

Canadian Dollar Outlook – Fall 2020

Economic Challenges Versus Risk Sentiment

December 2020

RBC Dominion Securities Inc.

George Davis, CMT (Chief Technical Strategist) (416) 842-6633 george.davis@rbccm.com



This communication has been prepared by RBC Capital Markets FX Trading/Sales personnel for your information only and is not a research report prepared by the RBC Capital Markets research department. This document has not been prepared in accordance with legal requirements designed to promote the independence of investment research.

This report was priced between November 10-13, 2020 (unless otherwise noted).
All values in U.S. dollars unless otherwise noted.



**Capital
Markets**

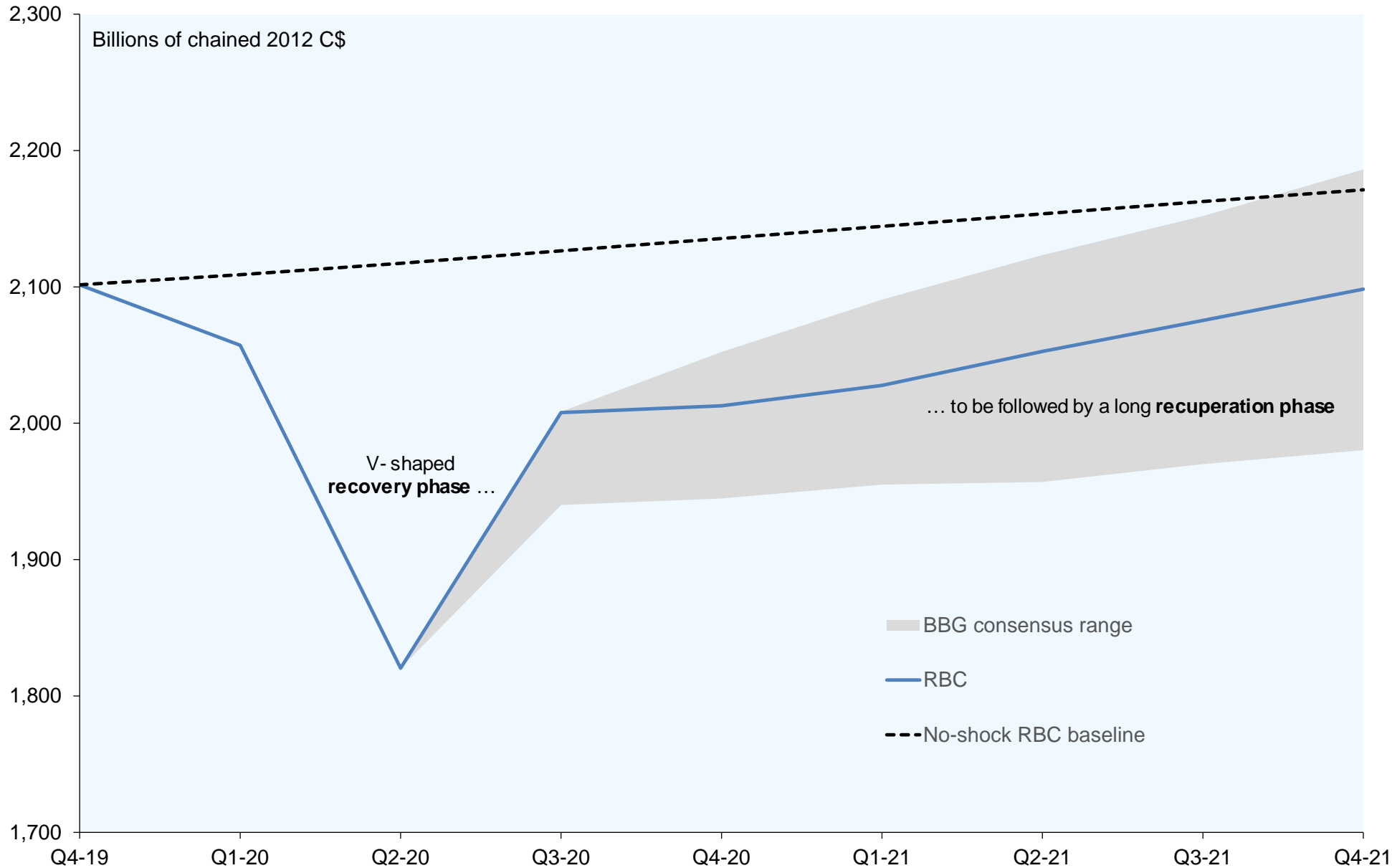
The Canadian economy is emerging from H1's deep hole ...



The Canadian economy bottomed in April (Q2 growth -38.1%), with the summer reopening beginning the healing process (Q3 growth 40.5%)

Source: Statistics Canada, RBC Economics

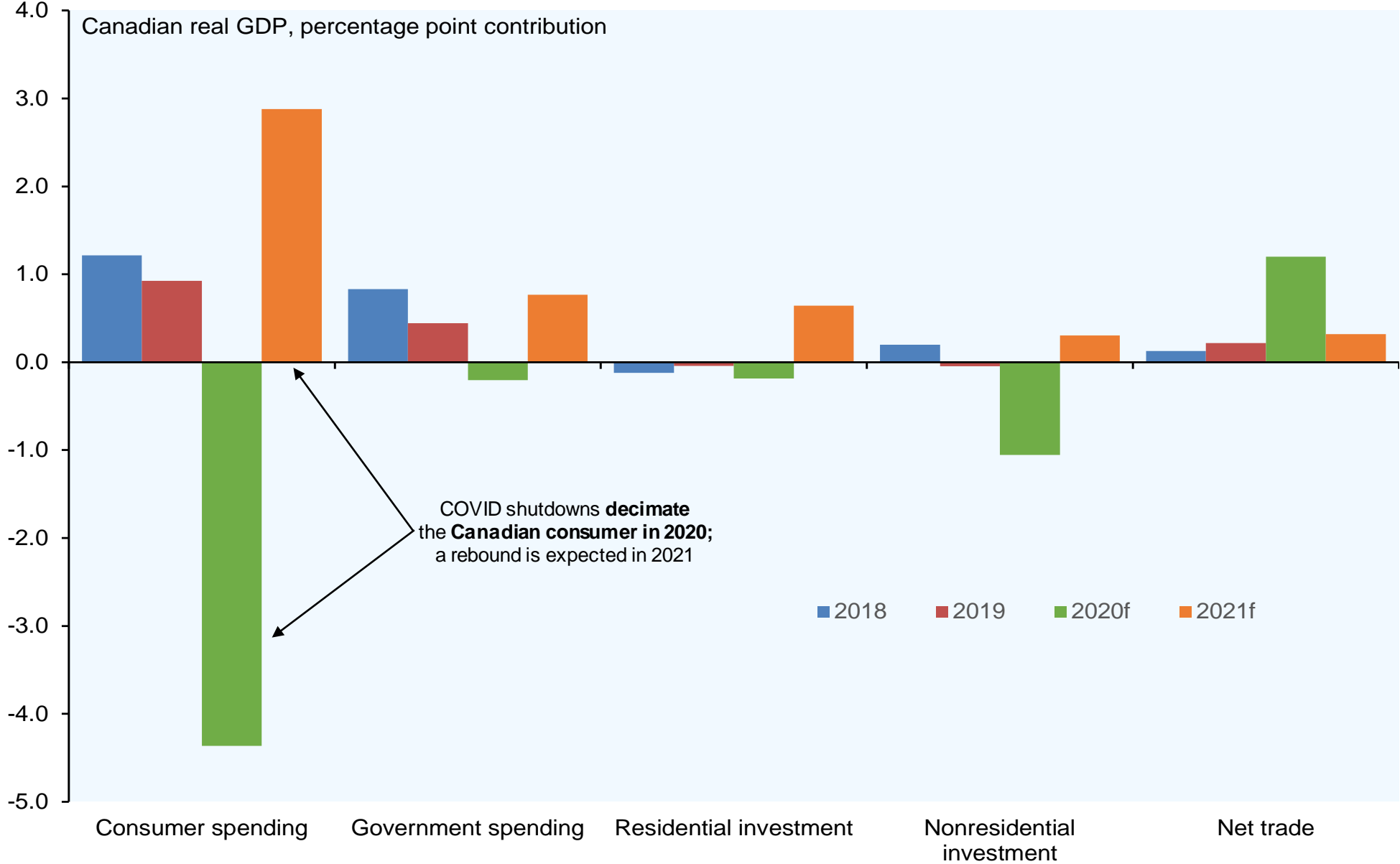
... but will not return to pre-crisis levels until late 2021/early 2022



The “v-shaped” recovery phase will give way to a bumpy and uneven recuperation phase as the COVID scars heal

Source: Bloomberg, RBC Economics

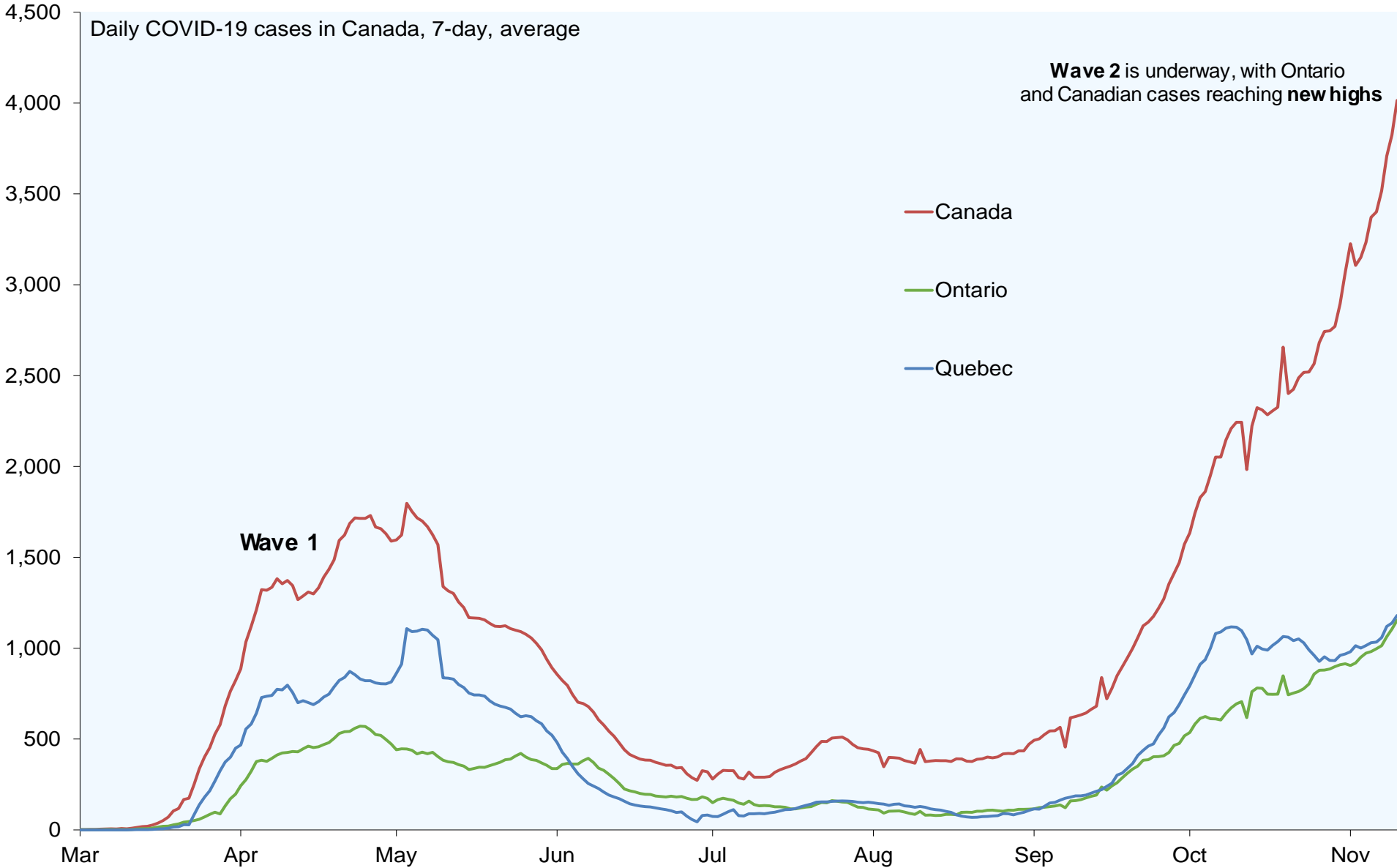
A large part of the healing will involve the Canadian consumer



The Canadian consumer was hard hit in 2020 but is expected to lead the recovery in 2021

