



When **insight matters.**TM

CAD: THE STORY FROM WORST TO BEST

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July 2014

SCOTIABANK: FORECAST

FX - USD a mixed path

	2012	2013	2014f	2015f
USDCAD	0.99	1.06	1.10	1.11
CADUSD	1.01	0.94	0.91	0.90
AUDUSD	1.04	0.89	0.92	0.89
EURUSD	1.32	1.37	1.30	1.24
GBPUSD	1.63	1.66	1.70	1.65
USDJPY	87	105	109	113
USDCNY	6.23	6.05	6.10	5.92

REAL GDP - US outperforms Canada

	00-12	2013f	2014f	2015f
US	1.9	1.9	1.8	3.0
Canada	2.2	2.0	2.2	2.5
Mexico	2.4	1.1	2.7	3.7
Euro Zone	1.3	(0.4)	1.0	1.4
UK	1.7	1.7	2.8	2.5
Japan	0.9	1.5	1.6	1.2
China	9.3	7.7	7.3	7.0

INFLATION - Back at target

US	1.2	2.2	2.2
Canada	0.9	2.2	2.0

COMMODITIES - Yearly averages

Oil (WTI)	98	102	103
Gold	1,410	1,300	1,350

INTEREST RATES - Diverging policy

	Q413	Q414	Q415
FED	0.25	0.25	1.00
BoC	1.00	1.00	1.25
ECB	0.25	0.15	0.15
BoE	0.50	0.50	1.50
RBA	2.50	2.75	3.50

USDCAD – TECHNICAL

USDCAD'S TWO YEAR UPTREND



USDCAD EXPECTED TO TRADE BACK TOWARDS 1.10

POSITIVE: Improving Canadian domestic data, U.S. recovery & oil above \$100 is a powerful combination

NEGATIVE: BoC will be vocal against a strong CAD; several long term fundamentals are bearish

CAD DRIVERS & OUTLOOK

CAD: THE UNBALANCED FX STORY

CAD DRIVERS

- I. US growth outlook
- II. Global growth outlook
- III. Canadian fundamentals
- IV. Oil & commodities
- V. Flow & sentiment
- VI. Broad USD movements
- VII. Risk appetite
- VIII. Triple-A status
- IX. Technicals

USDCAD – ONE YEAR CHART

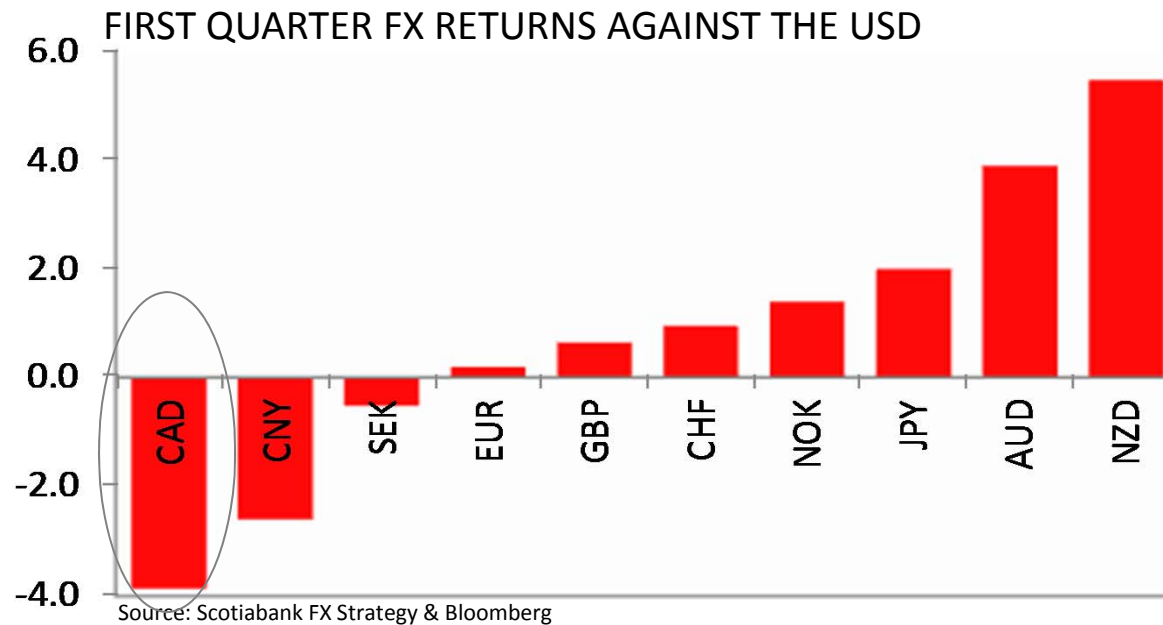


USDCAD EXPECTED TO TRADE BACK TOWARDS 1.10

POS: A U.S. RECOVERY & SUSTAINED CAD WEAKNESS & OIL ABOVE \$100 IS A POWERFUL COMBINATION

NEG: BOC WILL BE VOCAL AGAINST A STRONG CAD; SEVERAL LONG TERM FUNDAMENTALS ARE BEARISH.

