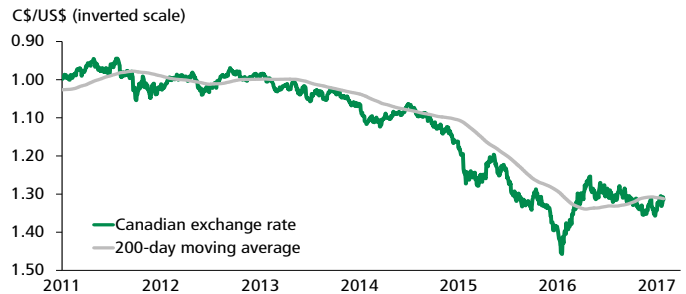
**François Dupuis**, Vice-President and Chief Economist  
**Hendrix Vachon**, Senior Economist

# Canadian dollar (CAD)

## There still appears to be strong potential for depreciation

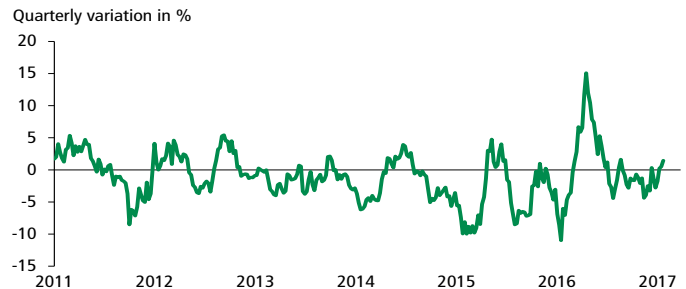
- At the end of 2016, the Canadian dollar was trading at around US\$0.74 (C\$1.35/US\$). Since then it has reappreciated and is now in the neighbourhood of US\$0.76 (C\$1.31/US\$), so it has gained around 1.5% from where it stood before the U.S. election. Compared with other currencies, the loonie's performance against the U.S. dollar is among the best.
- From a market viewpoint, the Canadian exchange rate appears to have settled into a comfort zone around US\$0.75. Its 200-day trend has flattened considerably. Net speculative positions are no longer showing strong pessimistic sentiment regarding future movements by the loonie.
- Fundamentally speaking, several factors have been benefiting the loonie lately. First, the agreement among many oil-producing countries to cut production has pushed crude prices back between US\$50 and US\$55 per barrel. Among other things, this has helped the loonie by stimulating foreign investors' appetite for the Canadian energy sector. The generally positive trend in the latest Canadian economic data also appears to have favoured the currency. Lastly, the generalized depreciation of the U.S. dollar in January has given the loonie another boost.
- The fact remains that numerous risks are still hanging over the Canadian economy, and the Bank of Canada (BoC) reminded us of that at its January monetary policy meeting. Even though a further interest rate cut was not discussed at that meeting, Governor Stephen Poloz mentioned at a press conference that such a scenario was still a possibility for future meetings. That remark briefly weakened the loonie, since the markets had previously been tending to bank on monetary firming by the end of this year.
- **Forecasts:** Despite the loonie's recent performance, we remain pessimistic for the upcoming quarters. Our forecasts include a further widening of interest rate spreads with the United States, and limited additional gains in oil prices. We also believe that the BoC will maintain a cautious tone due to the existence of several risks. The next batch of Canadian economic data could also be somewhat more mixed. We do not foresee any monetary firming in Canada before late 2018. The Canadian exchange rate should end 2017 in the neighbourhood of US\$0.71 (C\$1.41/US\$).

### CANADIAN DOLLAR Exchange rate and trend



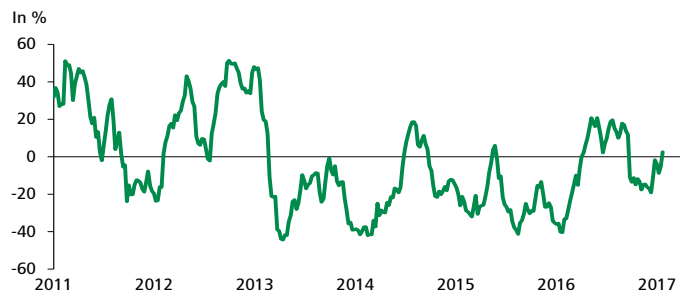
Sources: Datastream and Desjardins, Economic Studies