Source: Statistics Canada, RBC Economics

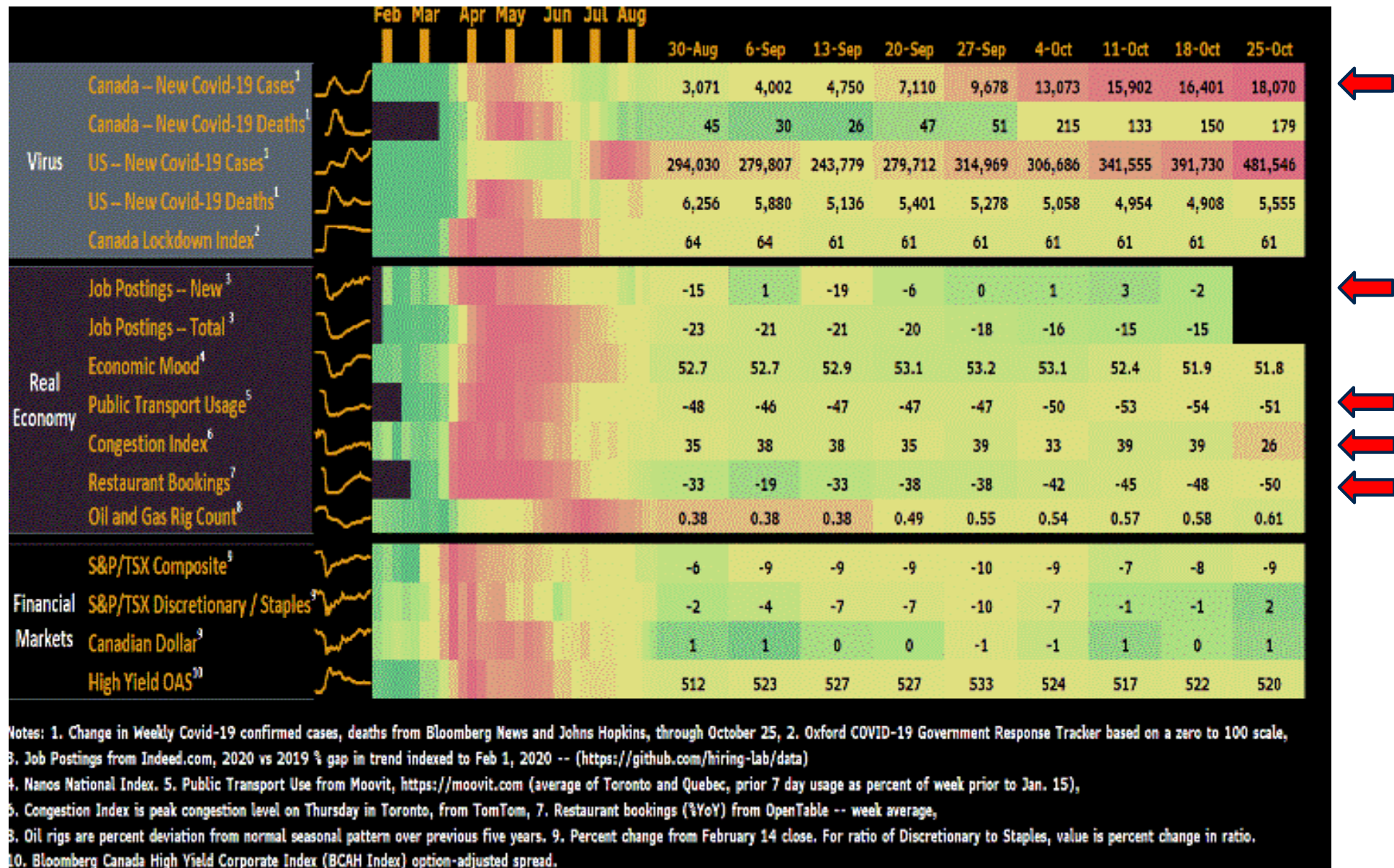
Challenge #1: A second wave of COVID infections is leading to more restrictions



New restrictions could slow growth in Q4 and beyond, subject to their severity and extent. The timing of a vaccine and large-scale immunization will be critical to the long-term economic recovery.

Source: CBC, RBC Capital Markets

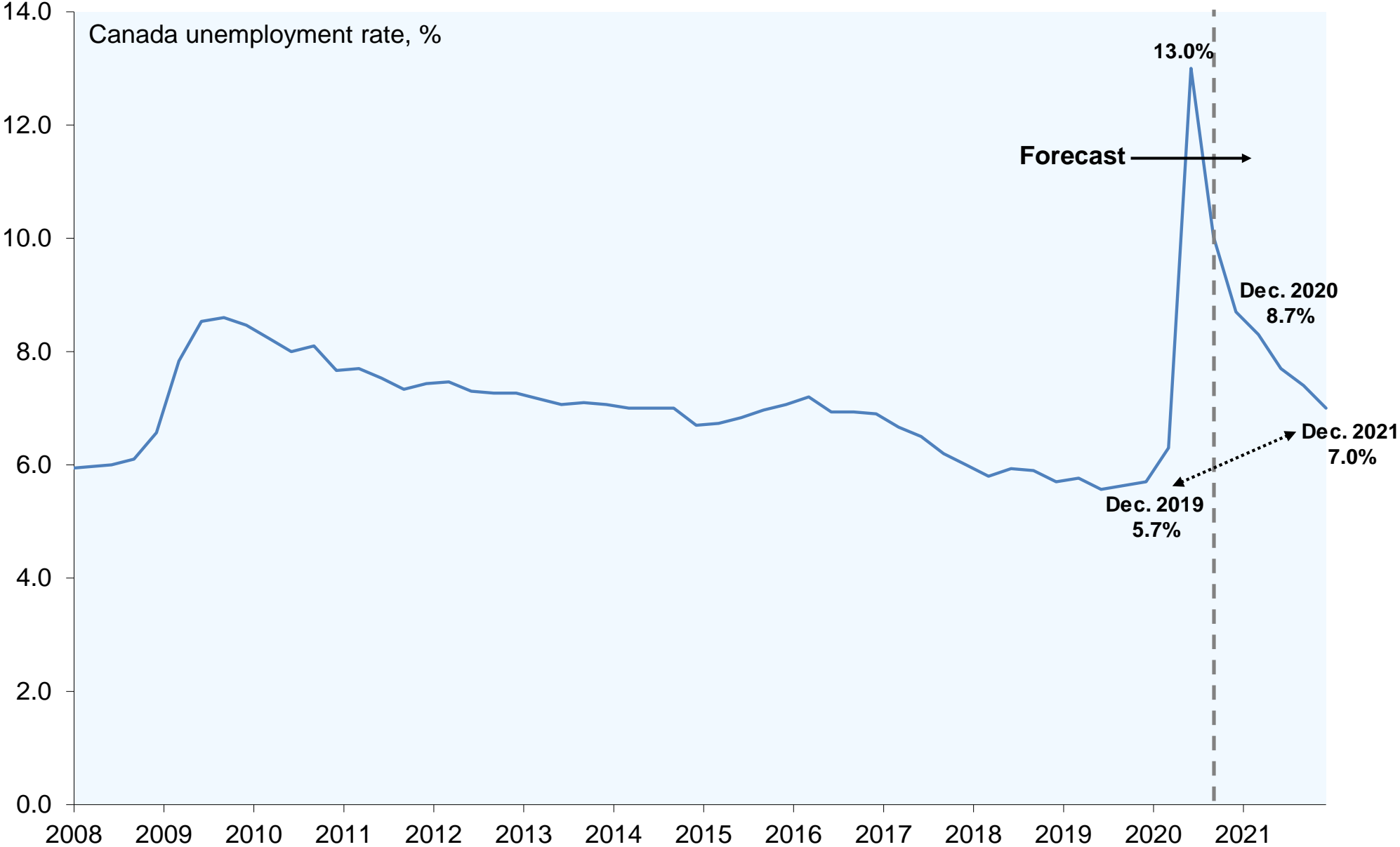
Canadian high frequency indicators: some warning signs of deterioration



New COVID cases are spiking, transport metrics and restaurant bookings are weakening

Source: Bloomberg, RBC Capital Markets

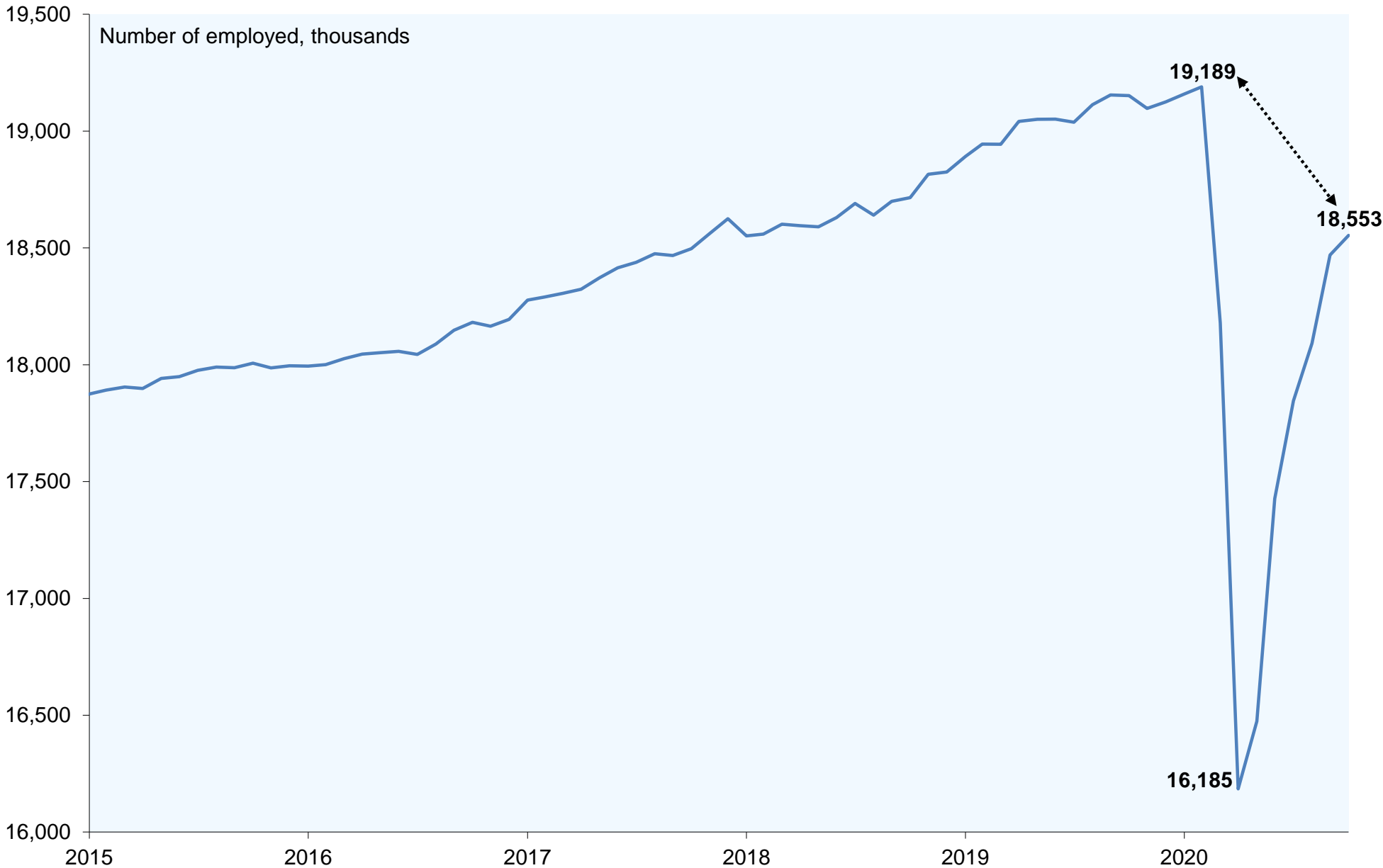
Challenge #2: Unemployment to remain above pre-pandemic levels through 2021



Labour market slack to remain in place; will limit the inflationary impulse. Temporary job losses may become permanent during the recuperation phase.