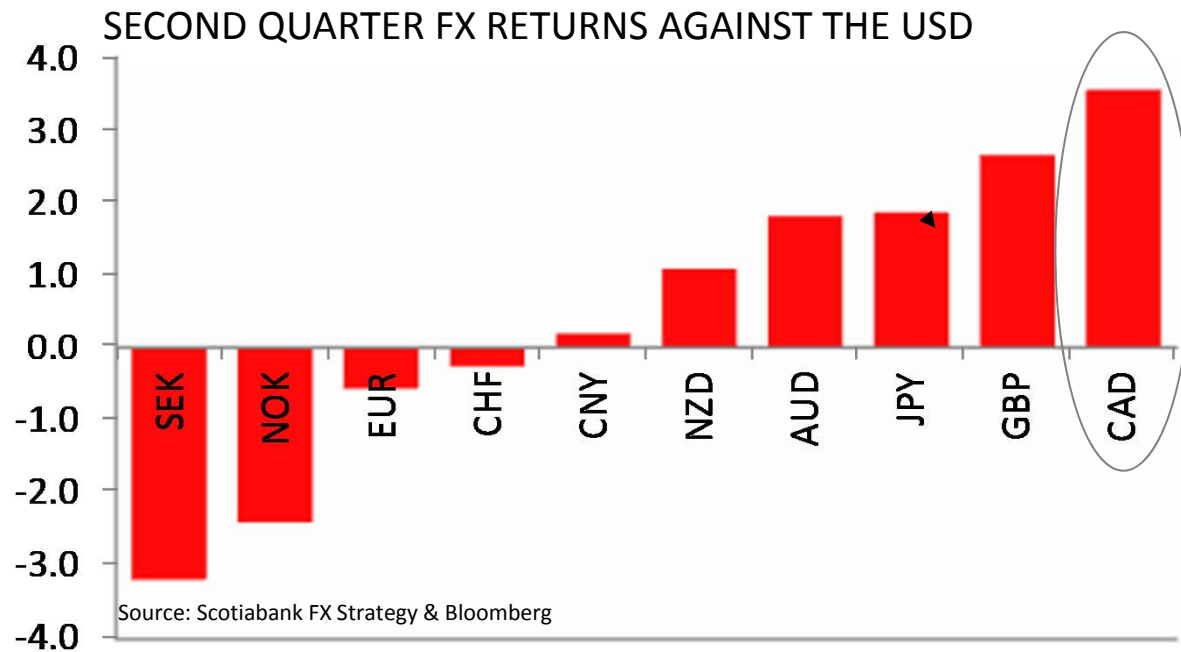
CAD PROVES **WORST** PERFORMING PRIMARY CURRENCY IN FIRST QUARTER



CAD PROVES WORST PERFORMING CURRENCY IN FIRST QUARTER OF 2014

- Domestic stories drive Q1 FX returns – not a broad USD trading environment
 - AUD & NZD benefited on central bank policy and domestic fundamentals
- CAD was on the back of deterioration in the domestic story and significant short building

CAD PROVES **BEST** PERFORMING PRIMARY CURRENCY IN SECOND QUARTER



CAD PROVES BEST PERFORMING CURRENCY IN SECOND QUARTER OF 2014

The CAD rally was not one event or shift but a turn in several drivers:

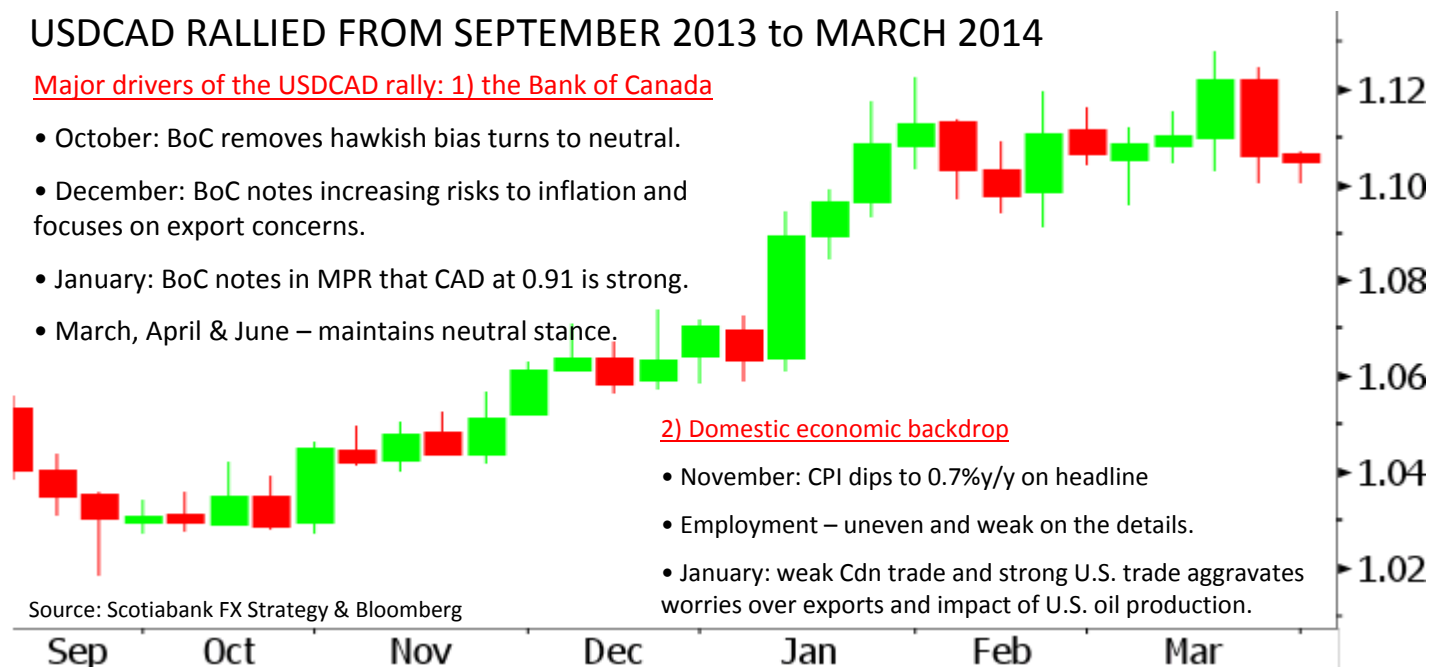
1. Improving outlook for exports, given earlier CAD depreciation & U.S. economic recovery
2. Rising Canadian inflation
3. Rising oil prices
4. Consistent tones from BoC and Fed
5. Short covering
6. Technicals – particularly as USDCAD broke 1.10

USDCAD – WHAT IS A REASONABLE VALUE FOR CAD

USDCAD RALLIED FROM SEPTEMBER 2013 to MARCH 2014

Major drivers of the USDCAD rally: 1) the Bank of Canada

- October: BoC removes hawkish bias turns to neutral.
- December: BoC notes increasing risks to inflation and focuses on export concerns.
- January: BoC notes in MPR that CAD at 0.91 is strong.
- March, April & June – maintains neutral stance.



