

CAD Weekly Outlook

Terms of Trade Gains an Unrealized CAD Positive

- The CAD weakened in response to Friday's slightly lower than expected CPI data but we still rather think that USDCAD rallies are a sell and that the CAD is primed to strengthen. Fundamental trends are improving as relative US-Canada data surprises continue to tilt more favorably for the CAD, spreads have narrowed notably since the start of the month (even if they remain at relatively elevated levels) and commodity prices remain robust. Crude oil is firm and WCS's discount to WTI has narrowed further amid signs that the Federal Government is intent on pushing through the Trans Mountain pipeline. Meanwhile lumber prices continue to surge to new records. The rapid and significant improvement in Canadian terms of trade remains a key focus for us as we feel it represents an under-appreciated upside risk for the economy, monetary policy and the CAD. The BoC's bogey is where they think inflation will be in 12-18 months and not where it was in April.
- Beyond the CAD-positive fundamental backdrop, the upside risk in the CAD is reflected in 1) A significant overvaluation in the USD versus our estimated equilibrium for funds (based on 5Y spreads and WTI). Spot remains near 1 standard deviation above fair value of 1.2483 even after spreads nudged a little wider following the CPI release. 2) Seasonal trends that continue to highlight the risk of a USD slide through the mid-year period, similar to 2017.
- NAFTA risks remain; prospects looked to be tilting a little more positively again, with the three parties apparently making progress on key areas and PM Trudeau suggesting yesterday that proposals for the auto sector were lining up with the US' bargaining position. The USTR reported late Thursday that "gaping" differences remain, however. The May 18th "deadline" referred to by some US officials has come and gone with no agreement but it was hard seeing this as a realistic objective for a comprehensive deal anyway. We do not expect a NAFTA collapse but, in the event of no deal emerging, we think CAD downside risks are limited by the fact that the US will need to serve a 6-month notice period (which may allow for more talks) and that US-Canada trade will

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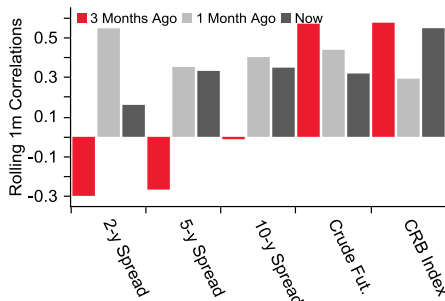
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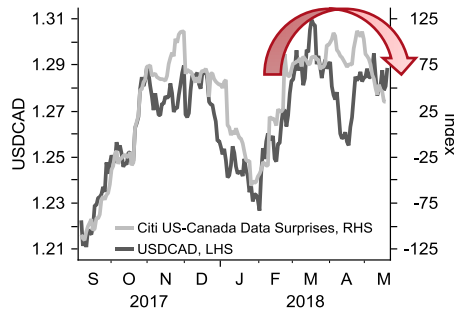
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What's Influencing the CAD?



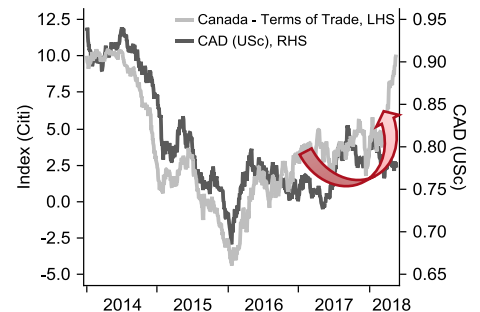
Source: Macrobond, Scotiabank FICC Strategy

Relative Economic Surprises Vs. USDCAD



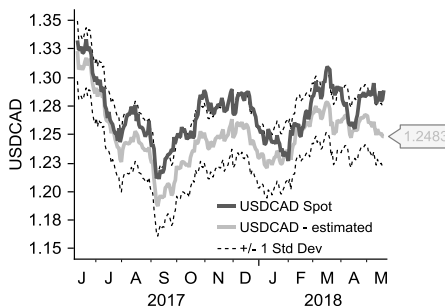
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Improving Terms of Trade Should Lift CAD