### CANADIAN DOLLAR Momentum



Sources: Datastream and Desjardins, Economic Studies

### CANADIAN DOLLAR Net speculative positions



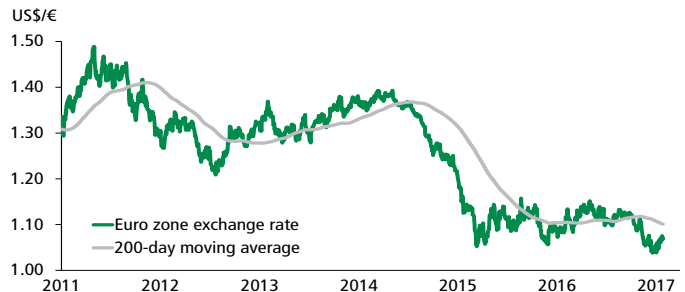
Sources: Datastream and Desjardins, Economic Studies

# Euro (EUR)

## The euro has picked up a bit, but is still vulnerable

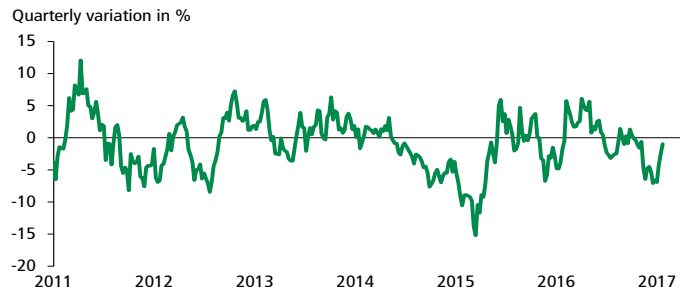
- The surge by the U.S. dollar after the election of Donald Trump sent the euro plunging; it even dropped below US\$1.04 in mid-December. At that point, the euro had lost over 6% compared to where it stood at the beginning of November. But the common currency has managed to come back up in recent weeks, to around US\$1.07. It should be mentioned that some doubts raised about the supposed positive effects of the U.S. election results have helped to reverse, to some degree, the rise in bond yields and the U.S. dollar since mid-December. The speculative position against the euro had also reached very high levels, opening the door to a technical rebound on profit-taking.
- Encouraging economic data have also bolstered the euro lately. Increases in purchasing managers' indexes and in some confidence indexes, along with a spike in industrial output in November, have generated some optimism about the economic outlook for the euro zone. However, we will have to keep watch on the many elections to be held in 2017; this could give rise to new worries about the future of the euro zone.
- Inflation has also accelerated recently in the euro zone, reaching 1.1% in December, the highest level in over three years. This was enough to lead some observers to speculate that the European Central Bank (ECB) might consider reducing its interventions. But Mario Draghi clearly closed the door on that possibility at his latest press conference. He believes that the rise in inflation mainly reflects higher energy prices, and that the euro zone economy still needs substantial monetary support. The ECB will therefore continue its financial asset purchases throughout 2017, and probably for a good portion of 2018, and it maintains that key interest rates will stay where they are, or drop even lower, for a good while longer. Thus, we can expect the spread between U.S. and European interest rates to keep widening, putting downward pressure on the euro.
- **Forecasts:** Since there is no indication of any change to the ECB's monetary policy, the fate of the euro will probably continue to be greatly influenced by investor sentiment toward the U.S. dollar. Continued monetary firming in the United States and widening interest rate spreads should drive the euro back below US\$1.05 within a few months.

### EURO Exchange rate and trend



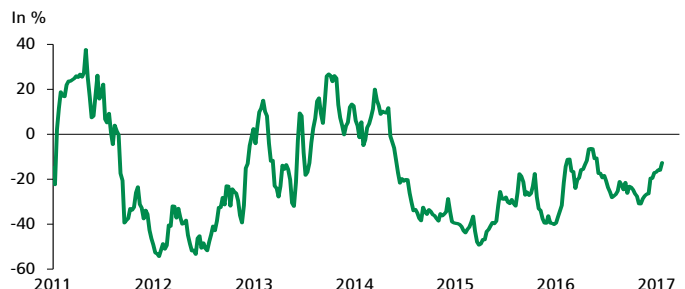
Sources: Datastream and Desjardins, Economic Studies