Source: Statistics Canada, RBC Economics

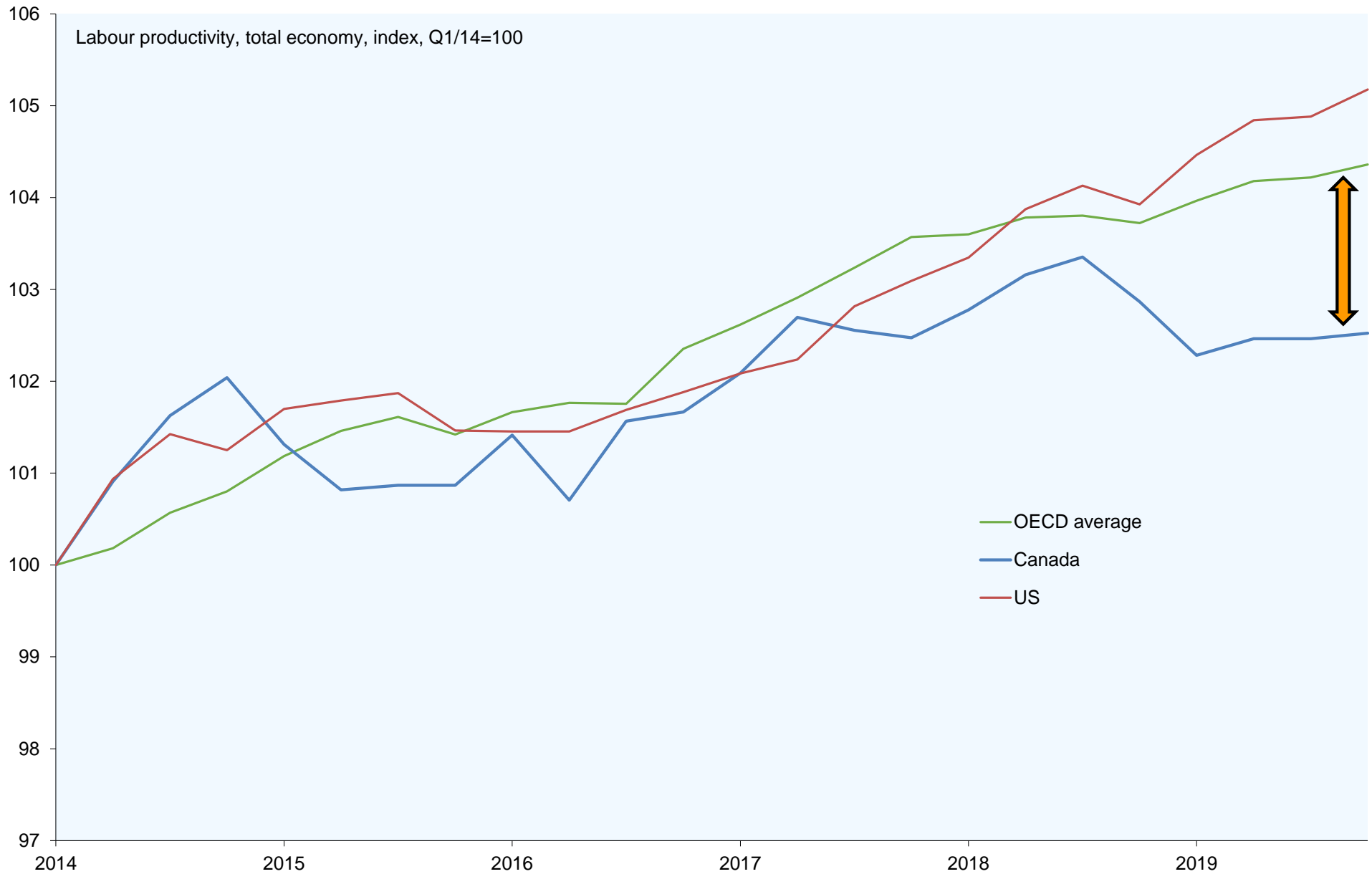
Jobs have returned as the economy reopens for business, but scars are visible



There are still over 600K more people on permanent layoffs in October compared to February's pre-COVID levels

Source: Statistics Canada, RBC Economics

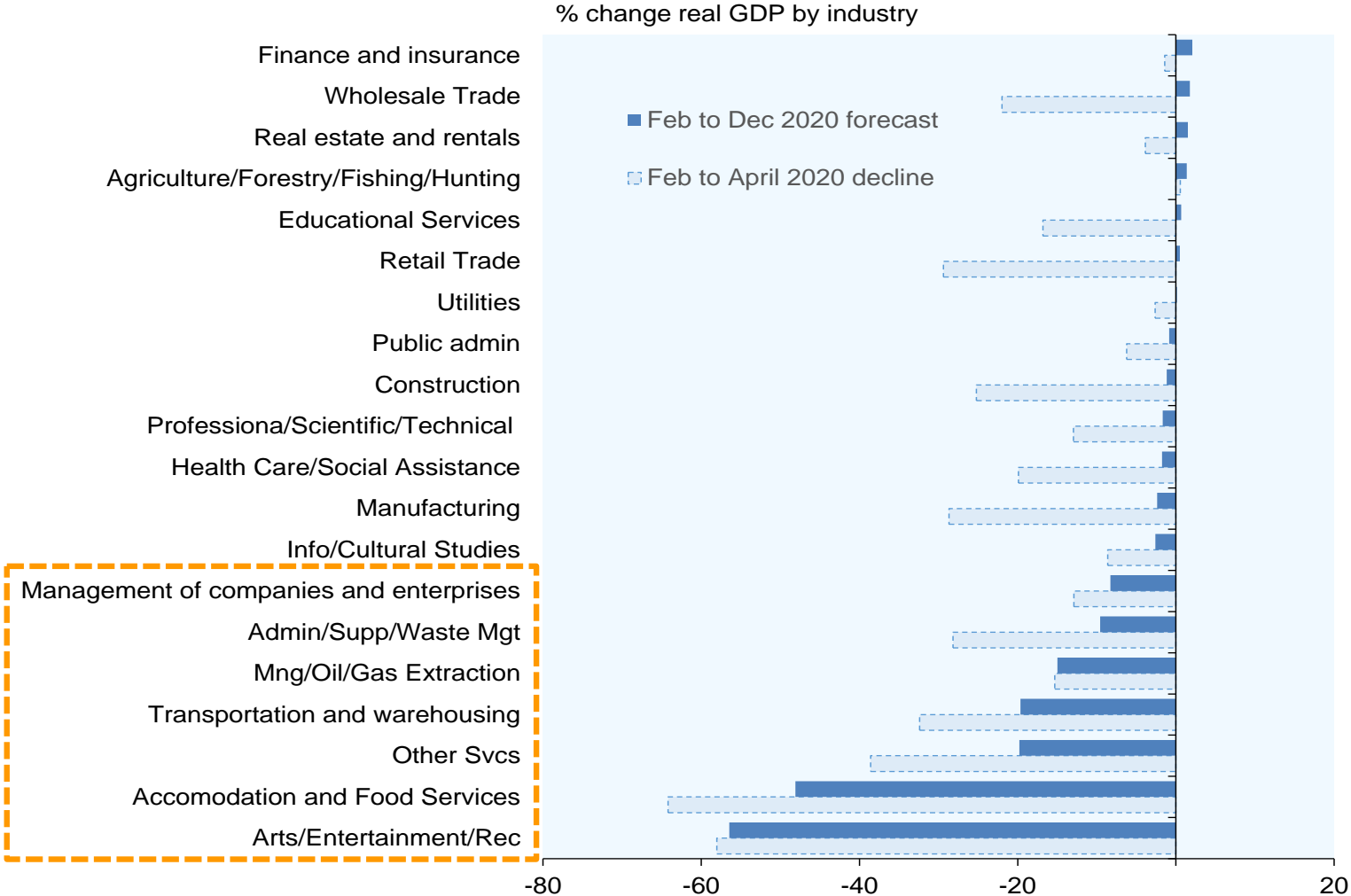
Job losses are amplified by productivity issues



The job loss scars and productivity issues will serve as a headwind to growth; productivity is impacted by weak business investment

Source: OECD, RBC Economics

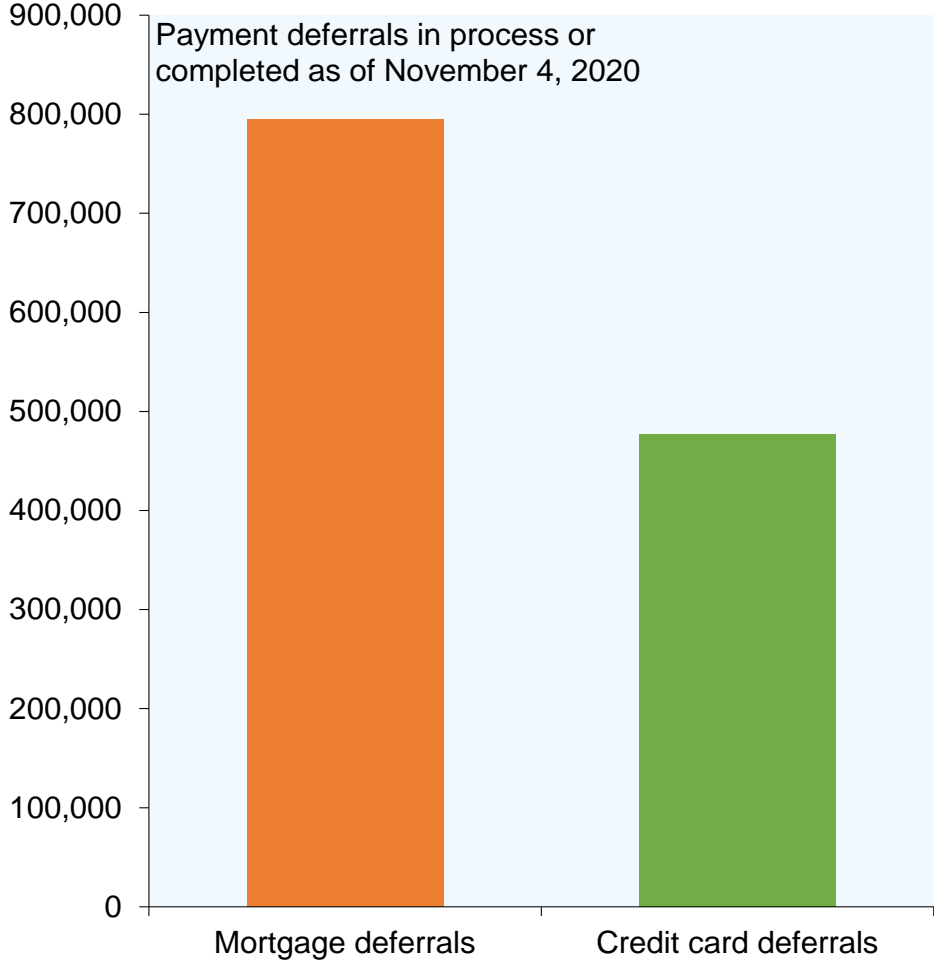
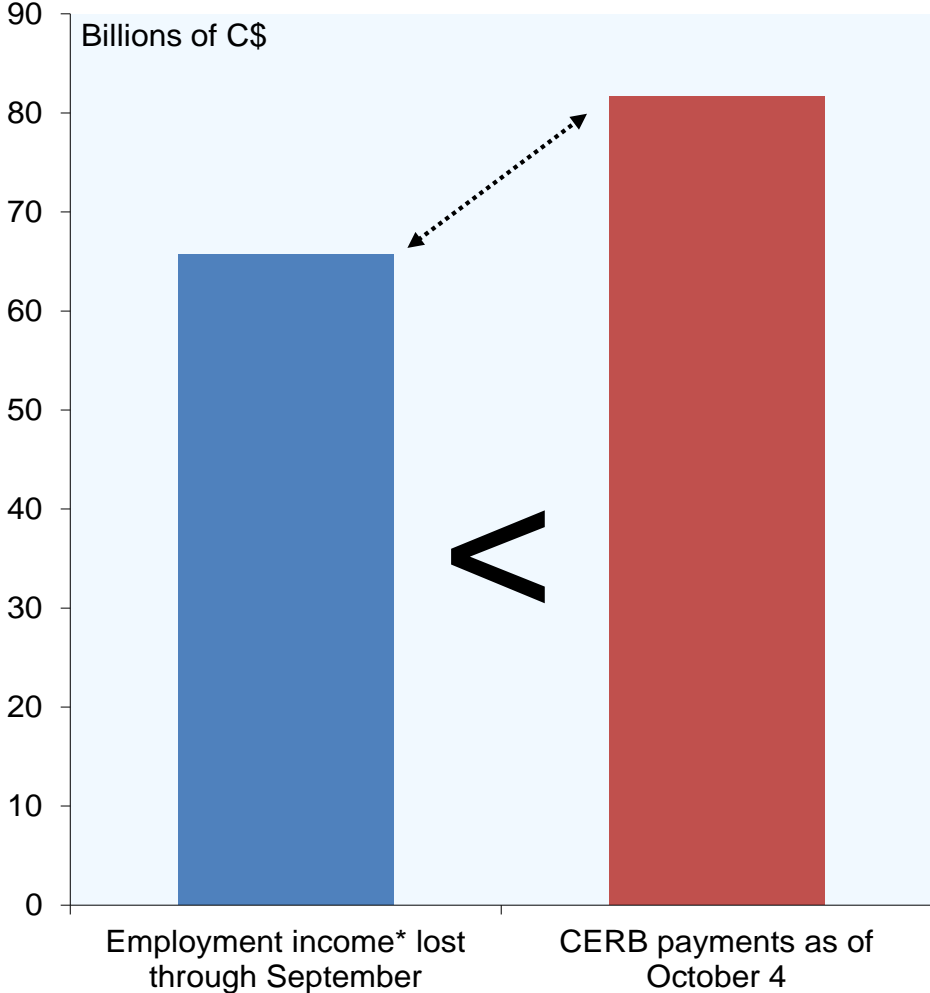
Challenge #3: An uneven GDP recovery to impact employment and consumer activity



