Towards a US$0.80 Loonie?

The Canadian dollar is doing well and its value is now hovering around US$0.765. At the rate things are going, will the 80-cent bar soon be reached?

It is often said that the Canadian dollar follows the price of oil. However, its recent increase in value has nothing to do with the price of crude, which has dipped since the third week of May.

The loonie’s recent rise is due instead to the change in the spread between Canadian and U.S. interest rates. Short-term Canadian rates in particular benefited from encouraging economic statistics and from the Bank of Canada’s (BoC) change in tone. The BoC is now signalling that key rates will rise soon. Financial markets estimate the likelihood of an increase in October at roughly 80%.

Statistics that are more mixed and doubts surrounding continued monetary tightening in the United States have limited the rise in U.S. interest rates. The value of the greenback has declined against several currencies.

**IMPLICATIONS**

The conditions that would have to be met for the loonie to reach US$0.80 include the difference in interest rates remaining very favourable, which means solid figures out of Canada, and other positive signals from the BoC. An unexpected increase in key rates in July would give the loonie added momentum, as the markets could start anticipating a second increase between now and the end of the year. At the same time, the markets would have to continue to question monetary firming in the United States. This could still be possible over the next few months if certain statistics remain mixed.

A nudge from oil prices would undoubtedly help the loonie reach US$0.80. Crude prices have risen slightly over the last few days, aided in part by the drop in inventory in the United States. This momentum would have to continue until prices return to between US$50 and US$55 a barrel.

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