### EURO Momentum



Sources: Datastream and Desjardins, Economic Studies

### EURO Net speculative positions



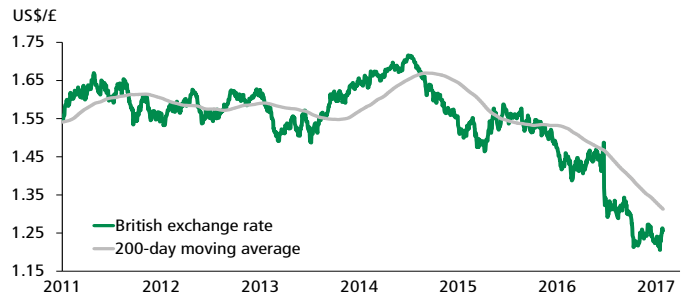
Sources: Datastream and Desjardins, Economic Studies

## British pound (GBP)

### Investors appreciated the Prime Minister's clarity

The British pound lost ground in the first weeks of 2017 amidst investors' concerns about the growing probability of a hard Brexit. The pound touched a new low of US\$1.20 in mid-January, despite the fact that the U.S. dollar was weakening against other currencies, including the euro. In an important speech on January 17, Prime Minister Theresa May confirmed her intention of negotiating a complete exit from the European Union and the common market, while attempting to work out a new free-trade agreement. This clear position, and the concession that any new agreement would be brought before Parliament, were well received by investors; the pound jumped several cents, returning to around US\$1.25. Moreover, the Supreme Court later confirmed that Parliament's consent would also be required before negotiations on leaving the European Union could begin. Other factors may lie behind the pound's appreciation. First of all, the British economy is still exhibiting resilience, and many forecasters have had to upgrade their growth forecast for 2017. That, combined with a sharp acceleration by inflation, has led the Bank of England to change its stance significantly, adopting a more neutral position regarding upcoming movements by key interest rates. **However, expected strengthening of the**

#### BRITISH POUND Exchange rate and trend



Sources: Datastream and Desjardins, Economic Studies

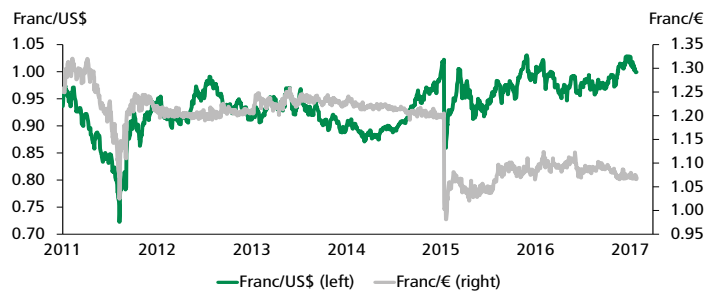
**U.S. dollar and a clearer slowdown of the British economy should put renewed downward pressure on the pound in the next few quarters.**

## Swiss franc (CHF)

### Little change foreseeable in the upcoming quarters

Like the euro, the Swiss franc lost ground against the U.S. dollar in the last few months of 2016, but it has picked up a bit of steam recently. After slipping somewhat after the U.S. presidential election, the EUR/CHF pair has stabilized slightly above 1.07 francs. Given that the European Central Bank is planning to continue its asset purchases throughout 2017, and various events, including Brexit negotiations and the French and German elections, could make the franc more attractive, the Swiss National Bank (SNB) will have to remain vigilant to avoid further appreciation of the franc. Switzerland's sluggish growth and low inflation give it plenty of leeway to keep its key interest rates in negative territory for many quarters to come. The SNB might also keep intervening directly in the markets to manage the franc. Such exchange rate transactions proved very worthwhile for the SNB in 2016. **We therefore predict that the franc will remain very stable against the euro throughout 2017.**

#### SWISS FRANC Exchange rate



Sources: Datastream and Desjardins, Economic Studies



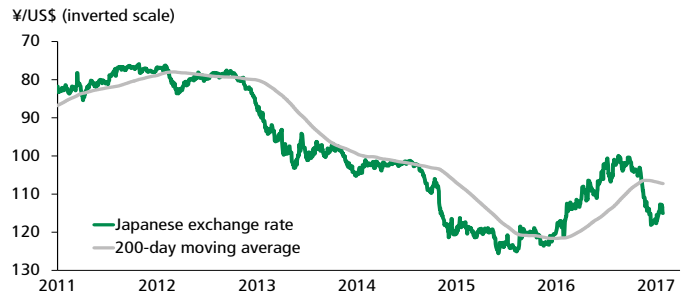
## Yen (JPY)

### Depreciation should resume

The yen depreciated sharply after Donald Trump's election in the United States. The exchange rate moved from around ¥105/US\$ to around ¥118/US\$ in the space of a few weeks. But the monetary policy meeting held by the Bank of Japan (BoJ) on December 20 marked the end of this new depreciation trend. The BoJ adopted a more optimistic tone in its press release, fuelling speculations about the possibility that it might raise the target for the 10-year bond yield. Since the start of the new year, the yen has resumed a slightly upward trend against the U.S. dollar; the exchange rate is currently in the neighbourhood of ¥114/US\$.