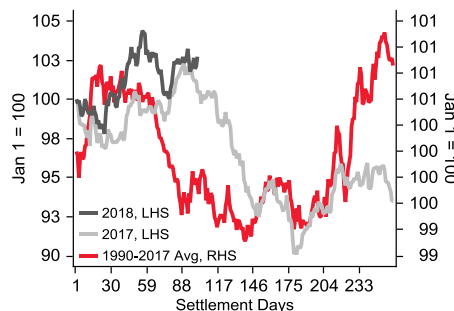
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USDCAD Vs. Estimated Fair Value



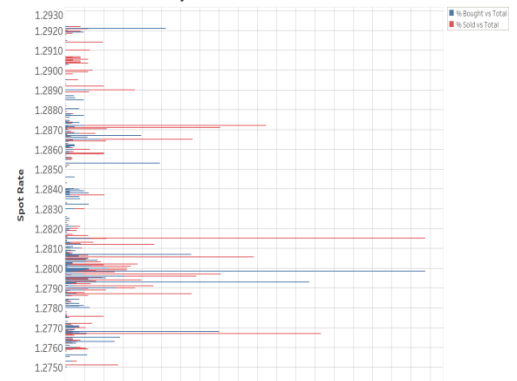
Source: Macrobond, Scotiabank FICC Strategy

USDCAD Seasonal Profile



Source: Macrobond, Scotiabank FICC Strategy

Weekly Volume % of Total



continue under pre-NAFTA rules.

- On tap next week:-
 - The US data calendar is dominated by May survey data (Richmond and KC Fed indices, Markit manufacturing, services and composite indices) and housing data. But there is a lot of Fed speakers and the minutes of the May 2 FOMC meeting to chew over. Key focal points for investors will be comments on the pace of tightening or references to the flatter yield curve that drew attention from Bullard and Bostic this week.
 - Canadian markets are closed on Monday and have a quiet week ahead beyond that. Wholesale trade data are released on Tuesday and represent the only major data point of the week. There are no BoC speakers as policy makers enter their quiet period ahead of the May 30th policy decision.
- Client flow data suggests that there was not a lot of participation in either of the USD's push higher to the upper 1.28s/low 1.29s this week, with most client activity concentrated around 1.28. Better net selling seems to have developed over the week broadly.
- Charts looked positive for the CAD last week as USDCAD tumbled over the week and closed lower but the USD's late week rally has blunted the bearish USD import of last week's price action to some extent and rather suggests more sideways range trading for USDCAD now. Broadly, we look for resistance around 1.2970 and support at 1.2650 over the coming week.

NEXT WEEK'S NORTH AMERICAN CALENDAR

Day	Country	Release	Period	Consensus	Last
Mon	US	Chicago Fed Nat Activity Index	Apr	--	0.10
	US	Fed's Bostic Speaks			
	US	Fed's Harker Speaks in New York			
	US	Fed's Kashkari Speaks			
Tue	CA	Wholesale Trade Sales MoM	Mar	--	-0.8%
	MX	Retail Sales YoY	Mar	--	1.2%
	US	Richmond Fed Manufact. Index	May	--	-3.0
Wed	MX	International Reserves Weekly	5/18/2018	--	\$173111m
	US	MBA Mortgage Applications	5/18/2018	--	-2.7%
	MX	GDP NSA YoY	1Q F	1.7%	1.2%
	US	Markit US Manufacturing PMI	May P	--	56.50
	US	Markit US Services PMI	May P	--	54.6
	US	Markit US Composite PMI	May P	--	54.90
	US	New Home Sales	Apr	680k	694k
	US	FOMC Meeting Minutes	5/2/2018	--	--
Thur	US	Fed's Dudley Speaks			
	US	Initial Jobless Claims	5/19/2018	--	222k
	MX	Bi-Weekly CPI	5/15/2018	--	0
	US	FHFA House Price Index MoM	Mar	--	0.6%
	US	Existing Home Sales	Apr	5.57m	5.60m
	US	Kansas City Fed Manf. Activity	May	--	26
Fri	US	Fed's Harker Speaks			
	US	Durable Goods Orders	Apr P	-1.5%	2.6%
	US	Durables Ex Transportation	Apr P	0.5%	0.1%
	US	Cap Goods Ship Nondef Ex Air	Apr P	--	-0.8%
	MX	Trade Balance	Apr	--	1917.5m
Fri	MX	Current Account Balance	1Q	--	-\$3207m
	US	U. of Mich. Sentiment	May F	98.80	98.80
	US	Fed's Kaplan, Evans and Bostic Speak			

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