Market Insights | April 2021

Investment Strategy Team
Currency update CAD

Brent Joyce, CFA
Investment Strategist

Justin Truong, CFA
Manager, Investment Strategy

Canadian dollar 2021 forecast = US$0.83 / CAD$1.20

(Positive directional comments refer to a stronger CADUSD quote, currently $US0.800 at 1:50 PM 04/21/2021; all data references source: Bloomberg, April 21, 2021)

We maintain our constructive forecast for the Canadian dollar, with upside risks to the low US$0.80's – low CAD$1.20's range possible.

What has changed?

Bank of Canada (BoC) turning more hawkish (impact = positive)

On April 21, 2021, the BoC followed through on previously hinted guidance to cut the weekly pace of its asset purchase program. The quantitative easing purchases fall from $4 billion per week to $3 billion. Furthermore, the BoC laid the groundwork to pull forward its guidance on the first policy rate hike to H2 2022 from previous expectations of Q1 2023.

Oil prices have surprised to the upside (impact = positive)

Canadian dollar

CADUSD

Source: Bloomberg April 21, 2021

The Canadian dollar is driven by the outlook for the domestic and global economies, general risk sentiment, the price for oil and other commodities, government bond yield differentials, and Canada's fiscal and trade balances. Many of these factors have been positive drivers for the Canadian dollar as of late, and the currency has responded accordingly.

Bank of Canada (BoC) turning more hawkish

On April 21, the Bank of Canada (BoC) announced that the overnight policy rate will remain unchanged at 0.25%. The BoC followed through on previously hinted guidance to cut the weekly pace of its asset purchase program (QE). The quantitative easing (QE) purchases fall from $4 billion per week to $3 billion. This brings the pace of the BoC QE program to ~6.8% of GDP per year, putting it in line with what the Federal Reserve's program is providing the US.

The surprise came as the BoC pulled forward its guidance on the first policy rate hike from 2023 previously to the second half of 2022. While the Bank reiterated that it will keep "the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2% (inflation) target is sustainably achieved", it now judges that Canada's output gap will close in Q4 2022. The output gap closing is a function of improved GDP growth forecasts. The BoC increased its estimates for real GDP (4Q on 4Q basis) in 2020 to -3.2% (previously -4.1%), 2021 to 5.4% (previously 4.6%), and 2022 to 3.1% (previously 2.9%). Recent improvements in the labour market and an overheating housing market likely played a role in the Bank's decision. Canada is the first G7 central bank to begin tapering its asset purchase program and officially signal that it could raise interest rates earlier than previously telegraphed. We continue to see an unwillingness from the BoC to tolerate a currency much stronger than the low US80¢ level. While tapering is likely to continue, especially in light of the Government's declining (albeit still large) borrowing requirements, lift-off for the overnight rate is likely dependent on US monetary policy and bond market expectations.

Oil prices have surprised to the upside

Oil prices have surprised to the upside (impact = positive). The recent shift higher for oil prices (on the back of production discipline from OPEC+ and US shale) should put upward pressure on the currency.

Other factors

Market positioning

The speculative positioning gap has closed, relieving some upward pressure (impact = neutral/slight negative). Currency traders were net short Canadian dollars for most of 2020; this has moved to a neutral position. There remains room for longs to move higher, but the potential for a boost due to short covering has passed.

Interest rate differentials

Canadian less US 2-year bond yield differentials have wobbled between 2 and 16 bps in 2021. They are currently at the top end of that range (16 bps), favouring a stronger Canadian dollar (impact = positive).

Trade

Canada's annualized trade balance has bounced off its historic December 2020 low but remains weak (impact = neutral/ small positive).

US Dollar trend

US dollar strength in Q1 2021 has returned to the weakening trend that had persisted from the spring of 2020 (impact = positive).

