Monday's Price Action

- The CAD appeared to react to strong housing data
- A closer look suggests other forces in play
- Fears growing for the impact from oil?

A closer look at Monday’s price action may be illustrative of the market’s fears for the health of the US and global economy.

We recently highlighted the breakdown of the CAD’s typically healthy relationship with oil prices while also noting that the rolling one-month correlation between daily movements in USD/CAD and US/Canadian 10-year yields had yet to fall below 77% since early March. We therefore concluded that yield had taken the baton from oil in driving the CAD.

As such, it appeared that the currency’s gains against the USD on Monday could be readily accounted for. At 1315 GMT+1, Canadian housing starts posted a healthy bounce-back in March and by the end of Monday’s session in North America, the CAD had posted an appreciable 0.5% gain for the day.

Nevertheless, the report - which actually fell marginally short of expectations - may have distracted attention away from other forces in play.

The USD notably lost further

Neil Mellor
Senior Currency Strategist, BNY Mellon

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traction just as NYMEX was rebounding sharply from the day's lows

Specifically, the CAD may have been caught up in a USD-based move exacerbated by rising oil prices.

Subsequent to the report, the USD - which had just started to come under broad-based pressure - notably lost further traction just as NYMEX was rebounding sharply from the day's lows of $63.20. And 24 hours later, the USD Index had fallen to the month's low shortly after oil had reached a five-month high.

In a market where supply is already being constrained by US sanctions on Iran and Venezuela, the latest developments in Libya certainly compound a bullish case for oil that may yet supplant yield considerations for the CAD. However, the bigger point here is that, just possibly, rising energy prices are stoking fears for the health of the US economy.

Studies have shown how high and rising oil prices compounded the real impact of the global financial crisis in 2008. One such report points out that the US household spend on gasoline had doubled in the five years to the summer of 2008 – something that imposed growing constraints on household budgets, which in turn were a factor in increasing mortgage delinquency rates.

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Clearly, there is no comparing current oil prices with the heady levels of that year (NYMEX peaked at $147), but timing is a genuine concern.

We have written at length about some of the similarities that have emerged over the past six months with this time 11 years ago; and the current trajectory of oil prices – after
a $22 increase since last December – will surely be of concern to a Federal Reserve that has declared a halt to its normalization cycle precisely because of concerns for the US outlook.

Against a somewhat different but equally troubling backdrop in September 2007, the Fed implemented the first of its 10 rate cuts over the following 12 months - stressing that “appreciably higher oil prices” implied by futures could “restrain spending by businesses and consumers”.

At the time NYMEX futures were trading at $80 after putting in a circa $20 increase over the preceding four months. So, if the past is anything to go by, developments in the oil market are certainly something that investors will be keeping a closer eye on from hereon.

Please direct questions or comments to:

AerialView@BNYMellon.com