CLUES FROM HISTORY

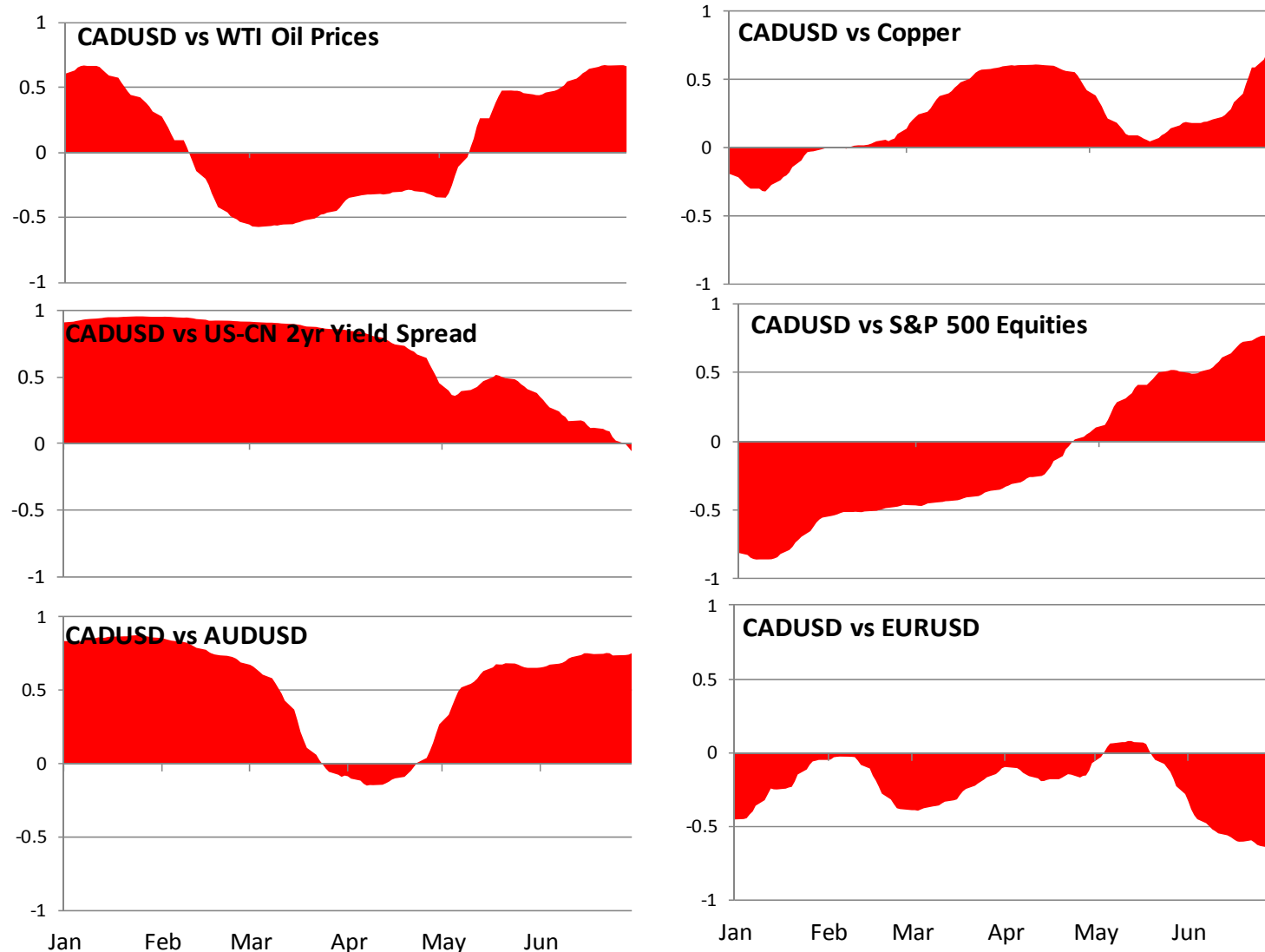
USDCAD's rally from September to March was driven by:

- the BoC's shift from hawkish to neutral/dovish; soft domestic data; fears over the oil market and building short positions.

LOOKING FORWARD – IT IS THE BOC TONE THAT WILL MATTER

CAD CORRELATIONS – THE SHIFTS PROVIDE CLUES

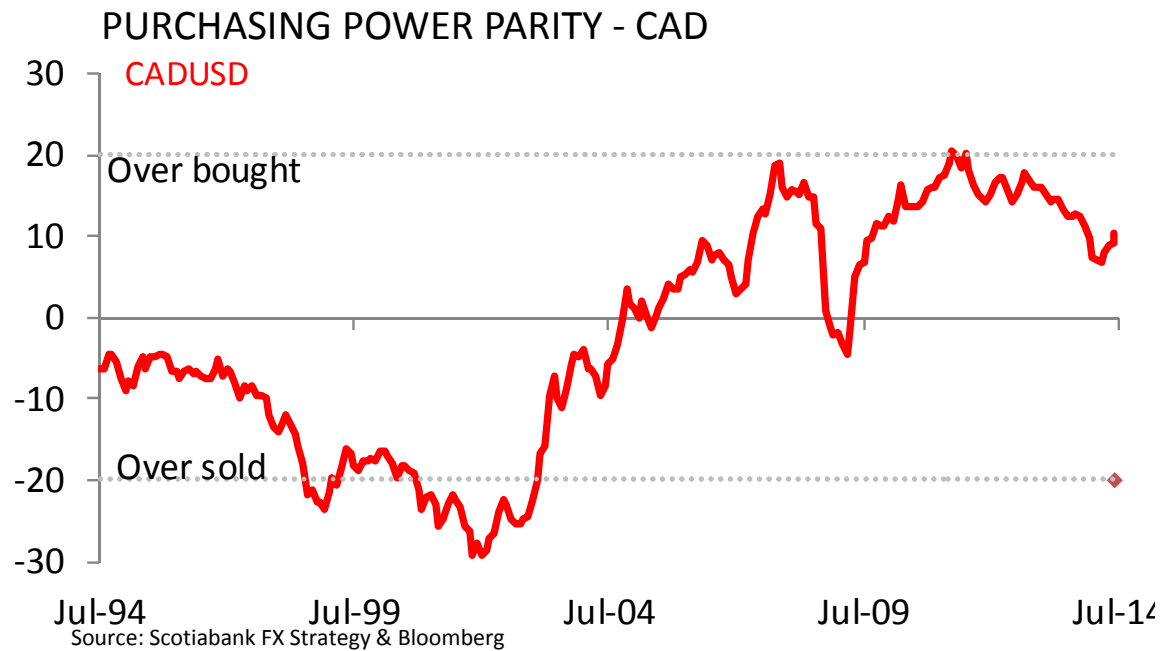
CAD – Correlations – Rolling 90-day correlations



CAD - Correlations

1. Central bank policy and bond markets: correlation with yield spreads were strong but then everything shifted in May.
2. Growth – commodities, growth currencies, equities and CAD correlation strengthens.
3. Weak correlation with EUR all year.

