ECONOMIC NEWS

The Loonie Has Not Done as Well on the Greenback's Latest Retreat

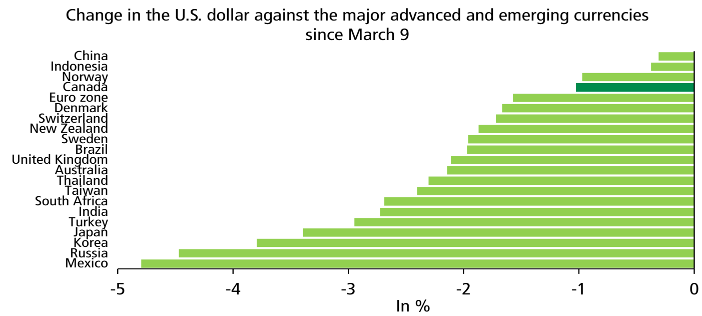
The greenback's February momentum quickly lost steam and several currencies recouped most of the ground they had lost. The Canadian dollar, however, stood out with a more tepid than average recovery. It is currently trading close to US$0.750 compared with about US$0.765 toward the end of February.

In February and early March, expectations of a key interest rate increase in the United States provided the U.S. dollar with the bulk of its support. Although the increase came through at mid-month, the greenback's rise did not last. The financial markets did not get the further indications they were hoping for from the Federal Reserve (Fed) as to ongoing monetary firming. The trend in the currency market also started to change on March 9 with the European Central Bank's more optimistic tone, suggesting to some investors that the Fed would not be going it alone on monetary firming for long. This benefited the euro and other European currencies. In the United States, the problems Donald Trump is having with fulfilling his promises added to the uncertainty over economic growth. This decreased the likelihood of overly high inflation in the United States, especially as oil prices have come down since the end of February.

The fact that oil prices are back below US$50 probably has a lot to do with the Canadian dollar's weak recovery. Moreover, unlike the euro and other European currencies, the loonie did not get the benefit of higher monetary firming expectations. This was due to the fact that the Bank of Canada (BoC) maintained a very cautious tone at its March 1st meeting; it is still highlighting the downside economic risks. Canadian inflation was a little lower than expected in February; this also seems to have played against the loonie, as this variable has frequently beat expectations in other countries. Lastly, doubts about the U.S. economy can be transposed to the Canadian economy, especially its exports.

U.S. DOLLAR

Another dip, but a small one against the loonie



Sources: Datastream and Desjardins, Economic Studies

IMPLICATIONS

We continue to expect a livelier U.S. economy in 2017, along with divergent monetary policy and a rise by the U.S. dollar. It could go up more steeply against the euro and other European currencies if the markets downgrade their expectations for non-U.S. monetary firming. The process seems to have started a few days ago. The loonie could eventually benefit from the reverse effect, as the Canadian economy's good performance could trigger a change of tone from the BoC, not to mention the positive impact that higher oil prices would have.

If crude prices close back in on US$55 a barrel quickly, the loonie could soon return to February's levels. However, we remain pessimistic over the longer term as interest rate spreads between Canada and the United States are expected to widen, even if the Canadian economy does well. Our year-end target for the exchange rate remains US$0.72 (C$1.39/US$).

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