Considering that the U.S. dollar should start gaining strength again in the upcoming quarters, it appears likely that the Japanese exchange rate will revisit new cyclical highs. Furthermore, even though the BoJ is sounding more optimistic, it could well maintain a high degree of interventionism for several more quarters, in order to push inflation back to 2%. Currently, the inflation rate is just barely in positive territory. Lastly, we consider that it is too soon to raise the target for the 10-year bond yield. By keeping that target around 0%, the BoJ should

#### YEN Exchange rate and trend



Sources: Datastream and Desjardins, Economic Studies

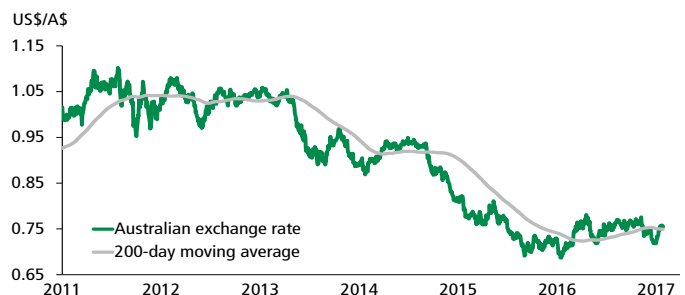
maintain its current pace of asset purchases. All told, **we believe that the ¥120/US\$ mark will be reached by the end of the year.**

## Australian dollar (AUD)

### The terms of trade have improved

Rising coal, iron and gold prices are improving Australia's terms of trade, giving strong support to the Australian dollar, which is currently in the neighbourhood of US\$0.76. Of course, the generalized depreciation of the U.S. dollar since the start of the year certainly helped matters. Consequently, a rally by the greenback could do much to quickly wipe out the Australian currency's recent gains. To that we must add a good deal of uncertainty about the robustness of the Australian economy. The Reserve Bank of Australia (RBA) maintained a cautious tone in December, but gave no indication about any further interest rate cuts. Growing inflation expectations could complicate the RBA's job. It will be interesting to see what it will have to say in early February. In the meantime, **we still prefer to bank on a weakening Australian dollar, against a backdrop of generalized appreciation by the greenback and a possible rebound in uncertainty around the world.**

#### AUSTRALIAN DOLLAR Exchange rate and trend



Sources: Datastream and Desjardins, Economic Studies

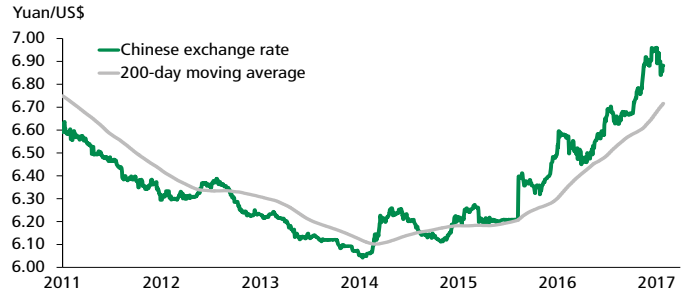
# Emerging currencies

## The Mexican peso is still under pressure

### CHINESE YUAN (CNY)

The Chinese currency has clearly been moving in reaction to the U.S. dollar in recent months. It neared the 7.00 yuan/US\$ mark at the end of the year, then recently fell back to around 6.85 yuan/US\$. Given that the Chinese trade surplus has been tending to lose ground in the past while, it is understandable that the Chinese authorities are not hesitating to let the yuan depreciate when the greenback is on a generalized upswing. Another factor to be considered is the reduction of China's currency reserves. In the space of two and a half years, they have shrunk by around US\$1,000B, reducing the monetary authorities' ability to support their own currency when it comes under pressure. **We forecast that the Chinese exchange rate will climb above 7.10 yuan/US\$ in 2017.**