CAD – WHAT IS A REASONABLE VALUE FOR CAD



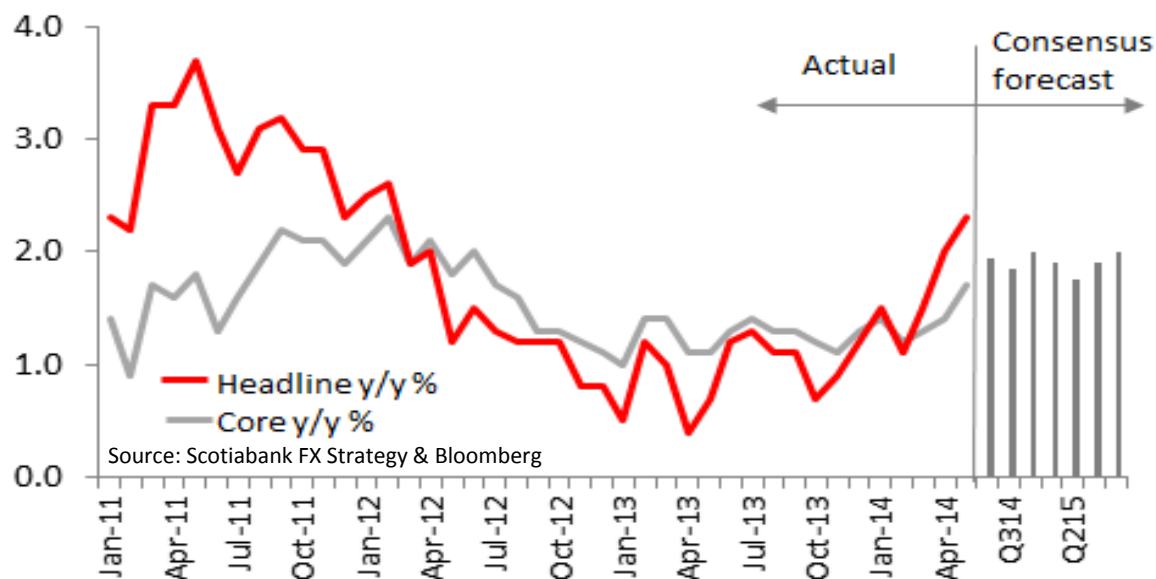
VALUATION FOR CAD – NO EASY TOOL

Purchasing Power Parity (PPP)

- CAD is overvalued
- CAD is closer to fair value than AUD, EUR or GBP
- Important for long term USD – more so than CAD; but does provide a starting point

INFLATION – THE KEY FOR THE BANK OF CANADA AND USDCAD

CANADIAN INFLATION – TRENDING HIGHER



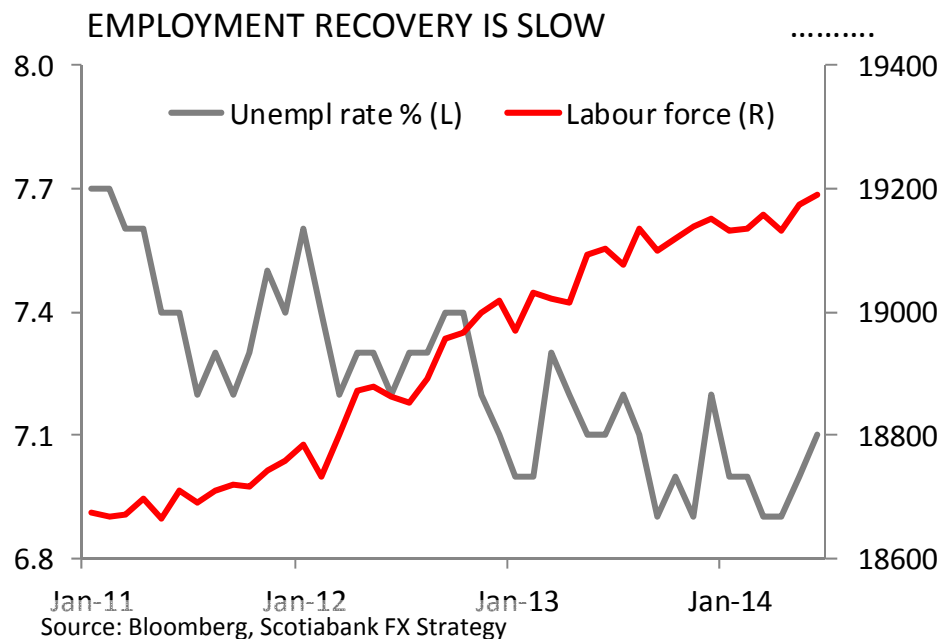
CPI COMPONENTS		
	% of total	May m/m
Shelter	27.5	0.2
Transportation	20.6	0.2
Food	16.0	0.4
Household operations	11.5	0.3
Recreation, education	11.2	0.3
Clothing, shoes	5.3	0.3
Health, personal care	5.0	0.3
Alcohol, tobacco	2.9	0.8

INFLATION

- Canadian inflation rises on base effects (retail competition), mortgage costs and energy.
 - Outlook: close to 2% and relatively stable over next two years.
- Risk: inflationary pressures are building faster than is currently priced in.