The service sector has been impacted the most and will lag in the recovery phase

Source: Statistics Canada, RBC Economics

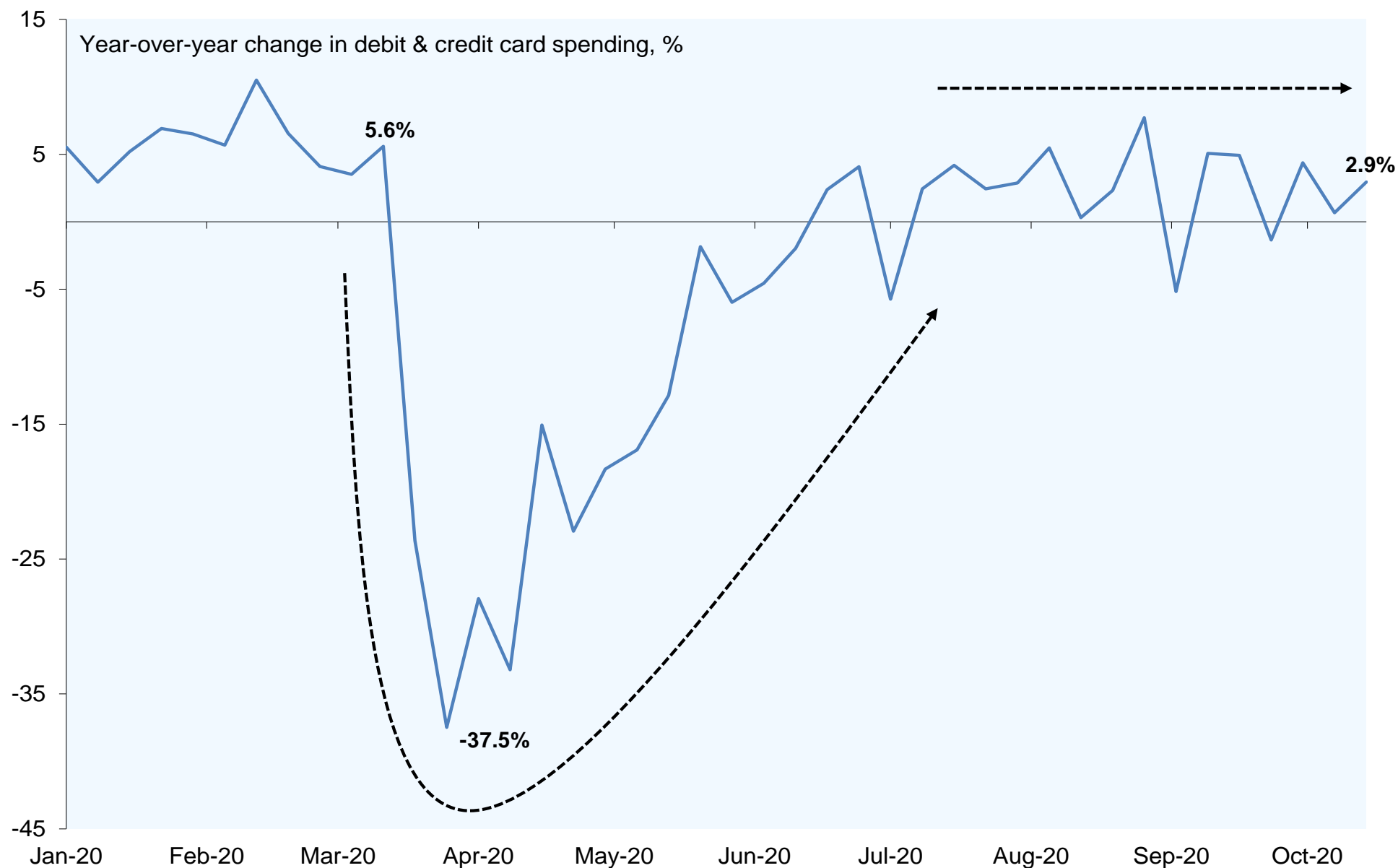
Government support and payment deferrals have provided temporary relief from layoffs



The \$2K monthly CERB payment has fully compensated some lower-wage workers (that have seen the most job losses). Mortgage and credit card deferrals are keeping households from falling into arrears – but can the labour market recover before the deferrals end?

Source: Government of Canada, Statistics Canada, Canadian Bankers Association, RBC Economics. * Excludes self-employment income; self-employed are eligible for CERB

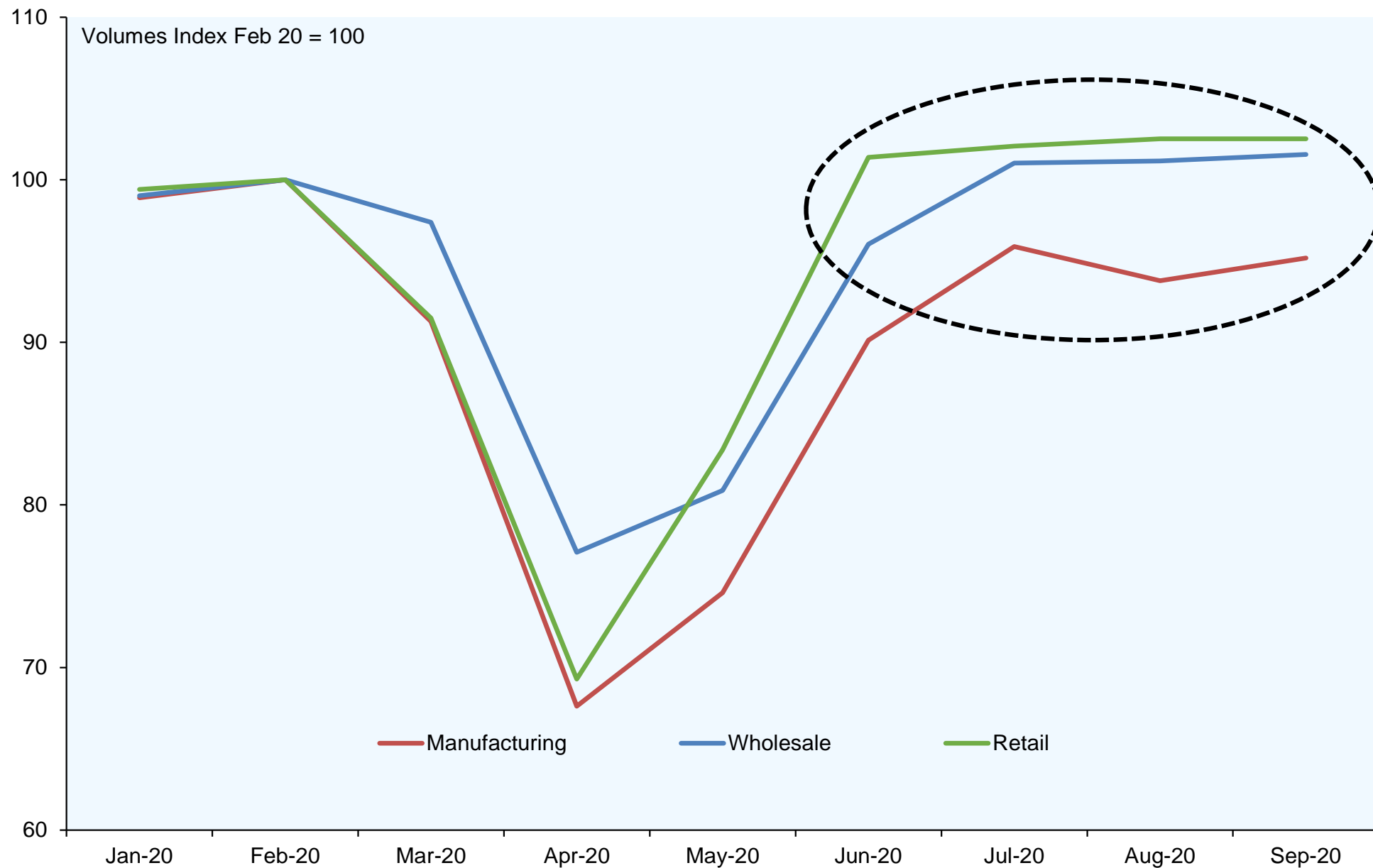
RBC's COVID Consumer Spending Tracker has levelled off near pre-COVID levels ...



RBC's COVID Consumer Spending Tracker measures anonymized card transactions by RBC's Canadian clients. Consumer spending has rebounded sharply from the March lows (-37.5%) but is now levelling off near pre-pandemic levels (~3.0%)

Source: RBC Economics, RBC Data & Analytics

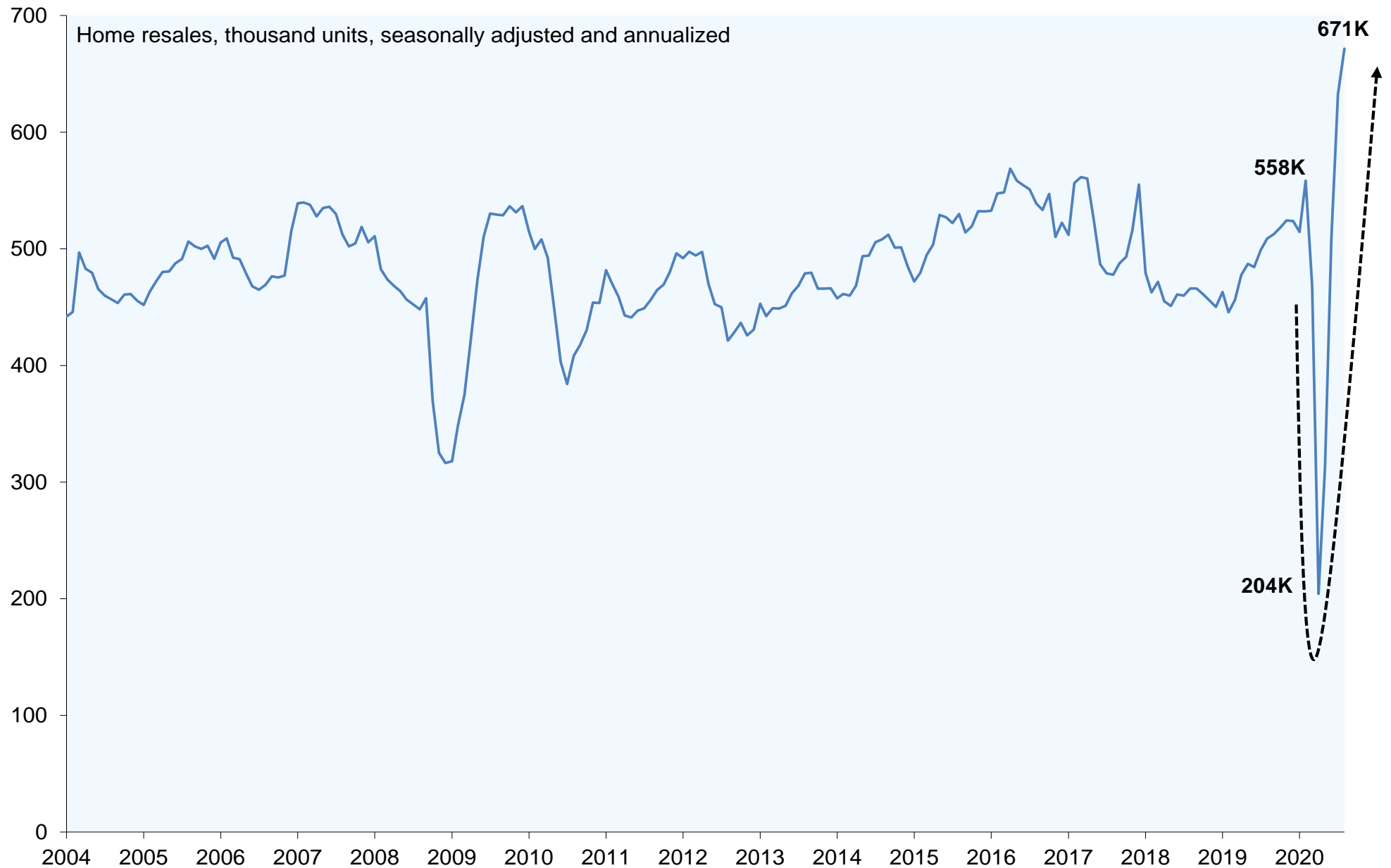
... corroborating what has been seen in other activity metrics