### CHINESE YUAN Exchange rate and trend

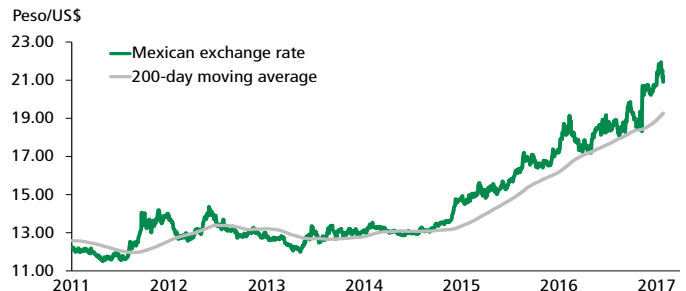


Sources: Datastream and Desjardins, Economic Studies

### MEXICAN PESO (MXN)

The USD/MXN peso pair has kept reaching new heights. Actions by the Bank of Mexico, including a 1% hike in key interest rates since the U.S. elections and vigorous exchange rate interventions, have occasionally managed to briefly reverse the peso's decline, but the effects have been short-lived. The peso's slump has been encouraged by numerous statements by the new U.S. president regarding his intention of penalizing companies that invest outside the United States, and of renegotiating the North American Free Trade Agreement (NAFTA) in the near term. Those negotiations promise to be very tough for Mexico, and the most likely scenario is that major restrictions will be imposed on exports from that country to the United States. **In these conditions, the peso's decline could well continue in the short term.**

### MEXICAN PESO Exchange rate and trend

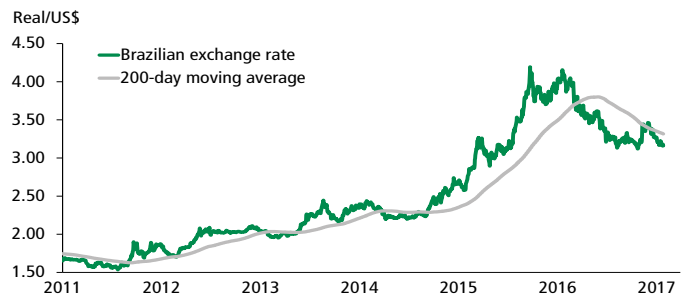


Sources: Datastream and Desjardins, Economic Studies

### BRAZILIAN REAL (BRL)

Like most other currencies, the Brazilian real depreciated in November and December; however, it won back lost ground in January and is now trading at close to 3.15 reals/US\$. One point in the real's favour is the subsiding inflation rate in Brazil. A year ago, annual price growth was above 10%. Today, it stands at 6.3%. This allows the Central Bank of Brazil to lower its key interest rate; this should give a boost to economic growth in the quarters ahead. Nevertheless, future trends in the U.S. dollar will remain key for the Brazilian exchange rate. **We therefore forecast a depreciation for 2017, bringing the exchange rate closer to 3.40 reals/US\$.**

### BRAZILIAN REAL Exchange rate and trend



Sources: Datastream and Desjardins, Economic Studies

**TABLE 1**  
**Currency market: Yields**

COUNTRY – CURRENCY*	SPOT PRICE	VARIATION (%)				LAST 52 WEEKS		
	Jan. 27	-1 month	-3 months	-6 months	-1 year	Higher	Average	Lower
<b>Americas</b>								
Argentina – peso	15.8855	2.40	4.43	6.12	14.18	16.1075	14.9372	13.7520
Brazil – real	3.1517	-3.84	-0.21	-4.13	-22.50	4.0706	3.4275	3.1186
Canada – (USD/CAD)	1.3125	-3.15	-1.96	-0.70	-6.89	1.4097	1.3183	1.2526
Canada – (CAD/USD)	0.7619	3.26	2.00	0.70	7.40	0.7983	0.7586	0.7094
Mexico – peso	21.0210	1.49	11.38	11.39	13.83	21.9550	18.9482	17.1292
<b>Asia and South Pacific</b>								
Australia – (AUD/USD)	0.7551	5.09	-0.51	0.81	7.48	0.7814	0.7467	0.7026
China – yuan renminbi	6.8817	-1.02	1.42	3.17	4.62	6.9610	6.6683	6.4490
Hong Kong – dollar	7.7593	0.00	0.05	0.03	-0.47	7.7990	7.7608	7.7527
India – rupee	68.1050	0.19	1.83	1.54	-0.06	68.7835	67.2439	66.1060
Japan – yen	115.08	-2.00	9.30	9.18	-3.03	121.06	108.62	99.89
New Zealand – (NZD/USD)	0.7264	5.43	2.00	2.66	12.96	0.7451	0.7006	0.6431
South Korea – won	1,159	-4.03	1.46	2.20	-3.61	1,239	1,159	1,090
<b>Europe</b>								
Denmark – krona	6.9543	-2.19	1.88	3.38	1.50	7.1569	6.7413	6.4525
Euro zone – (EUR/USD)	1.0706	2.37	-1.95	-2.58	-1.52	1.1518	1.1046	1.0378
Norway – kroner	8.3419	-4.10	0.92	-2.29	-3.69	8.7306	8.3738	7.9816
Russia – ruble	59.5900	-1.88	-4.96	-10.05	-23.87	80.4175	65.7743	59.0962
Sweden – krona	8.8515	-4.07	-2.53	2.57	4.01	9.4090	8.5925	7.9588
Switzerland – swiss franc	0.9982	-2.96	0.50	0.48	-1.88	1.0312	0.9857	0.9513
United Kingdom – (GBP/USD)	1.2549	2.37	3.08	-4.31	-11.97	1.4807	1.3396	1.2065