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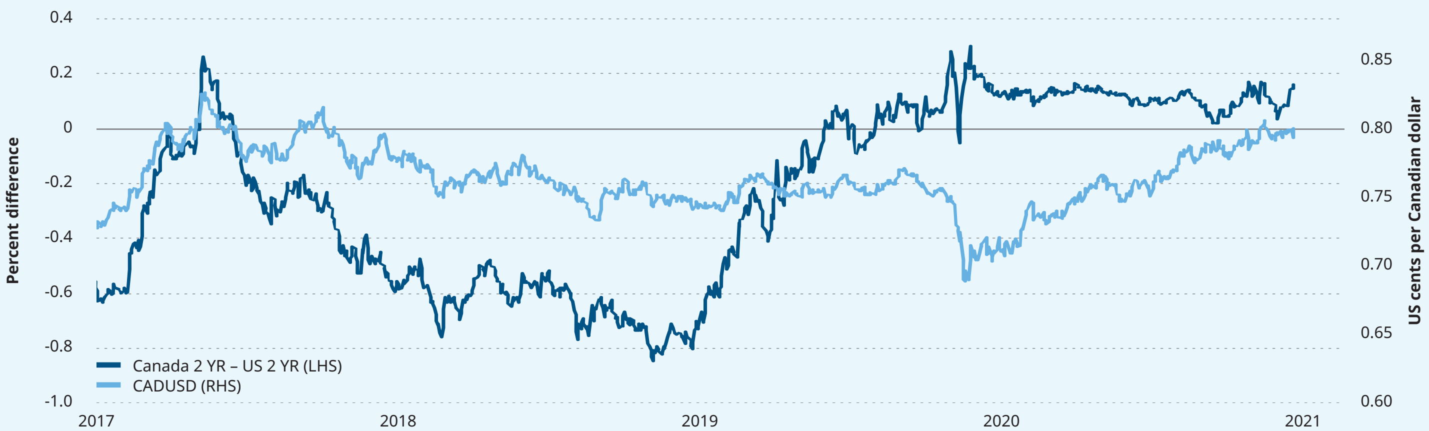
WTI Oil

WTI crude oil spot (US$/bbl)

Source: Bloomberg April 21, 2021

Loonie & yield spreads

Canadian – US 2-yr yield spread vs Canadian dollar



Source: Bloomberg April 21, 2021

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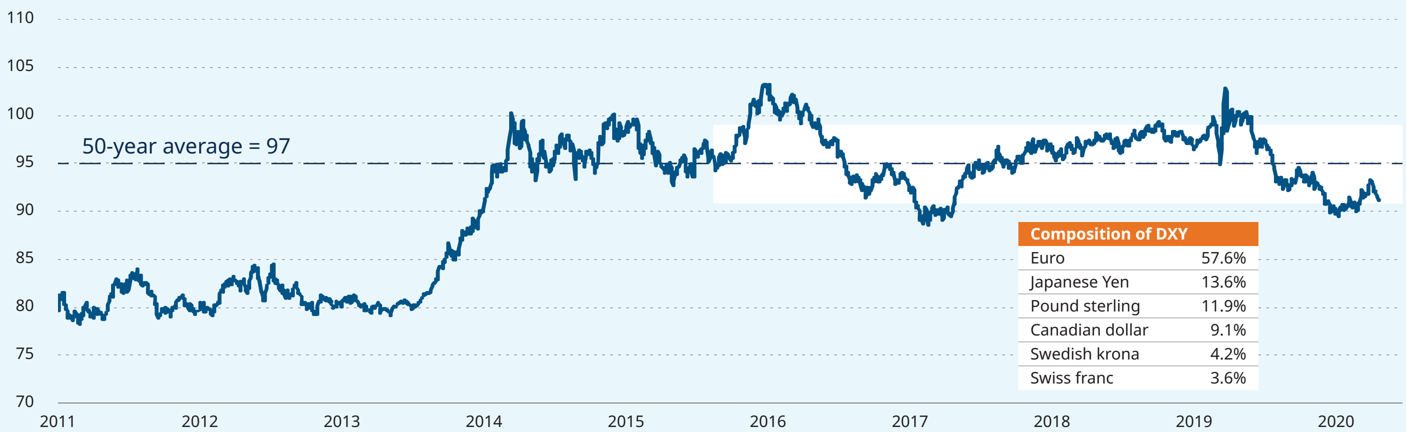
US dollar

US Dollar Index (DXY)



Composition of DXY	
Euro	57.6%
Japanese Yen	13.6%
Pound sterling	11.9%
Canadian dollar	9.1%
Swedish krona	4.2%
Swiss franc	3.6%

Source: Bloomberg April 21, 2021

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