Manufacturing, wholesale and retail sales volumes are all levelling off

Source: Statistics Canada, RBC Capital Markets

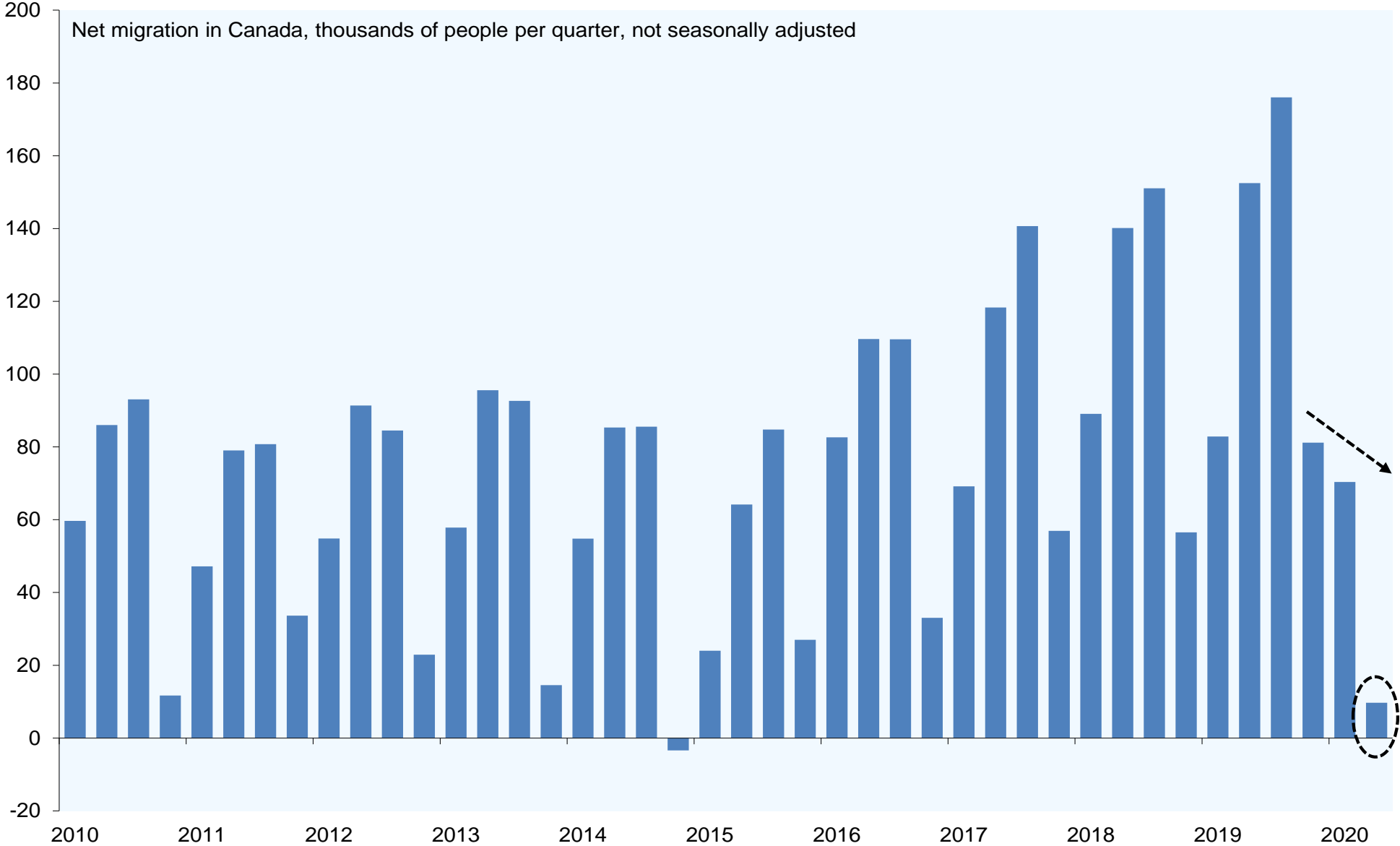
Housing activity spiked higher during the summer reopening



The COVID-19 shutdown shifted housing activity from spring to summer, pushing home resales to record highs

Source: Canadian Real Estate Association, RBC Economics

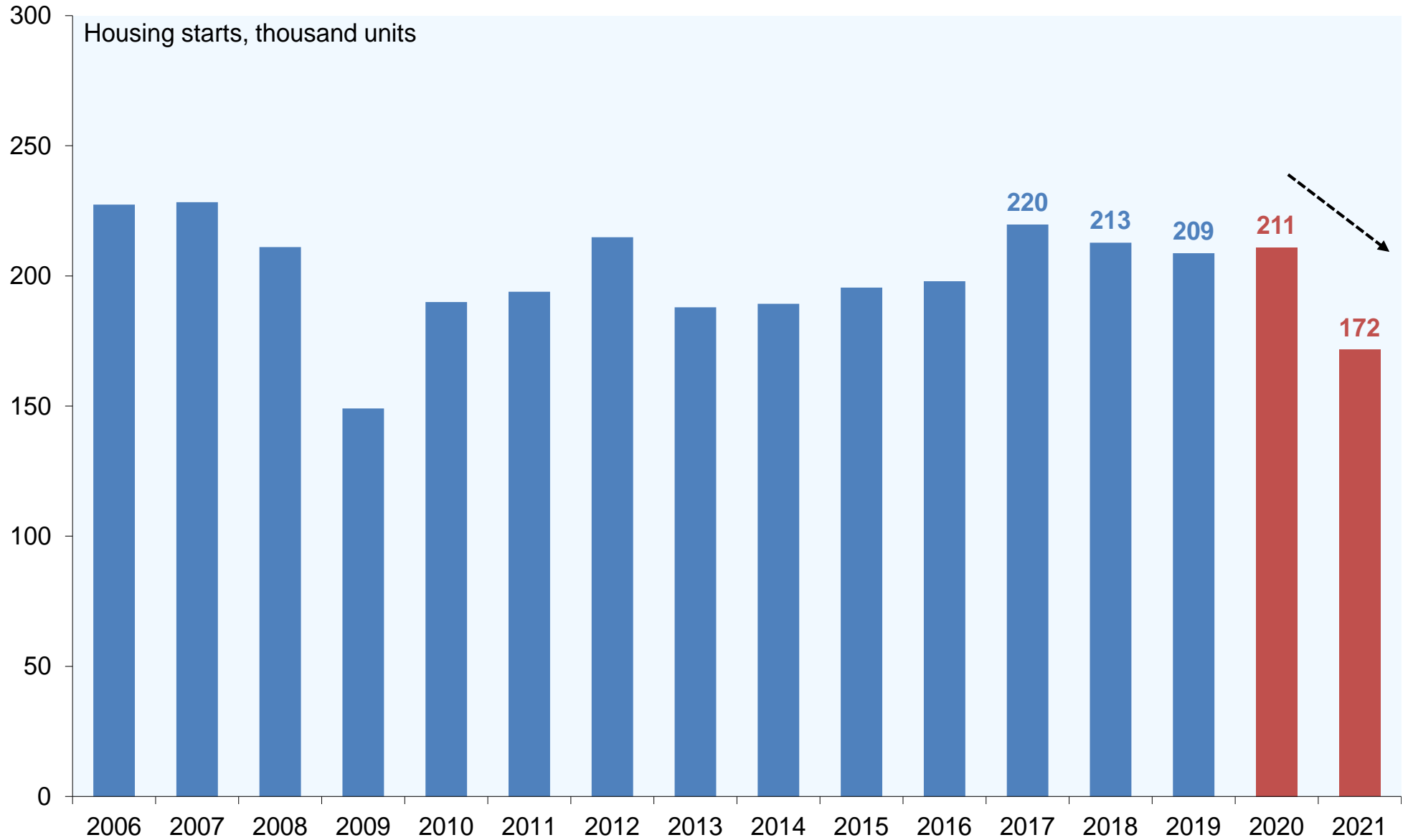
Challenge #4: The border closure is making a huge dent on immigration ...



Reduced immigration will slow population growth and household formation over the next year (and possibly beyond). A Biden administration would also increase the competition for global talent as they have pledged to lift the temporary suspension of H-1B visas (used by the tech sector) and provide exemptions on visa limits in other areas (PhD students in STEM programs).

Source: Statistics Canada, RBC Economics

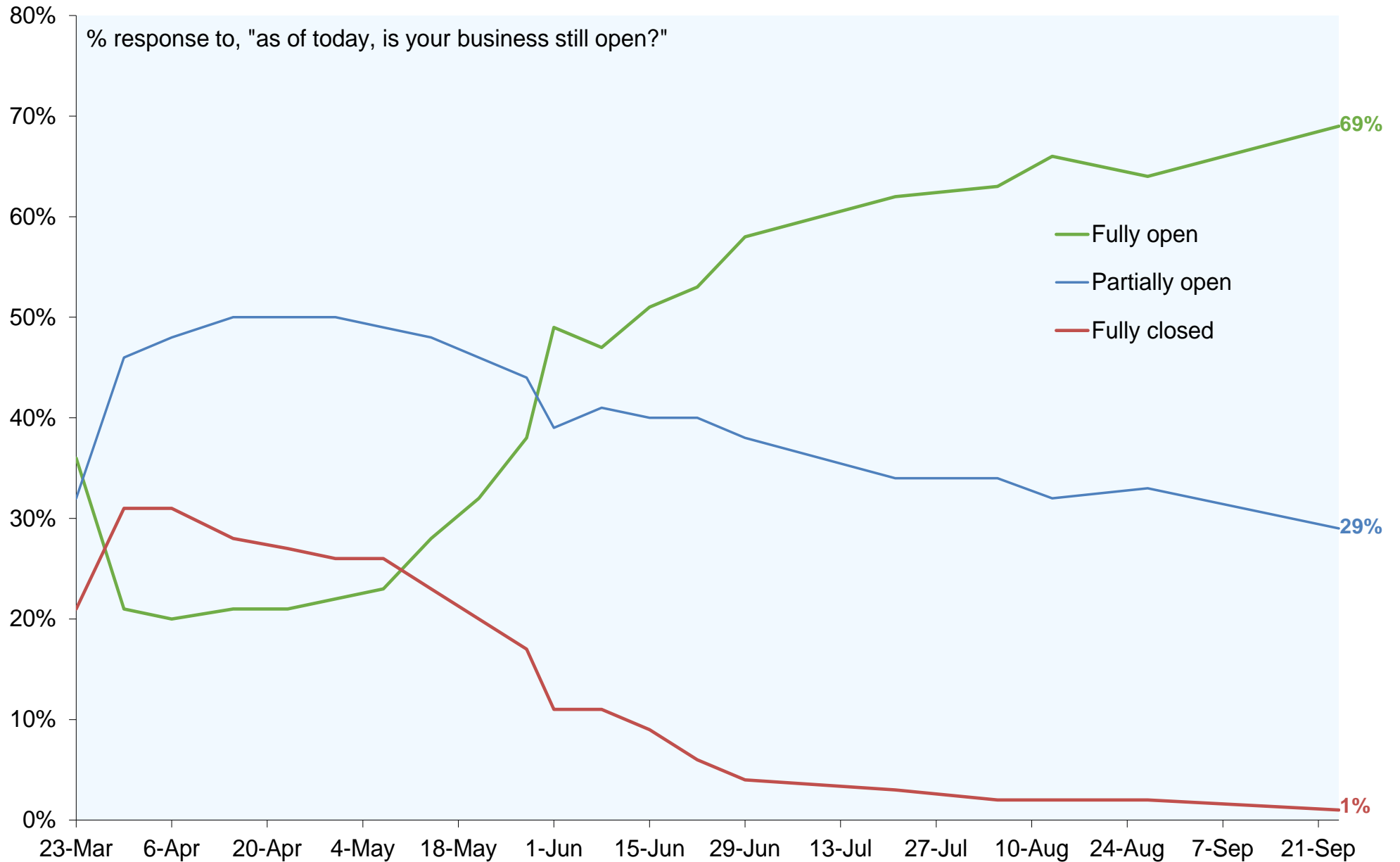
... which is poised to slow down new home construction



Construction activity is expected to slow in 2021 as lower migration levels take their toll