FOR CAD - IT IS THE BOC TONE THAT WILL MATTER

CAD – DOMESTIC FUNDAMENTALS - EMPLOYMENT



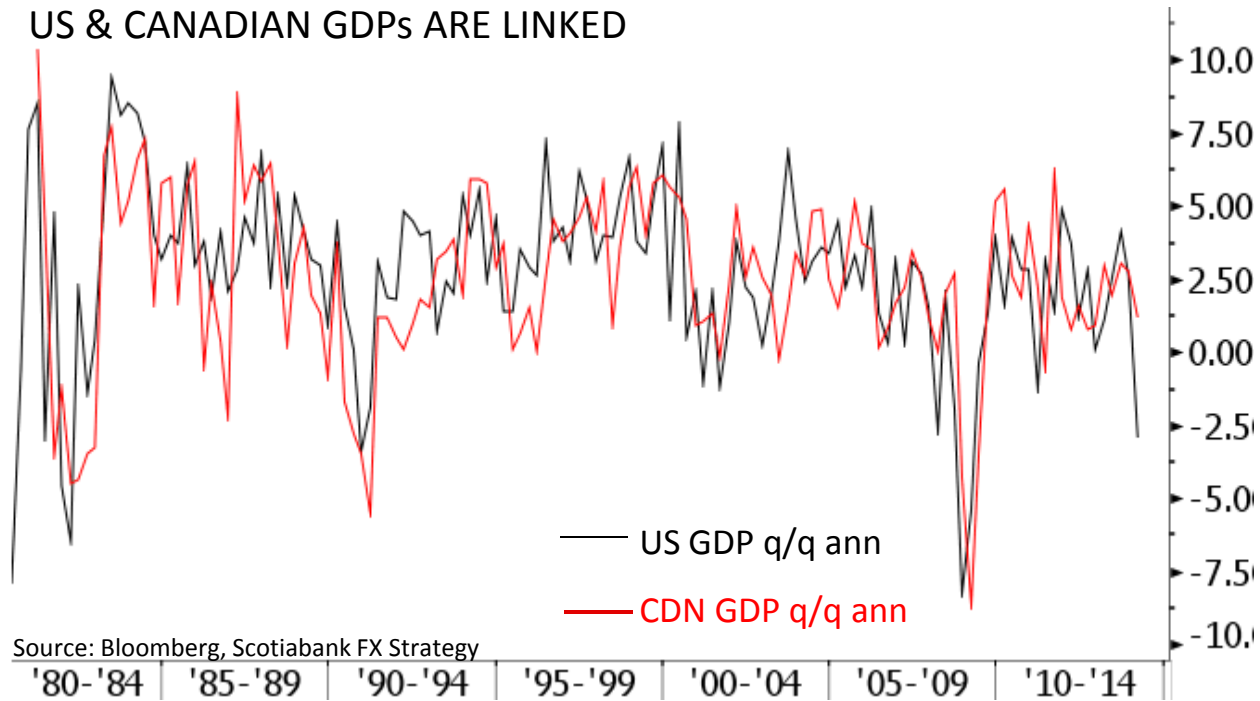
DETAILS ARE WEAK

- Total employment: 95k jobs added in last year.
- Of those 95k jobs: Alberta added 82k
- Slowest pace of y/y job growth since February 2010.

EMPLOYMENT OUTLOOK – SLOW PROGRESS

- Headline employment growth suggest moderate job gains in Canada
 - Details weaker than moderate growth headline suggests
 - Jobs are concentrated geographically and by type

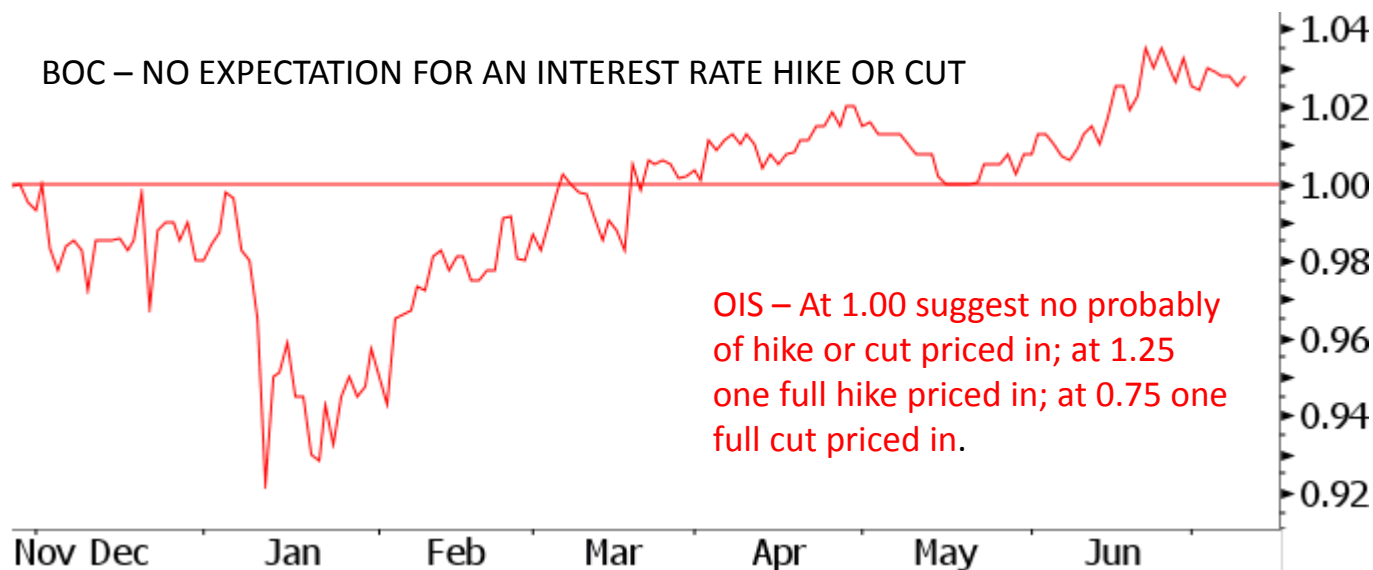
CANADA TIED TO THE U.S.



CANADIAN GDP IS TIED TO THE U.S.

- What is good for the U.S. is good for Canada and vice-versa.

CAD – DOMESTIC FUNDAMENTALS IMPROVE & BOC IS NEUTRAL

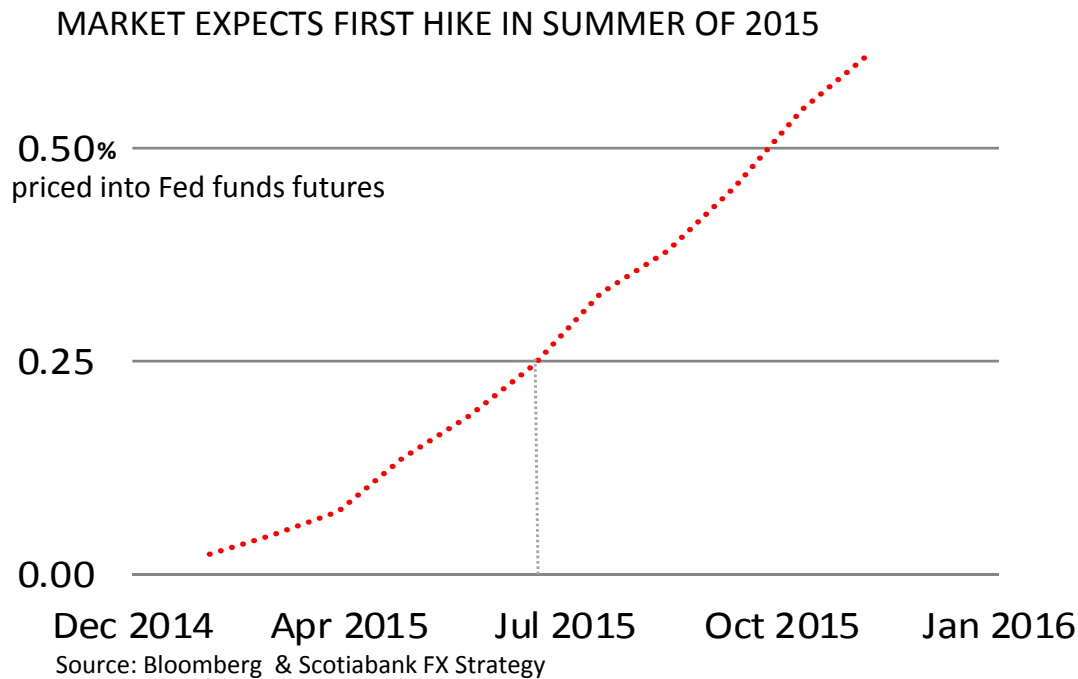


Source: Bloomberg & Scotiabank FX Strategy

BOC HAS NEUTRAL TONE

- Governor Poloz favours a weak CAD – complicated by rising inflation.
- Reference to CAD has increased materially: importance for exports as well as how it feeds into inflation.
- As Canadian data improves, Governor Poloz has fine balancing act stabilizing CAD.
 - Expect BoC to lag Fed interest rate hikes.

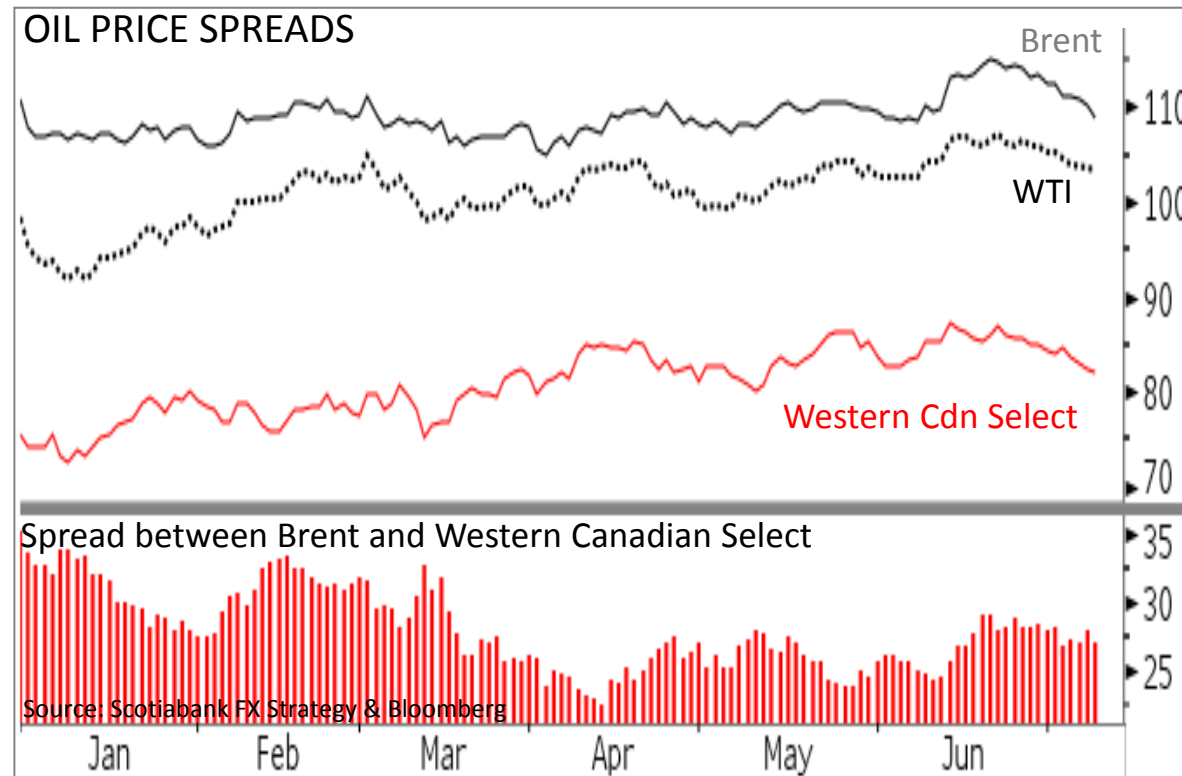
CENTRAL BANK POLICY – THE US INTEREST RATE OUTLOOK



THE FED'S MESSAGE

- Tapering path is not preset but likely to end in October 2015
 - Interest rate hikes likely to begin in Q2 of 2015
 - Interest rate hikes likely to be slow and cautious
- Exit plan – Chair Yellen hasn't released details – likely in September

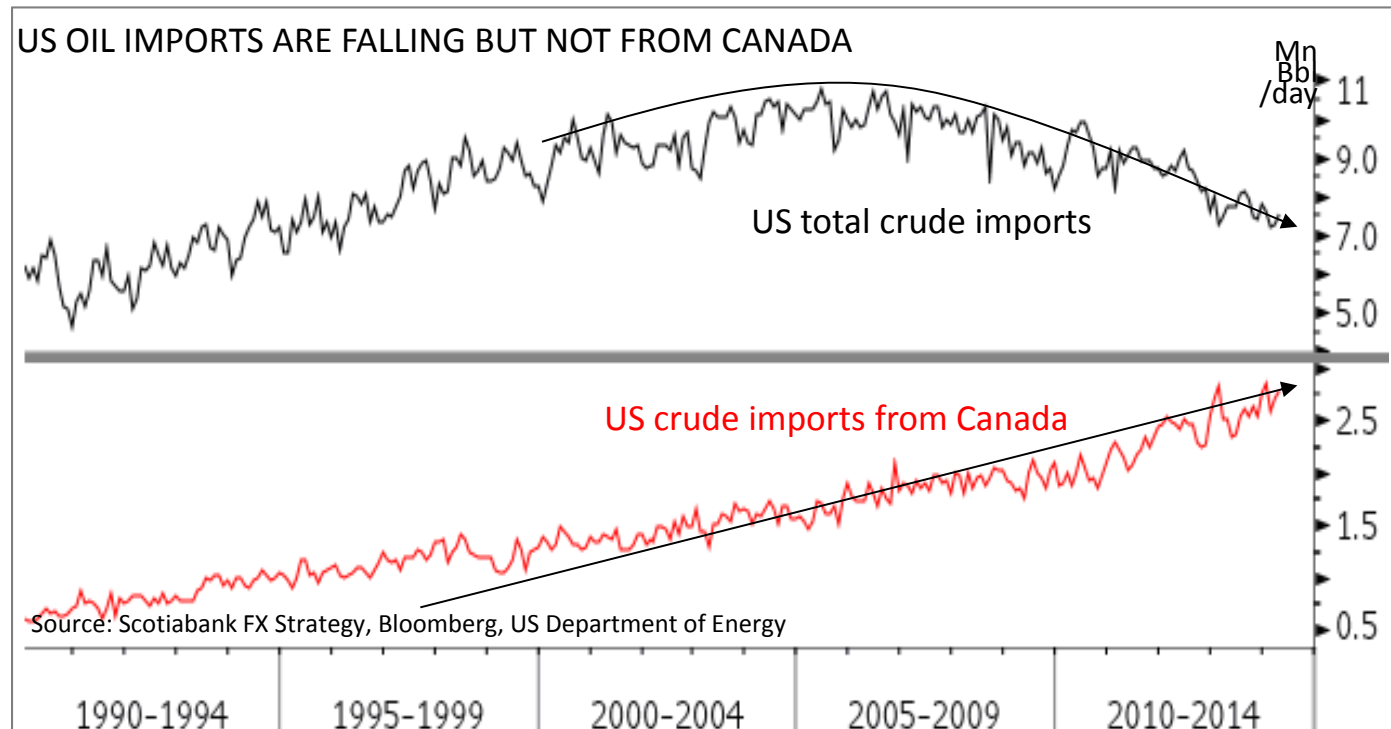
CAD RISK: NORTH AMERICAN OIL PRICING



OIL: PRICING IMPROVED & IMPORTANT

- Oil WTI prices over \$100 is a positive for Canadian economy backdrop – but weigh on U.S. growth.
 - The Brent – Western Cdn Select spread is an important driver of CAD.
- This spread is important for Canada; when it is narrow it is CAD pos and vice-versa.

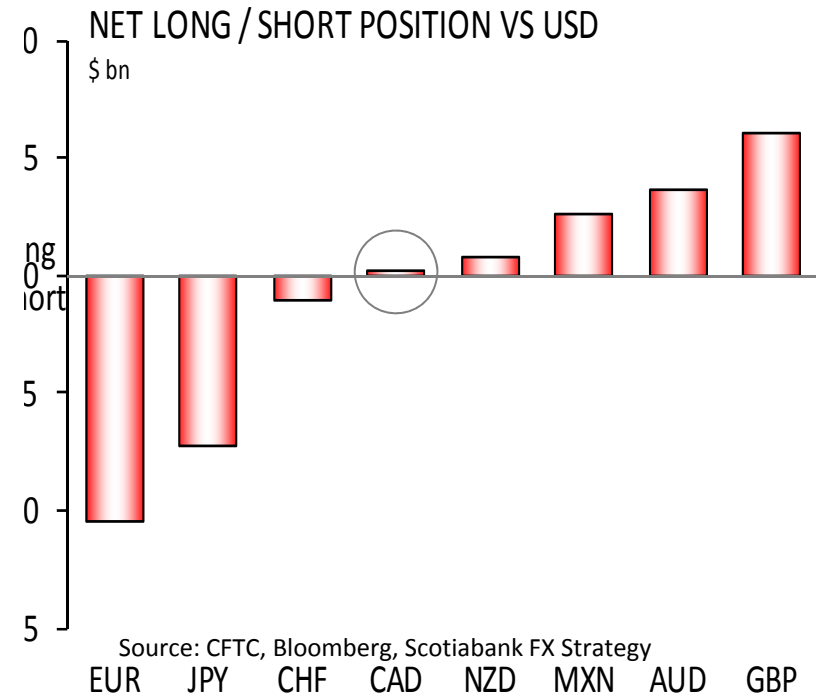
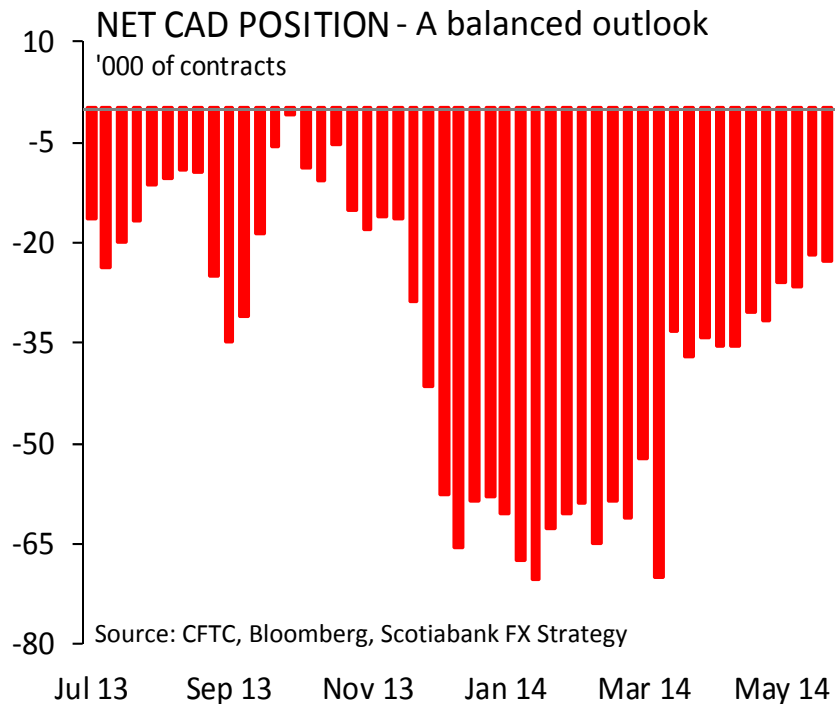
CANADA'S UNFOLDING OIL STORY



US DOMESTIC PRODUCTION DOES NOT EQUAL LOWER CDN OIL EXPORTS

- US oil imports have declined over the last decade; but Canada's oil exports to the US have risen.
 - Canada's share of US oil imports doubled in the last decade to 33%;
 - IMF forecasts it to increase to 50% by 2020.
- Canada's crude oil export volumes are projected to increase 5.5% (quarterly avg) 2014 to 2019 (IMF).

CAD – MARKET IS NEUTRAL



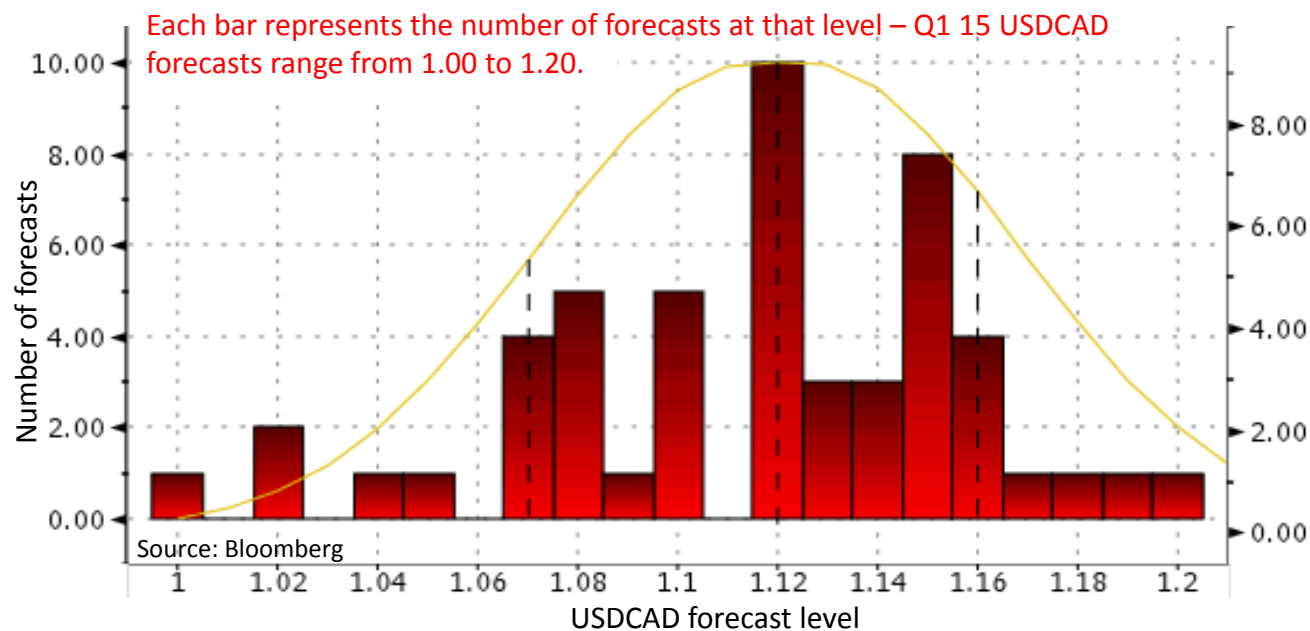
CAD SENTIMENT IS NEUTRAL

- Short covering from March to June – added to CAD’s rally.
- Position now balanced.

CAD – MARKET IS BEARISH

USDCAD CONSENSUS FORECAST Q1 15: 1.1200

MARKET IS BEARISH CAD IN THE LONG TERM



CAD OUTLOOK – CONSENSUS IS BEARISH

- Q414: forecasts range from 1.02 to 1.20; with 1.11 as the median
- Q115: forecasts range from 1.00 to 1.20; with 1.12 as the median

SUMMARY

FX OUTLOOK - SUMMARY

- USDCAD poised to move back towards 1.10.
- EUR weakens materially by year-end to 1.30 and continues to trend lower in 2015
 - JPY weakens materially by year-end and continues to depreciate in 2015
 - GBP's outlook is the encouraging; but already priced to perfection

SCOTIABANK - FX STRATEGY

FX STRATEGY – SUMMARY OF DOCUMENTS

- Daily FX Update – Published at 7:45am (EST)
- Daily LatAM Update – Published at 7:45am (EST)
- Daily Asian Update – Published at 11:00pm (EST)
- Currency Sentiment CFTC Report – Published every Friday
- Special Reports – Active trade strategies; interesting readings, etc.

FX STRATEGY JOINT PUBLICATIONS WITH ECONOMICS

- Global Views – Weekly update across asset classes
- FX Monthly – Review of global currencies and forecasts

FX OUTLOOK CONFERENCE CALL

- Twenty minute update on FX strategy (USDCAD outlook)

FX STRATEGY - GLOBAL COVERAGE

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