

ECONOMIC NEWS

Rising Oil Prices Fail to Lift the Loonie

The Canadian dollar has reacted more to changes in oil prices in the past. The correlation observed in the past seems to suggest that the exchange rate may reach approximately US\$0.85, with the price of a barrel of WTI (West Texas Intermediate) at more than US\$70. The loonie is currently hovering around US\$ 0.78. Why?

This does not mean that the magic between the Canadian currency and the price of oil has stopped working. Instead, it's because other factors are cancelling the effect. One of these is the overall strength the U.S. dollar has demonstrated since mid-April, combined with the more pronounced increase in bond rates in the United States. In relative terms, the Canadian dollar is faring better than most of the other major currencies, however. The rise in the price of oil probably has something to do with this.

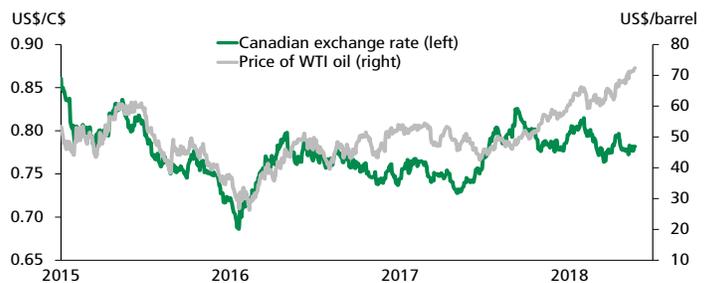
It is possible that the saturation of Canadian oil export capacity is preventing the currency from benefiting as much as before from the rise in international prices for black gold. In addition, the value of the Canadian dollar could be higher if there was less uncertainty surrounding continued monetary tightening in Canada. Even if the economy is doing well, risks continue to hover over the real estate market, household debt and the future of the North American Free Trade Agreement (NAFTA).

IMPLICATIONS

Despite high oil prices, the situation is not favourable to a major increase in the value of the Canadian currency. Nonetheless, we believe that the exchange rate will reach approximately US\$0.80 during the summer. The economy is expected to accelerate and inflationary pressures should heighten. This should motivate the Bank of Canada to keep up monetary tightening.

One might think that a currency that doesn't appreciate much would be good news for the economy, especially for exporters. However, it can penalize other areas, in particular, changes in the price of gasoline. Normally, the link between the loonie and oil

GRAPH 1
The Canadian dollar is holding at nearly US\$0.78



WTI: West Texas Intermediate
Sources: Datastream and Desjardins, Economic Studies

GRAPH 2
Currently, most of the other currencies are struggling more against the greenback



Sources: Datastream and Desjardins, Economic Studies

prices helps to ease the rise in gasoline prices. This is not really the case right now.

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