Source: CMHC, RBC Economics

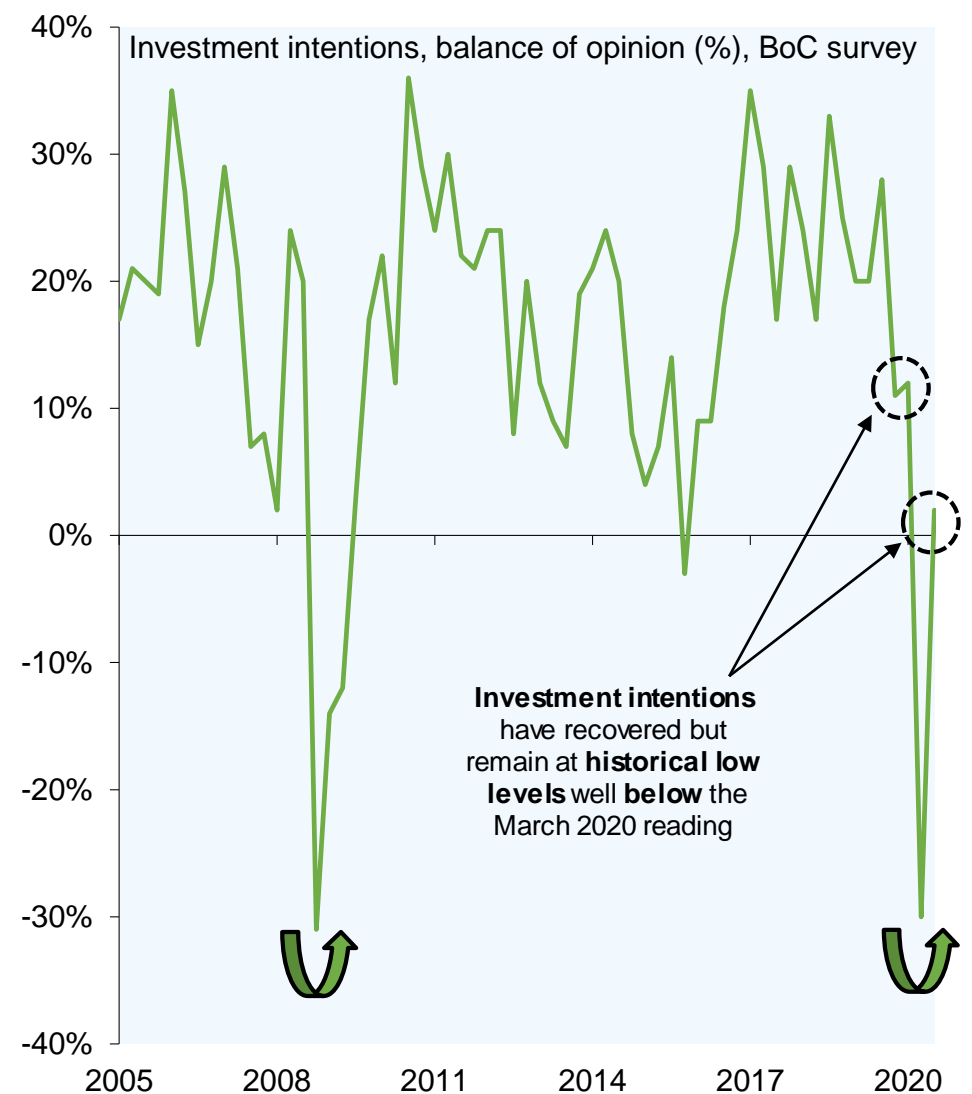
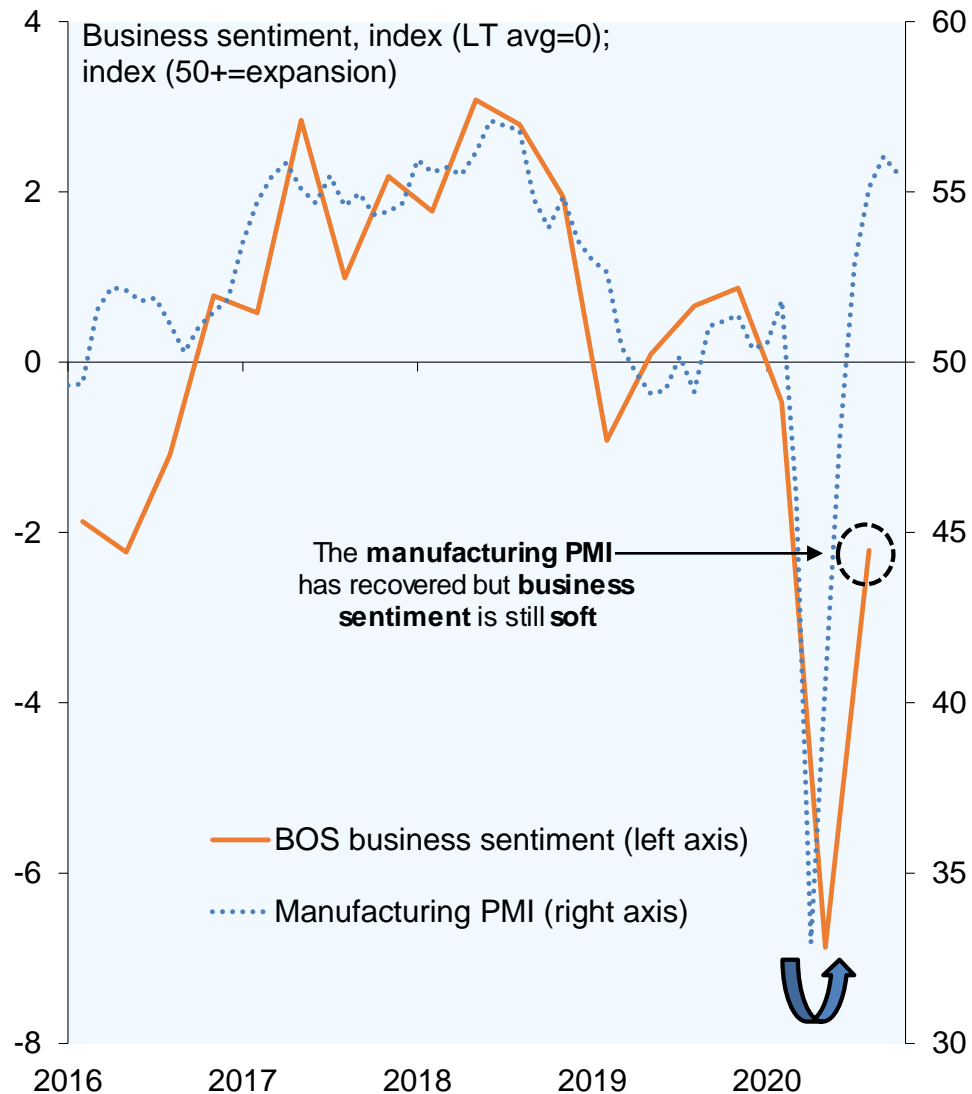
Businesses have been reopening since early May ...



Business activity has been on the rise through the summer

Source: CFIB, RBC Economics

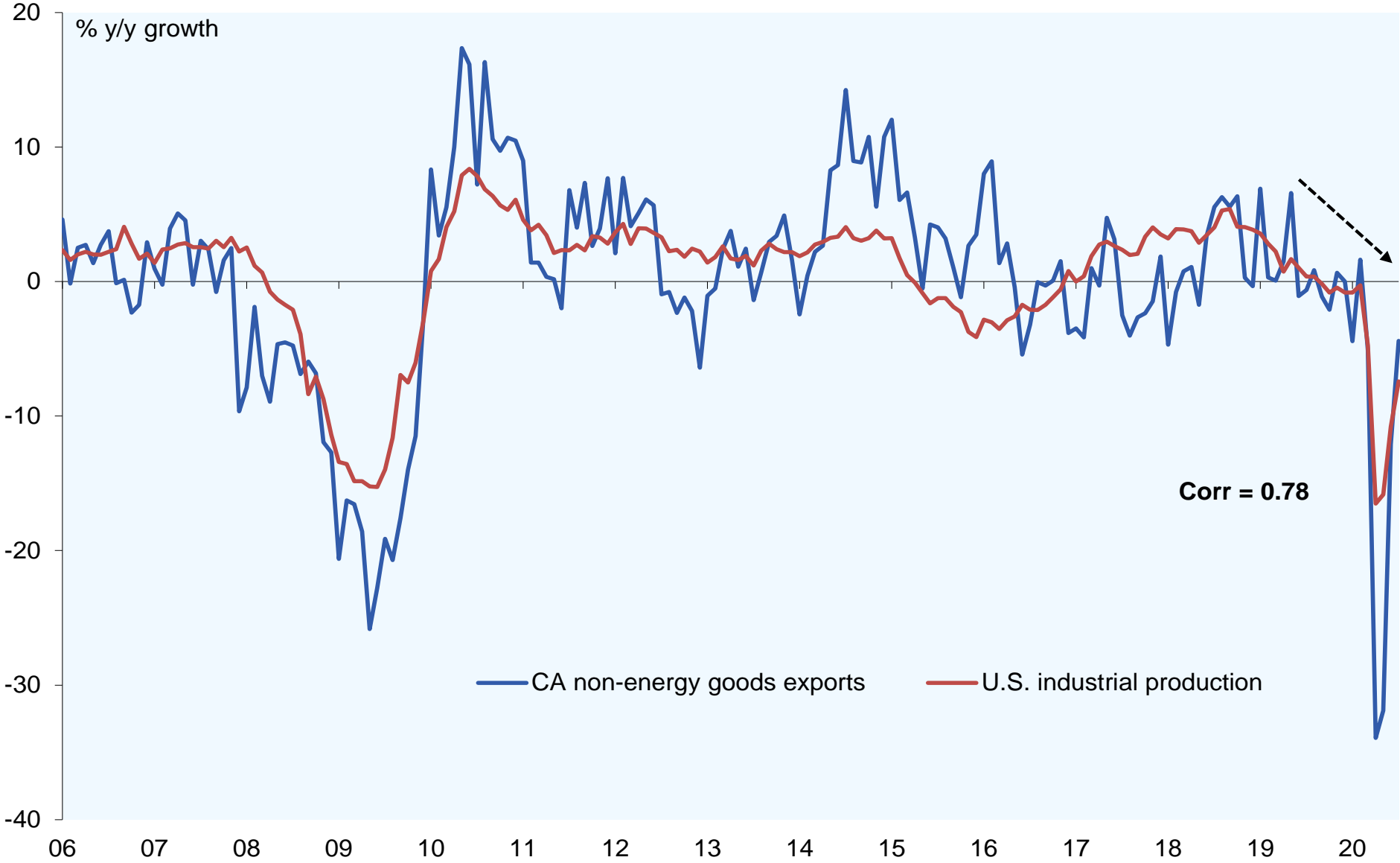
... yet business sentiment remains soft and investment intentions are weak



Businesses are likely to remain cautious/conservative with respect to capital expenditures. Biden's plans to revoke permits for the US portion of the long-delayed Keystone XL pipeline project may be another reason for caution as Canadian oil and gas investment is 80% below 2014 levels as of Q2 2020.

Source: IHS Markit, Bank of Canada, RBC Economics

Weakness in US industrial production has magnified the export challenges

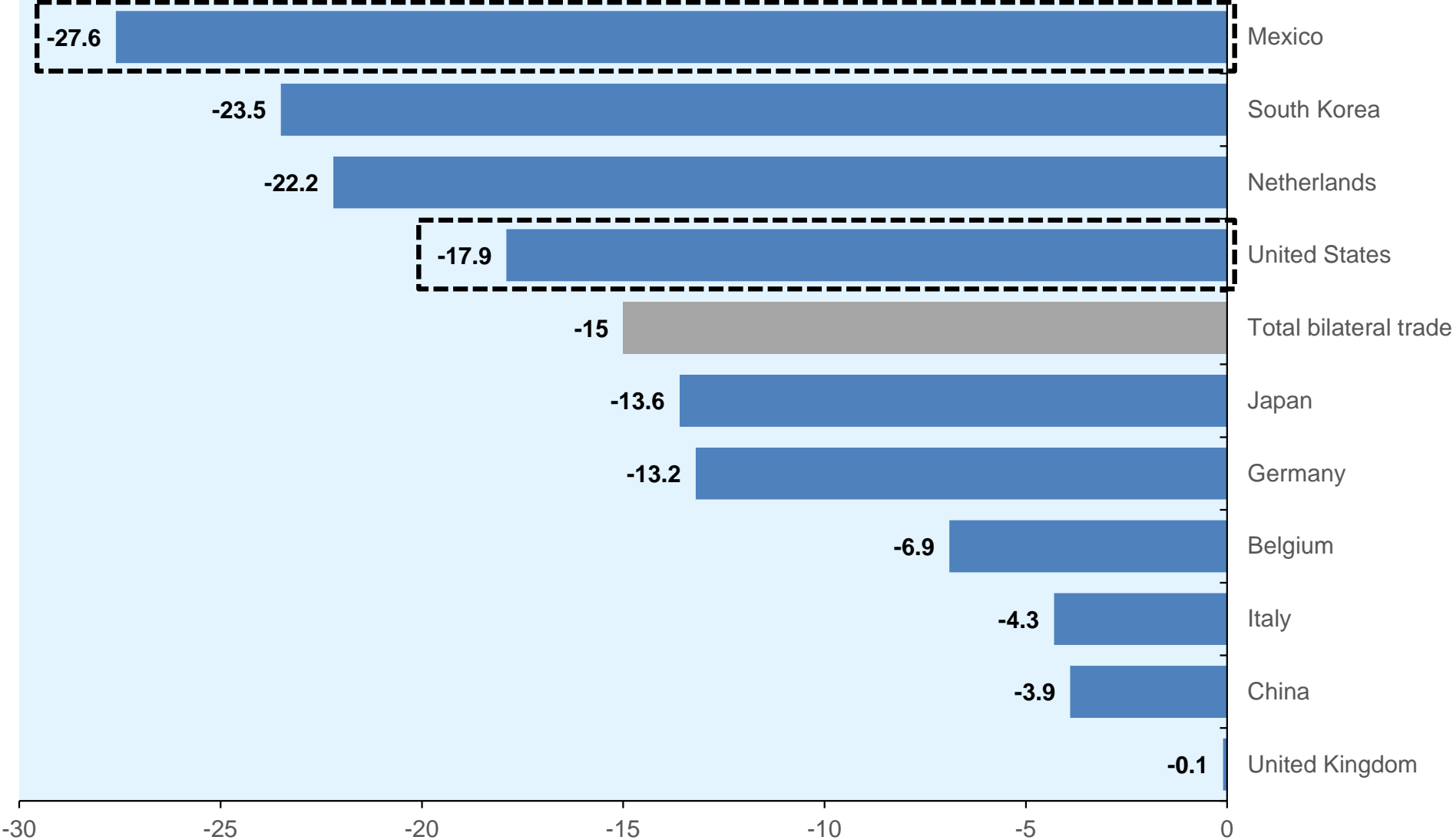


There is a strong relationship between US industrial activity and Canadian non-energy exports. Biden's "Made in America" policy may impact exporters.

Source: Statistics Canada, U.S. Federal Reserve, RBC Capital Markets

Challenge #5: Weak business investment and trade headwinds

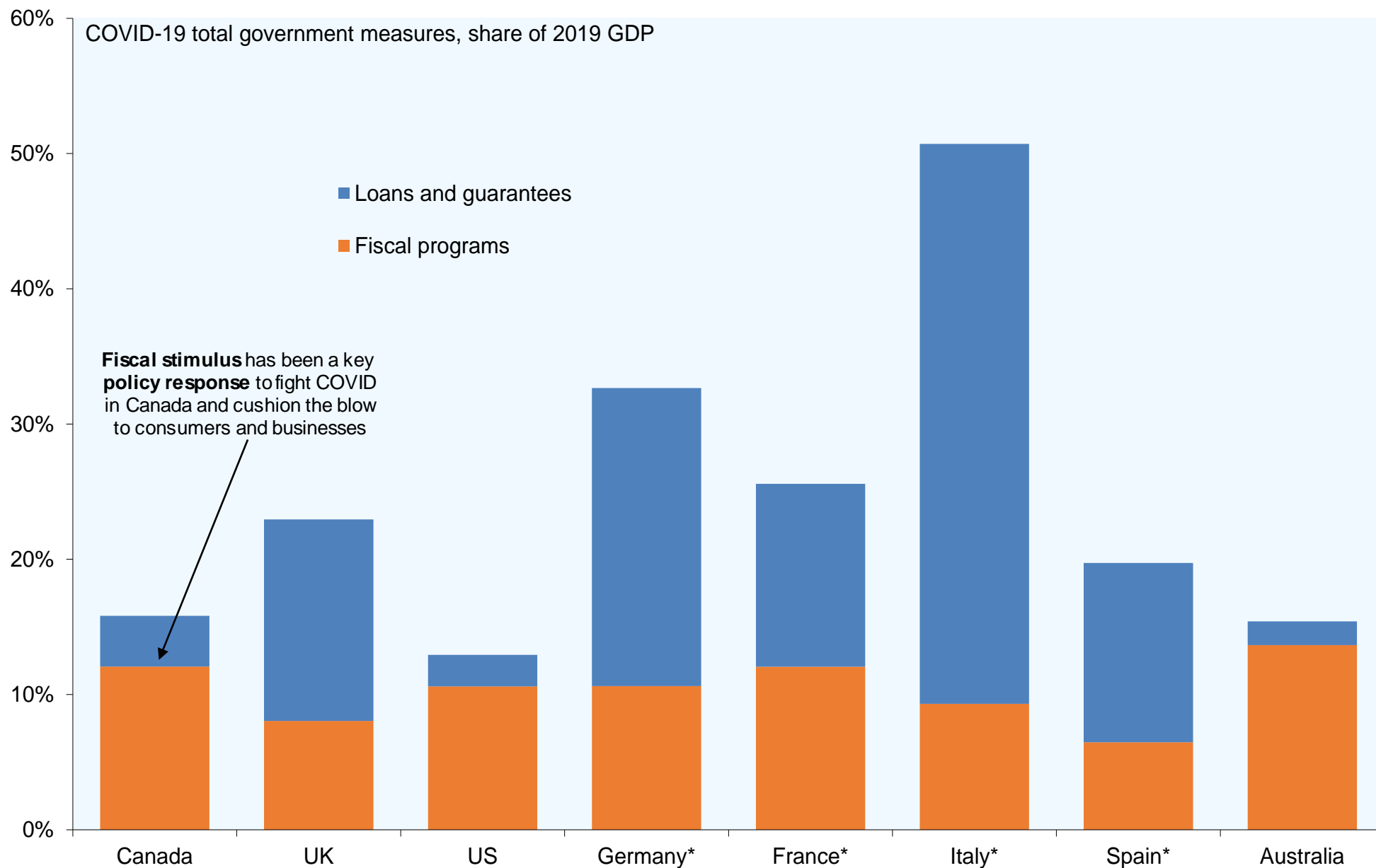
Percent change in exports and imports, 2020 YTD (through July) vs. same period last year



Canada's trade with Europe and China is holding up better than with North America (the US is our largest trading partner)

Source: Statistics Canada, RBC Economics

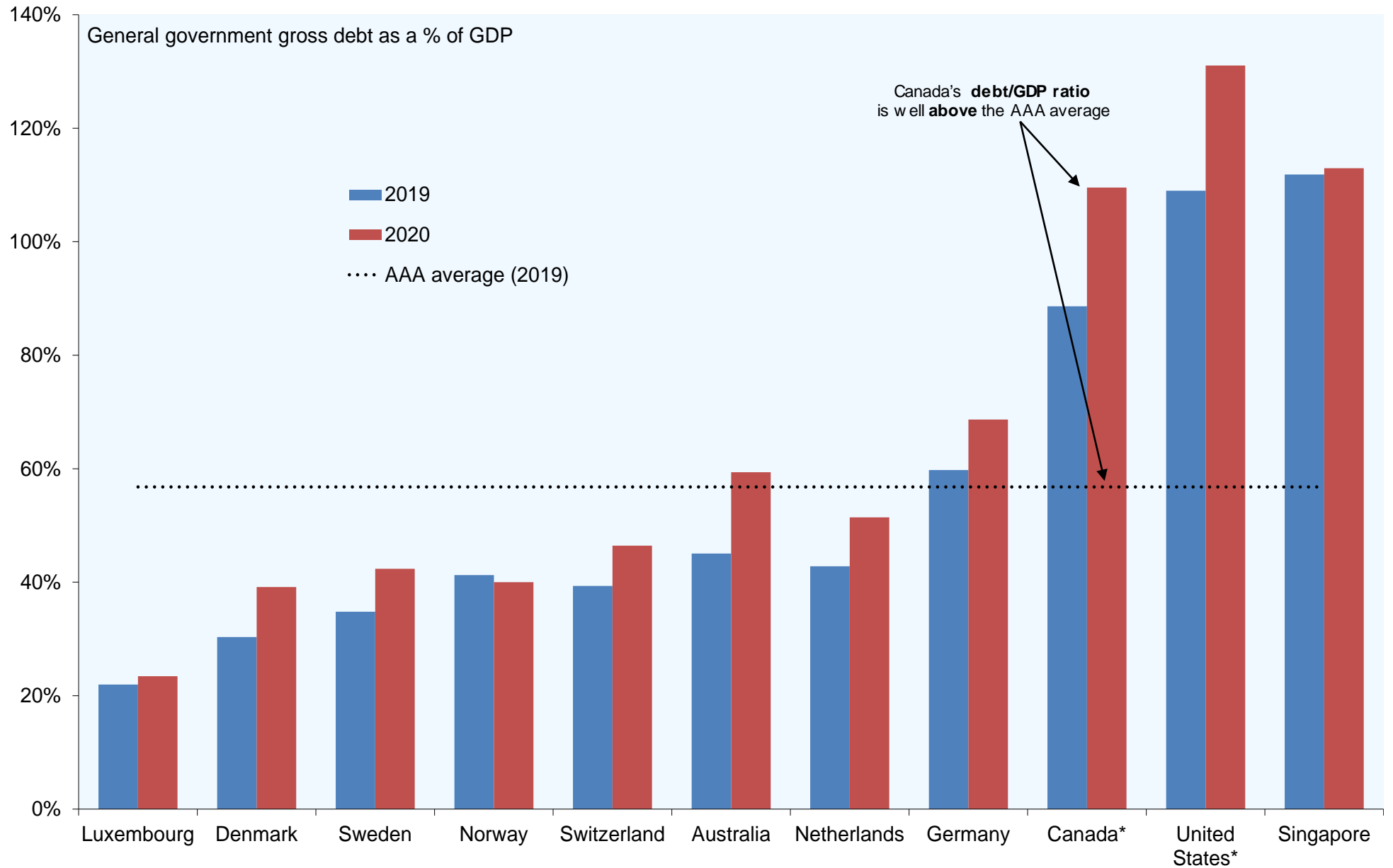
Fiscal stimulus will have to do the “heavy lifting” with interest rates at the zero bound ...



Additional growth or COVID setbacks may require supplemental fiscal stimulus as governments “do whatever it takes” to make up for shortfalls

Source: Haver Analytics, RBC Economics. * includes estimated share of EU-level grants

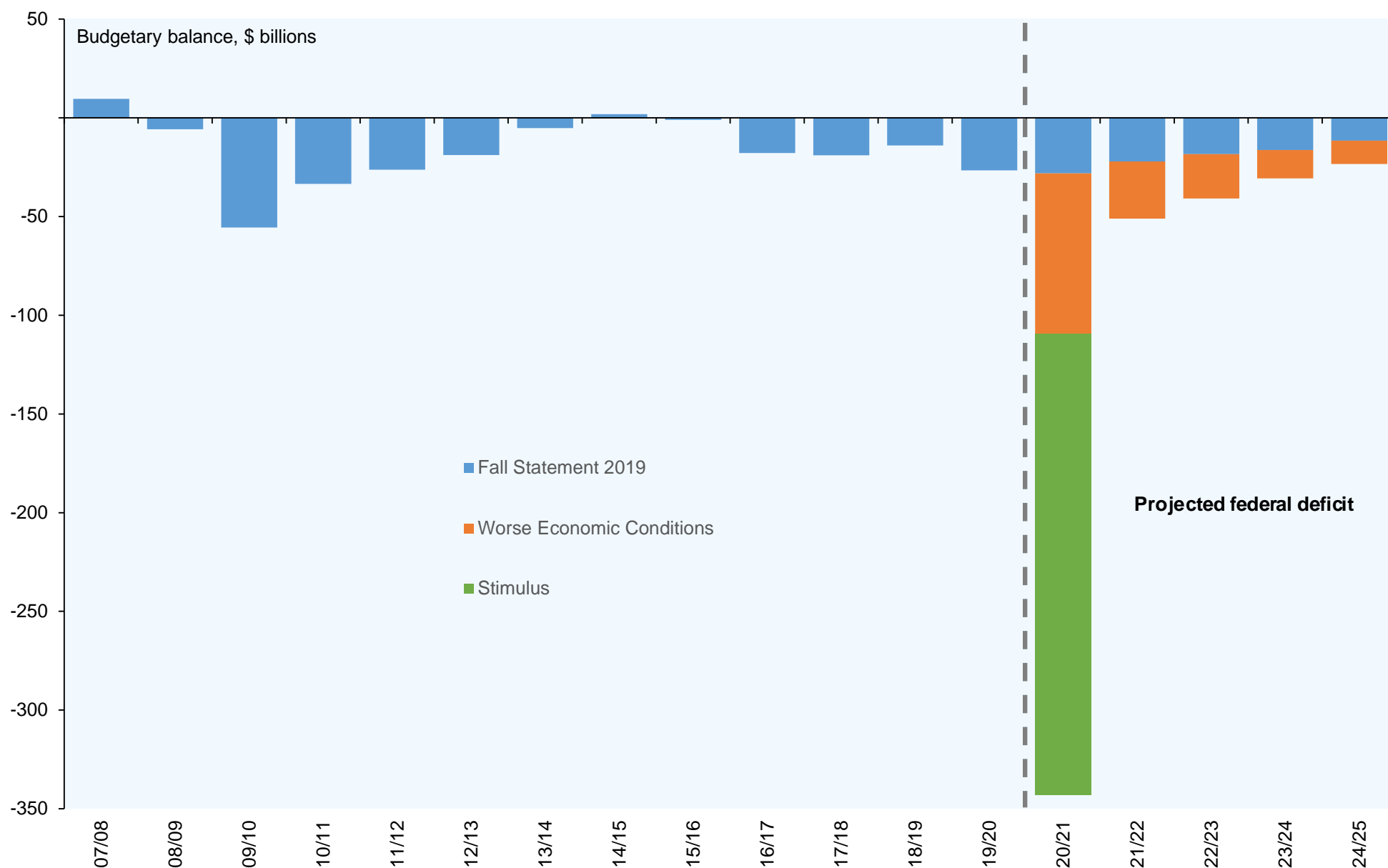
... but that comes with potential risks and costs ...



