

Factors and Fundamentals

Foreign Exchange Strategy

Canadian dollar (USDCAD)

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USDCAD has been slowly drifting lower over the past five weeks and we expect that drift to continue in August, albeit at a slower pace with a 1.29 1M target. We would put 50-60% odds on a new NAFTA deal being reached prior to the US midterm election but our 1.27 3M target doesn't depend solely on that factor. Looking into 2019, we expect USDCAD to continue to gently drift lower along with the USD index. We expect markets to shift focus to the Fed being closer to done tightening than the BoC and others.

FX Strategy Team View	1m	3m	6m	9m	12m
USDCAD spot	1.29	1.27	1.26	1.25	1.24
EURCAD spot	1.52	1.50	1.47	1.53	1.55
GBPCAD spot	1.70	1.64	1.58	1.71	1.77
Fed base rate	1.75 - 2.00%	2.00 - 2.25%	2.25 - 2.50%	2.50 - 2.75%	2.75 - 3.00%
BoC base rate	1.50%	1.75%	1.75%	2.00%	2.25%

Bullish USDCAD factors

- The Trump team has changed tack in NAFTA negotiations and is now publicly threatening to freeze out Canada. If Mexico and the US were to reach a deal without Canada, Canada would face immense pressure to cave on its unique priorities, like protection of its dairy sector. This pressure should be USD bullish until a deal is reached. And as all side have noted, there is a chance that a deal is never reached and we are left with 'zombie NAFTA'.
- We expect the Fed to hike two more times in 2018 with the BoC hiking only once. OIS curves have about 23bps in BoC hikes vs 44bps of Fed hikes. If we're right, the 3M and 2Y interest rate differentials will move further in the USD's favor between now and the end of the year.

Bearish USDCAD factors

- The Trump Administration suddenly seems eager to reach a deal on NAFTA. After Canada refused to kick Mexico to the curb in June, Mexico will return the favor. We could easily see a deal by the end of October.
- The WCS grade of oil has averaged \$44 thus far in 2018—a 16% increase over the same period in 2017. With the Trans Mountain pipeline expansion now on the way, Alberta producers should ramp up production over the next 12M.
- Large deficits in the fiscal and current accounts undermine the credibility of a currency, with -5.0% for the sum of those deficits being a key risk threshold. The US 'twin sin' score was -5.8% for 2017 and is forecast to deteriorate to -6.2% for 2018. Canada's twin sin score was smaller at -3.8% in 2017 is forecast to deteriorate to only -4.0% in 2018.

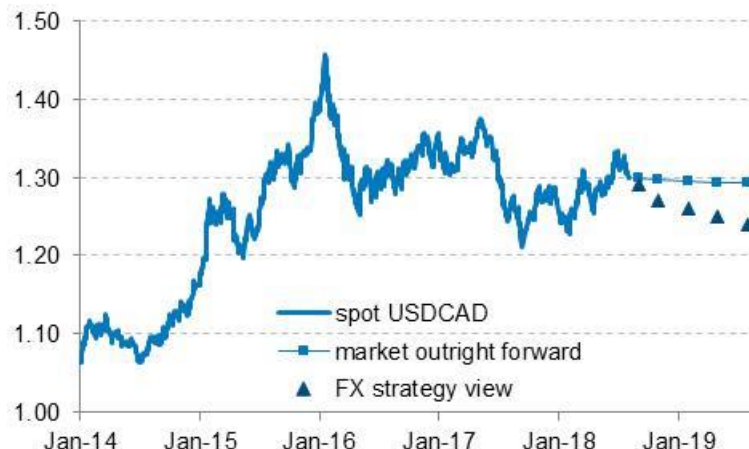
Canada FX fundamental facts

- **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:** 1.3% annualized QoQ and 2.3% YoY for Q1 2018; +3.0% 2017 annual; median forecast is 2.0% for 2018
- **Inflation:** Total CPI 2.5% YoY for Jun-2018; +2.0% YoY avg of 3 core CPI measures; median forecast is 2.2% for 2018
- **Current account balance:** -3.2% of GDP for Q1 2018; -3.0% for calendar 2017; median forecast is -3.2% 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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