

Factors and Fundamentals

Foreign Exchange Strategy

Canadian dollar (USDCAD)

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The USMCA deal has pushed USDCAD to 1.28; now the market doesn't have a clear driver. We don't expect much movement through the end of 2018, but we think risk factors are a bit skewed toward a lower USDCAD. Our 3M outlook is 1.27. We think USDCAD will drift lower in 2018 as the growth gap narrows and the USD index loses upward momentum. We have USDCAD going to 1.24 on the 9M horizon before running out of steam as Canadian election hedging enters the frame at the 1Y horizon.

FX Strategy Team View	1m	3m	6m	9m	12m
USDCAD spot	1.28	1.27	1.26	1.24	1.24
EURCAD spot	1.48	1.42	1.41	1.43	1.54
GBPCAD spot	1.65	1.57	1.51	1.60	1.75
Fed base rate	2.00 - 2.25%	2.25 - 2.50%	2.50 - 2.75%	2.75 - 3.00%	2.75 - 3.00%
BoC base rate	1.75%	1.75%	2.00%	2.25%	2.50%

Bullish USDCAD factors

- West Texas Crude may be trading at \$75, but Western Canada Select is stuck in the \$35-40 range due to the dearth of pipeline capacity. It has been weeks since the court ruling and Trudeau hasn't announced his Plan B for Trans Mountain.
- BMO's econ team expects the Fed to hike 3 more times over the next 9M but OIS only has 2 hikes priced in. The CAD OIS curve has 3 BoC hikes priced in, which matches our expectation. If we're right on the Fed, interest rate differential should move 25bps in the USD's favor.
- We are now just 12M away from the next Canadian election and right now it looks like it will be close. If it still looks likely to be close a year from now, there will likely be a tiny move higher at the 1Y horizon as foreigners hedge CAD exposures.

Bearish USDCAD factors

- The USMCA deal is now in the price, but the US dropping steel & aluminum tariffs probably isn't. That bit of good news could easily emerge within the next 1-2 months.**
- There are rumors that Trudeau and Morneau are working on tax reforms designed to enhance competitiveness (like accelerated depreciation). Details are likely to emerge in the Fall Fiscal Update.
- 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 threshold. The US 'twin sin' score was -5.8% for 2017 and is forecast to deteriorate to -6.5% for 2018. Canada's twin sin score was only -3.8% in 2017 is forecast to shrink to -3.6% for 2018.

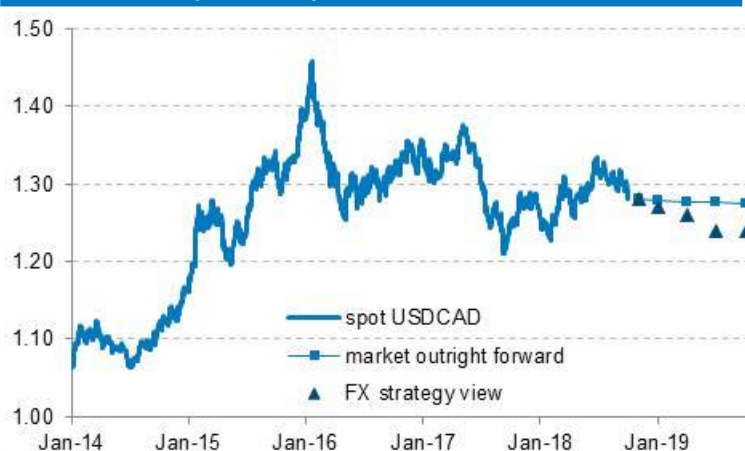
Canada FX fundamental facts

- FX weights:** 2016 BIS volume weight 6.3% (6th); BBDXY weight 11.4% (3rd); 2018 Fed's broad USD index weight 11.9% (4th)
- Population and per capita GDP:** 37mn, USD 45,077/year nominal or 48,265 IMF PPP-adjusted for calendar 2017 (USDCAD 1.30)
- Next general election:** A Federal election must be held on or before October 21, 2019
- Prime Minister:** Justin Trudeau (since Nov-15)
- Finance minister:** Bill Morneau (since Nov-15)
- Central bank governor (Bank of Canada or BoC):** Stephen Poloz (since Jun-13)
- Central bank objective:** inflation targeting (since 1991) with a target of 2.0% and a +/- 1% band
- Inflation:** Total CPI 2.8% YoY for Aug-2018; +2.1% YoY avg of 3 core CPI measures; median forecast is 2.4% for 2018
- GDP growth rate:** 2.9% annualized QoQ and 1.9% YoY for Q2 2018; +3.0% 2017 annual; median forecast is 2.1% for 2018
- Current account balance:** -3.1% of GDP for Q2 2018; -2.9% for calendar 2017; median forecast is -2.8% for 2018
- Budget balance:** -0.8% for 2017; median forecast is -0.8% for 2018
- Sovereign credit:** S&P rating AAA (stable); Moody's rating Aaa (stable); 5Y CDS 31bps (+5bps YTD)

USDCAD and Western Canada Select crude oil



USDCAD price history, forward curve and our outlook



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