

Canadian Dollar weekly



The latest foreign exchange topics and trends

May 14, 2012

Highlights This Week

Monday @ 08:30: **New motor vehicle sales** are expected to fall 2% in March, continuing the pullback after January's surge.

Tuesday @ 09:00: **Existing home sales** are expected to rise 10% above year-ago levels, up from the modest 1.7% rise the prior month. Average prices likely pushed back into positive terrain as well, with an 8.5% rise in Toronto leading the way. The reported dip in March prices nationally was a technicality in any event, pulled down by a steep decline in Vancouver sales volumes—the vast majority of cities still reported modest price gains, and we expect that to be repeated in April.

Wednesday @ 08:30: **Manufacturing sales** are expected to be unchanged in March, as suggested by the softness in exports and a decline in auto production. New orders look to be down 1%.

Wednesday @ 12:05: GoC 2-year \$3.3 bln bond auction.

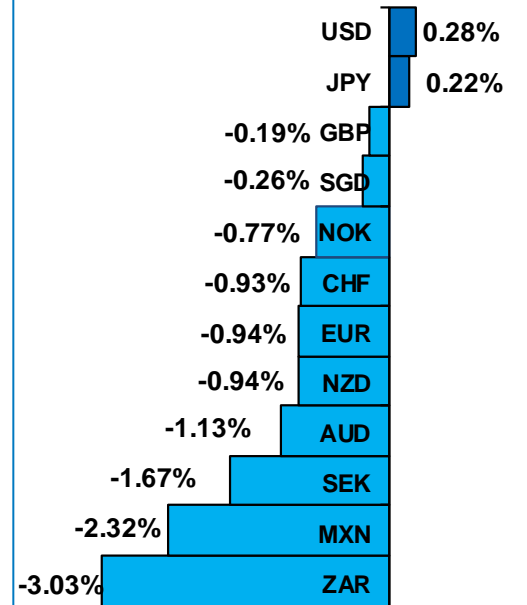
Thursday @ 08:30: The weakness in international trade points to a modest gain in March **wholesale trade** (+0.3%).

Thursday @ 08:30: Canada's **international securities transactions** for March will be released. In the prior month, foreign investors bought a net \$12.5 bln of Canadian securities (\$13.7 in bonds, \$0.4 bln in equities, while selling \$1.7 bln in money market instruments). Canadian investors sold a net \$2.2 bln of foreign securities, with the bulk of the sales in fixed income.

Thursday @ 10:30: The **Bank of Canada** releases its quarterly Review.

Friday @ 08:30: Even with another 3% rise in gasoline prices and some further boost in home prices, we still look for both headline and core **inflation** trends to cool further in April. Thanks to a friendly year-ago comparison (when pump prices jumped more than 6%), we look for the 0.2% rise in overall CPI to trim the annual inflation rate a tick to 1.8%. Similarly, a mild 0.1% rise in core prices will also shave the annual trend in underlying CPI to 1.8%, just two months after it flared up to 2.3%. Both readings are a tad below where the BoC saw things for all of Q2 in their latest MPR.

One-Week Spot % Return vs. CAD



FX SALES & TRADING

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Hiking Speculation

The Bank of Canada's policy announcement on April 17 declared that "in light of the reduced slack in the economy and firmer underlying inflation, some modest withdrawal of the present considerable monetary policy stimulus may become appropriate." Although the Bank noted that "the timing and degree of any such withdrawal will be weighed carefully against domestic and global economic developments," the market pulled forward its rate hike expectations. The Bank is projecting the output gap to close in 2013 H1. Given their GDP projection (that runs stronger than ours) and estimates of potential growth, the gap's closure should be more a Q2 story than a Q1 event (a conclusion reinforced by the weak GDP reading for February). This heralds a resumption in potential rate hikes as early as this summer.

We judge the BoC: (1) will want to have non-negative real policy rates by around the time the output gap closes, (2) is loathe to push Canada-U.S. overnight rate spreads beyond 200 bps (so rate hikes beyond 2% will have to wait until the Fed starts tightening), and (3) will move in 25-bp increments and (breaking with tradition) not in consecutive meetings with an eye on potential appreciation of the Canadian dollar. Given our slower GDP growth projection (the output gap closing by the end of next year), our forecast is for rate hikes to resume in January 2013, on a quarter-per-quarter pace, re-pausing at 2% next autumn.

While the loonie is vulnerable to bouts of global risk aversion and signs of weaker U.S. growth (the latter via its perceived indirect impact on BoC policy), the net result should be more of a sideways trend than a weakening one. But, as BoC rate hikes get closer and, presumably, the U.S. economy starts gathering momentum again, the Canadian dollar should break to the strong side of the range established over the past several quarters, eventually averaging around US\$1.05.

Michael Gregory
Senior Economist

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The View From Here

USDCAD threatened to break out of the upper end of its 3 and a half month trading towards the end of the week, only to be sucked back to the middle following another surprise to the upside in Friday's Canadian Employment data. Further range trading is likely in store for the week ahead. Look for 0.9900/25 to provide primary support early in the week with secondary support kicking in near 0.9825/35. On top, 1.0050/70 continues to act as primary resistance with a break needed to spark an extension to 1.02/1.03. Suggested range this week 0.9900/1.0050.

USD/CAD Weekly Chart



Technicals

SUPPORT LEVELS		RESISTANCE LEVELS	
0.9931	50% fib of the 0.9800/1.0064 rally.	1.0064	High last week
0.9900	61.8% fib of the 0.9800/1.0064 rally.	1.0105	Weekly resistance line off 1.0658/1.0522.
0.9800	2012 low - April 27.	1.0122	61.8% fib of this year's 1.0321/0.9800 range.
0.9725	Low - Aug. 31, 2011.	1.0198	76.4% fib of this year's 1.0321/0.9800 range.

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Trade Recommendation

- Buy a 2 month 1.2800/1.3200 EURCAD Double no touch
- Our expectation is for EURCAD to continue to stay in a tight range

Background:

This trade is perhaps a bit of a contrarian position, as speculative positions have been eyeing up a break of triple bottom formation at 1.2880. Given the resiliency of the EUR in the face of the continued political and fiscal turmoil, however, the substantial gains beyond the year's lows may not be as tenable as most believe. With ECB on hold for the rest of this year at least, and softer global growth potential likely to hinder Mr. Carney's determination to raise rates by year end, EURCAD's ability to break its recent range could be in question.

Spot Reference: 1.2910

Cost: 2.00% of EUR notional

Time Horizon: 2 Months

Risk: Europe collapses under the pressure of Greek and peripheral instability. CAD economic data continues to surprise.



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Rate Forecast

	Actual	2012			2012		2013			
	Apr	May	Jun	July	Q3	Q4	Q1	Q2	Q3	Q4
BoC overnight	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75	2.00
10-yr Canadas	2.06	2.00	2.00	2.10	2.20	2.50	2.80	3.10	3.40	3.65
Fed funds	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
10-yr Treasuries	2.05	1.90	1.90	2.00	2.10	2.40	2.65	2.90	3.15	3.40
C\$ per US\$	0.993	0.991	0.990	0.988	0.987	0.982	0.974	0.965	0.956	0.950
US\$/€	1.32	1.32	1.31	1.31	1.31	1.30	1.31	1.32	1.33	1.35
US\$/£	1.60	1.60	1.60	1.59	1.59	1.58	1.58	1.60	1.62	1.64
¥/US\$	81	81	81	82	82	84	87	89	92	94

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