

# Factors and Fundamentals

## Foreign Exchange Strategy

### Canadian dollar (USDCAD)

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The move in USDCAD above 1.29 has the market on edge. While we don't rule out a spike up to 1.31, the FX Strategy team expects the next major USDCAD move to be a reversal lower. We now expect a full NAFTA deal by July 1, which should reverse the direction of USDCAD. We expect USDCAD to move to 1.25 on a NAFTA deal. With oil where it is, we expect a continued drift lower to 1.20 on a 1Y horizon. We expect one more Fed than BoC hikes in 2018 but BoC hikes mean more to the FX market.

FX Strategy Team View	1m	3m	6m	9m	12m
USDCAD spot	1.27	1.25	1.24	1.22	1.20
EURCAD spot	1.49	1.51	1.55	1.56	1.56
GBPCAD spot	1.71	1.74	1.80	1.82	1.84
Fed base rate	1.50 - 1.75%	1.75 - 2.00%	2.00 - 2.25%	2.25 - 2.50%	2.50 - 2.75%
BoC base rate	1.25%	1.50%	1.75%	2.00%	2.25%

#### Bullish USDCAD factors

- We expect the Fed to hike three more times in 2018 with the BoC hiking only twice. The OIS curve, on the other hand, has about 52bps in BoC hikes and 57bps of Fed hikes. If we're right, the 3M and 2Y interest rate differentials will move further in the USD's favor.
- All parties in the NAFTA negotiations are hanging onto their red lines. Mexico and Canada don't seem interested in an 'agreement in principal' that violates their red lines but the Trump team hasn't budged on its demands thus far. If there isn't a breakthrough soon, a deal won't happen in 2018 and the market will be left with the uncertainty of a 'zombie' NAFTA for months or years.

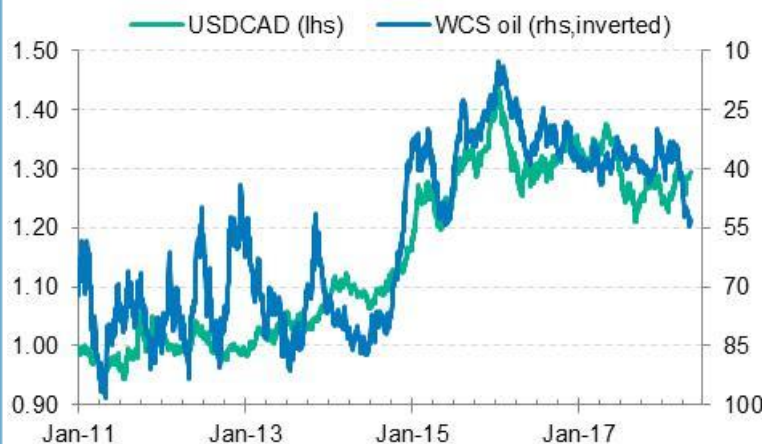
#### Bearish USDCAD factors

- The WCS grade of oil has been above \$50 for a month (see chart). Alberta is profitable at this level. If oil holds here for a few months, then CAD is cheap relative to the important long-term fundamental and should surge when a pipeline deal emerges.
- NAFTA negotiations are down to crunch time. If a deal isn't struck by 01-July, Mexico's president will be a lame duck and Trump won't have fast-track trade negotiating authority. We expect a full deal by that date.
- Large deficits in the fiscal and current accounts undermine the credibility of a currency. We view it as a problem when the sum of those accounts is worse than -5.0% of GDP. The US 'twin sin' score was -5.8% for 2017 and should deteriorate in 2018. Canada's twin sin score is smaller at -3.7% and stable.

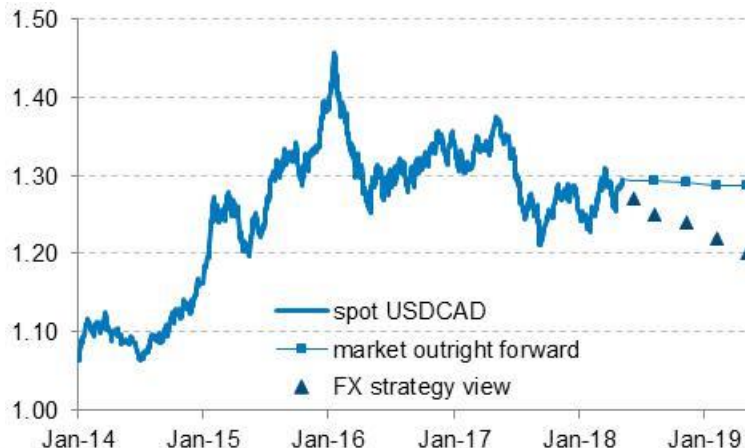
#### Canada FX fundamental facts

- Population and per capital GDP:** 37mn, USD 45,077/year nominal or 48,265 IMF PPP-adjusted for calendar 2017 (USDCAD 1.30)
- Central bank objective:** inflation targeting (since 1991) with a target of 2.0% and a +/- 1% band
- Central bank governor (Bank of Canada or BoC):** Stephen Poloz (since Jun-13)
- Finance minister:** Bill Morneau (since Nov-15)
- Prime Minister:** Justin Trudeau (since Nov-15)
- Forthcoming elections:** General election on or before October 21, 2019
- GDP growth rate:** 1.7% annualized QoQ and 2.9% YoY for Q4 2017; +3.0% 2017 annual; median forecast is 2.1% for 2018
- Inflation:** Total CPI 2.3% YoY for Mar-2018; +2.0% YoY avg of 3 core CPI measures; median forecast is 2.2% for 2018
- Current account balance:** -3.0% of GDP for Q4 2017; -2.9% for calendar 2017; median forecast is -2.7% for 2018
- Budget balance:** -0.8% for 2017; median forecast is -0.8% for 2018

#### USDCAD and Western Canada Select crude oil



#### USDCAD price history, forward curve and our outlook



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