The BoC and Currency Wars

- CAD has been inching towards potentially pivotal level
- BoC has often aired its 'timely' thoughts on the CAD
- Policy supportive of currency strength looks incongruous

The Bank of Canada is clearly troubled by trade turbulence – something that means the CAD has been inching towards a potentially pivotal level.

Notwithstanding the USD's broad recovery yesterday, the CAD has been one of the best-performing currencies against the greenback this year having gained 3.7% - half of which has materialized since mid-to-late-June, during which time the USD has gained 1.5% in trade-weighted terms.

As oil prices have been broadly flat, this has been about perceived shifts in relative economic performance with 10-year yields moving steadily in Canada’s favor - an important consideration for USD/CAD given the pair’s 93% correlation with the spread since 2010.

However, for what has been a stellar run, the CAD’s gains had - as of yesterday morning - slowed to a crawl: 0.14% average daily gains in June had fallen to just 0.02% since the start of July, and the growing proximity of the 1.30 level could well have been a factor.

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1. RBNZ taking "another look at its strategy for unconventional monetary policy" >

2. RBA’s Kent indicates that QE is highly unlikely >

3.
Certainly, the level has proven significant in the past, and most famously in 2008 when its resistance brought the CAD’s 40% slide to a halt and precipitated a near three-year long 30% gain.

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But would the BoC be concerned about a breach of this level in 2019 if the CAD were to resume its recent uptrend?

The BoC abandoned all talk of a rate hike back in April, but, unlike many of its peers, the Bank appears to see a high bar to any cut.

Certainly, the stellar jobs market may well be cooling a tad, and retail sales dipped 0.1% in May (although partly down to bad weather); but all-in-all, the economy continues to perform well and the Bank has upped its GDP growth forecast this year, accordingly.

Yet there is a "but" and potentially, a rather big one: the BoC is evidently concerned about Canada’s ability to endure trade conflict and uncertainty.

The Bank regards trade risks as the “biggest wildcard” facing the economy and its concerns are such that accompanying its July recent policy announcement was a series of analyses on varying trade scenarios.

The point is here that if the Bank is fretting about trade, then its concerns cannot exist independently of the very mechanism, the CAD, through which pain is amplified.

And although the Bank is (rightly) regarded as rather more reticent on currency matters than many of its peers, it has been known to air its thoughts in a timely fashion.

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In September last year and after USD/CAD 1.30 was breached, BoC Governor Stephen Poloz underpinned a marked uptrend in USD/CAD with his observation that the Bank "has to take US rates into account as Canada will inevitably import some of the bond market movements".

This came almost a year to the day after BoC Deputy Governor Carolyn Wilkins sent the CAD flailing amid criticism of the Bank’s rate hike a week earlier by noting that the Bank was open to alternatives to inflation targeting.

So could we expect something similar?

Well, Mr Poloz has already reminded us that the Bank “takes into account the CAD” in its forecasts; and continued CAD strength would hardly be in keeping with the ‘convergence’ of the US and Canadian economies – a point about which Ms Wilkins was emphatic in the Bank’s July policy statement.

But all in all, as we have argued, in a low growth, disinflationary world beset with trade turbulence, any policy that is notionally supportive of a stronger currency looks increasingly incongruous.

And there is no reason to believe the BoC sees it any differently.

Please direct questions or comments to:

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