\* 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	2016		2017				2018				
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	
<b>U.S. dollar</b>											
Canadian dollar	USD/CAD	1.3129	1.3433	1.3514	1.3699	1.3889	1.4085	1.4085	1.4286	1.4085	1.3889
Euro	EUR/USD	1.1238	1.0547	1.0500	1.0400	1.0300	1.0200	1.0100	1.0100	1.0000	1.0100
British pound	GBP/USD	1.2990	1.2357	1.2400	1.2000	1.1700	1.1500	1.1400	1.1200	1.1000	1.1000
Swiss franc	USD/CHF	0.9684	1.0160	1.0200	1.0300	1.0400	1.0400	1.0500	1.0500	1.0500	1.0500
Yen	USD/JPY	101.35	116.90	117.00	119.00	120.00	122.00	123.00	124.00	125.00	125.00
Australian dollar	AUD/USD	0.7664	0.7216	0.7400	0.7300	0.7300	0.7200	0.7200	0.7100	0.7100	0.7200
Chinese yuan	USD/CNY	6.6716	6.9450	6.9500	7.0500	7.1000	7.1500	7.2000	7.2500	7.3000	7.2500
Mexican peso	USD/MXN	19.38	20.73	21.50	22.50	22.50	23.00	23.00	23.50	24.00	24.00
Brazilian real	USD/BRL	3.2459	3.2588	3.2000	3.3500	3.2500	3.4000	3.3500	3.4500	3.5000	3.4500
Effective dollar <sup>1</sup>		90.01	95.76	96.10	97.90	98.70	99.90	100.60	101.30	101.70	100.80
<b>Canadian dollar</b>											
U.S. dollar	CAD/USD	0.7617	0.7445	0.7400	0.7300	0.7200	0.7100	0.7100	0.7000	0.7100	0.7200
Euro	EUR/CAD	1.4754	1.4168	1.4189	1.4247	1.4306	1.4366	1.4225	1.4429	1.4085	1.4028
British pound	GBP/CAD	1.7055	1.6598	1.6757	1.6438	1.6250	1.6197	1.6056	1.6000	1.5493	1.5278
Swiss franc	CAD/CHF	0.7376	0.7564	0.7548	0.7519	0.7488	0.7384	0.7455	0.7350	0.7455	0.7560
Yen	CAD/JPY	77.19	87.02	86.58	86.87	86.40	86.62	87.33	86.80	88.75	90.00
Australian dollar	AUD/CAD	1.0062	0.9693	1.0000	1.0000	1.0139	1.0141	1.0141	1.0143	1.0000	1.0000
Chinese yuan	CAD/CNY	5.0816	5.1703	5.1430	5.1465	5.1120	5.0765	5.1120	5.0750	5.1830	5.2200
Mexican peso	CAD/MXN	14.77	15.43	15.91	16.43	16.20	16.33	16.33	16.45	17.04	17.28
Brazilian real	CAD/BRL	2.4723	2.4261	2.3680	2.4455	2.3400	2.4140	2.3785	2.4150	2.4850	2.4840

f: forecasts; <sup>1</sup> Trade-weighted against major U.S. partners (1973 = 100).  
 Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies