

ECONOMIC NEWS



The Loonie's Surge Seems Stretched

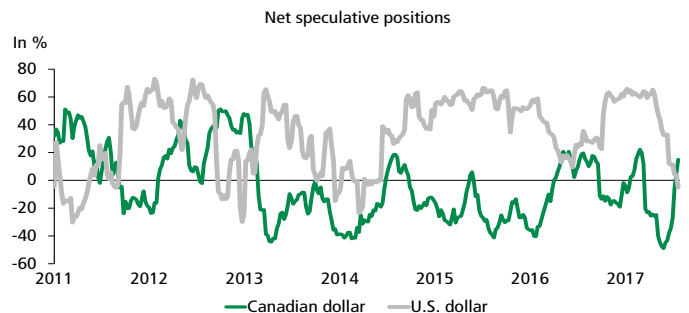
The loonie continues to soar, having recently surpassed the US\$80 mark. This surge is clearly due, in large part, to the start of monetary tightening in Canada. Yet the speed at which the currency increased in value surprised most forecasters. One can only wonder if another hike in Canadian key rates this fall will not send the loonie soaring even higher.

We commented in June that several developments would be needed for the loonie to reach US\$80. In the end, the situation was even more favourable than we could have imagined. Not only did the Bank of Canada (BoC) begin to tighten its monetary policy in July, but Canadian economic data remained extremely strong. As a result, the highly negative feelings among investors regarding the Canadian currency changed completely, with investors now counting on more Canadian key rates hikes over the coming quarters. The mixed economic data and chaotic political environment in the United States have also led speculators to take positions against the greenback. Rising oil prices also favoured the loonie.

IMPLICATIONS

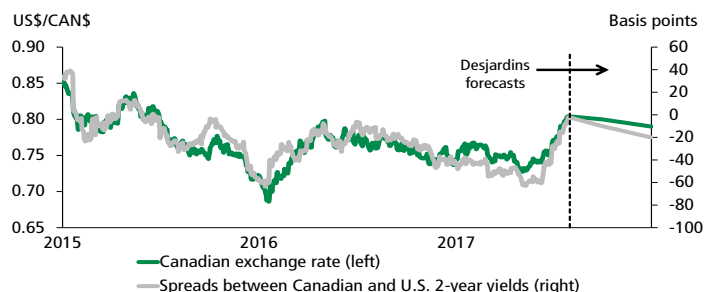
The Canadian currency's momentum is very strong, and this could continue over the short term, especially if the rise in oil prices continues or if the political situation in the United States deteriorates further. However, we feel that the positioning of investors in favour of the loonie may have peaked. It is especially difficult to justify the fact that the spread in 2-year yields between Canada and the United States is now practically zero. This assumes that Canadian key rates will, on average, be at least equal to U.S. key rates. Given that the Federal Reserve is expected to continue to gradually tighten its monetary policy, we anticipate a rise in U.S. bond yields and a return to a more positive sentiment regarding the greenback. Although it will raise its key rates for a second time this fall, the BoC may also signal its unease regarding the rapid rise in the value of the loonie. This should calm investor enthusiasm somewhat and bring the Canadian dollar back to around US\$79 at the end of 2017.

GRAPH 1
Speculator feelings regarding the loonie and the greenback have changed completely over the last few months



Sources: Bloomberg and Desjardins, Economic Studies

GRAPH 2
Changing rate spreads have contributed to the loonie's rise, but the next few months are expected to be less positive



Sources: Datastream and Desjardins, Economic Studies

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