Fiscal stimulus is pushing government debt loads higher

Source: IMF, RBC Economics. * rated AAA by two of three major rating agencies

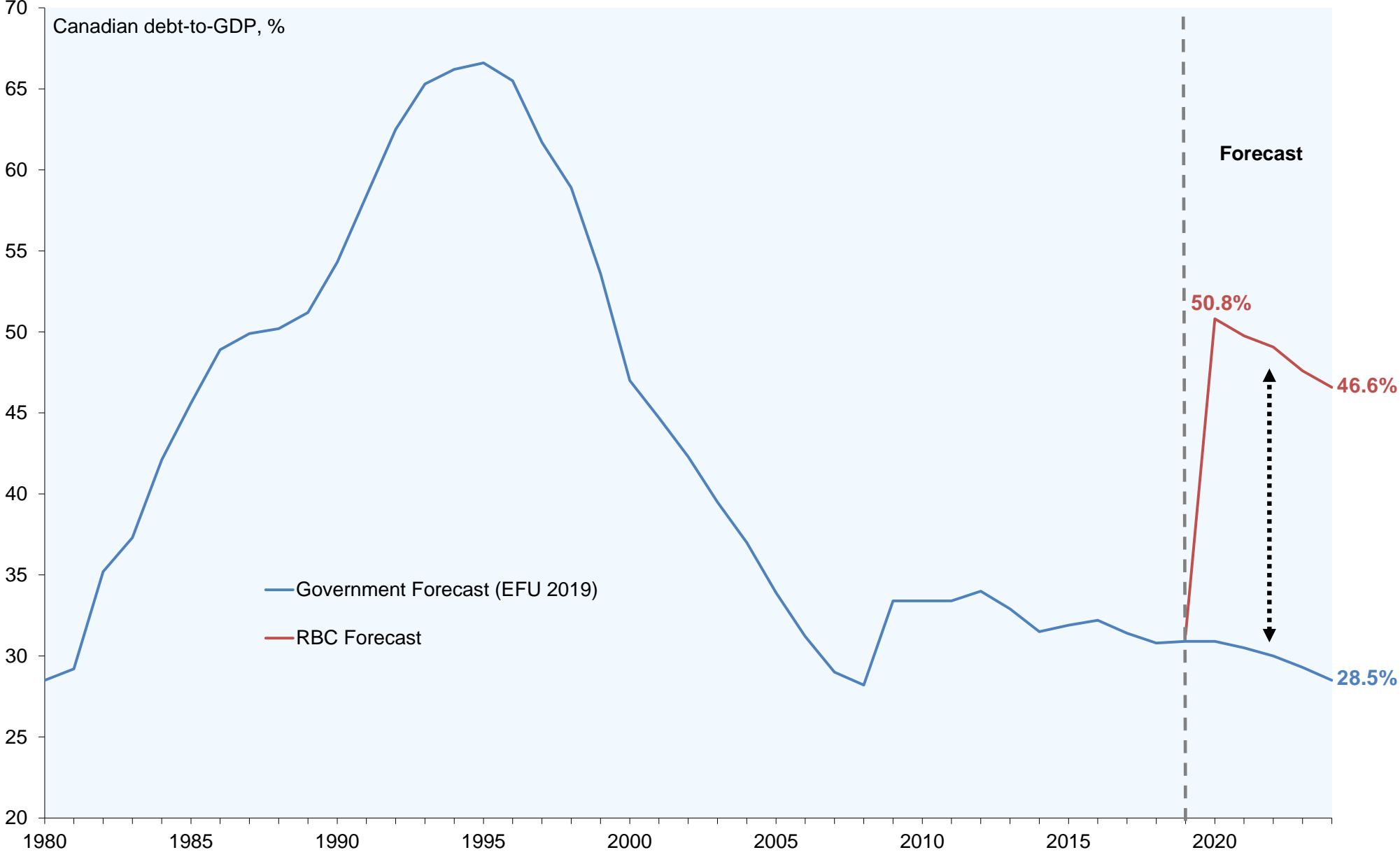
... as it has caused the deficit to balloon in the process



Unanticipated stimulus measures have caused a deterioration in the deficit profile (now estimated to be C\$382bn for the 2020/21 fiscal year)

Source: Department of Finance, RBC Economics

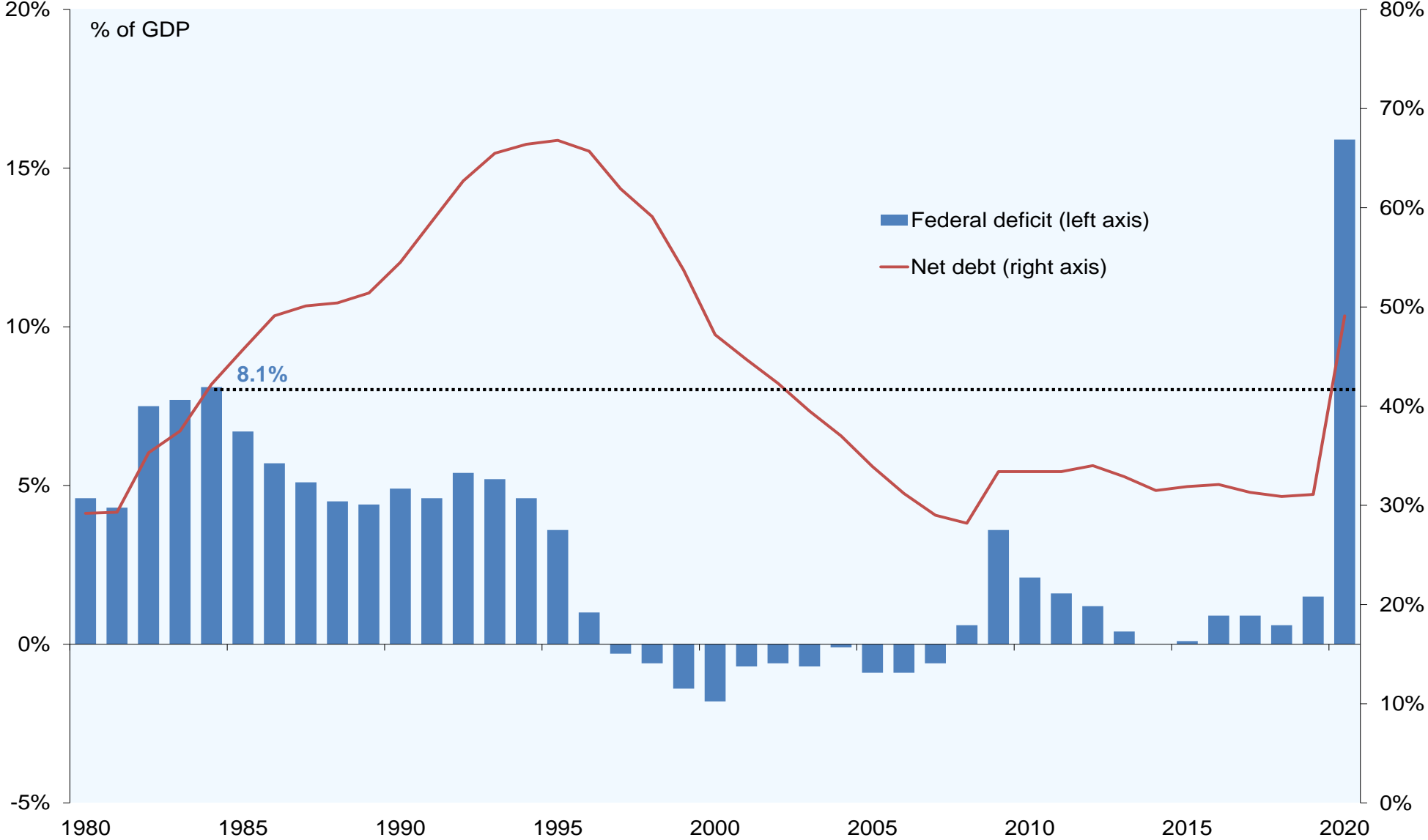
The federal debt-to-GDP ratio is forecast to spike to a 20-year high



The government response to the COVID shutdown has sidelined the debt-to-GDP forecast from the 2019 economic and fiscal update

Source: Department of Finance, Haver Analytics, RBC Economics

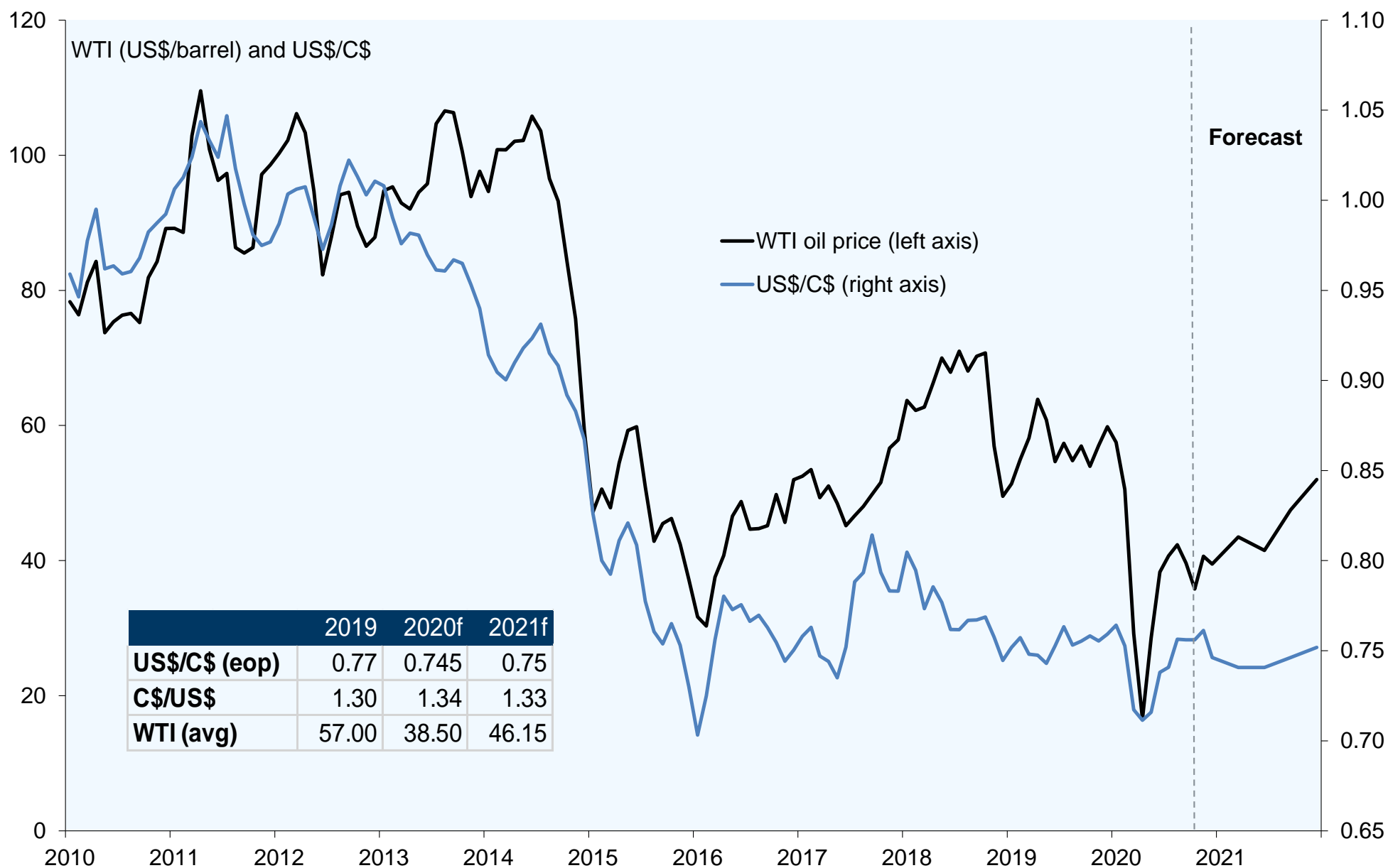
Challenge #6: Federal debt levels and new downgrade risks



The Canadian government has projected a C\$382 billion deficit in the current fiscal year in their Fall Economic Statement. A deficit of this magnitude would represent a post-war high. Fitch downgraded Canadian debt to AA+ from AAA in June due to the pandemic's fiscal toll on federal and provincial governments.

Source: Department of Finance, RBC Economics



CAD to remain on the defensive through Q2 2021, then begin to recover



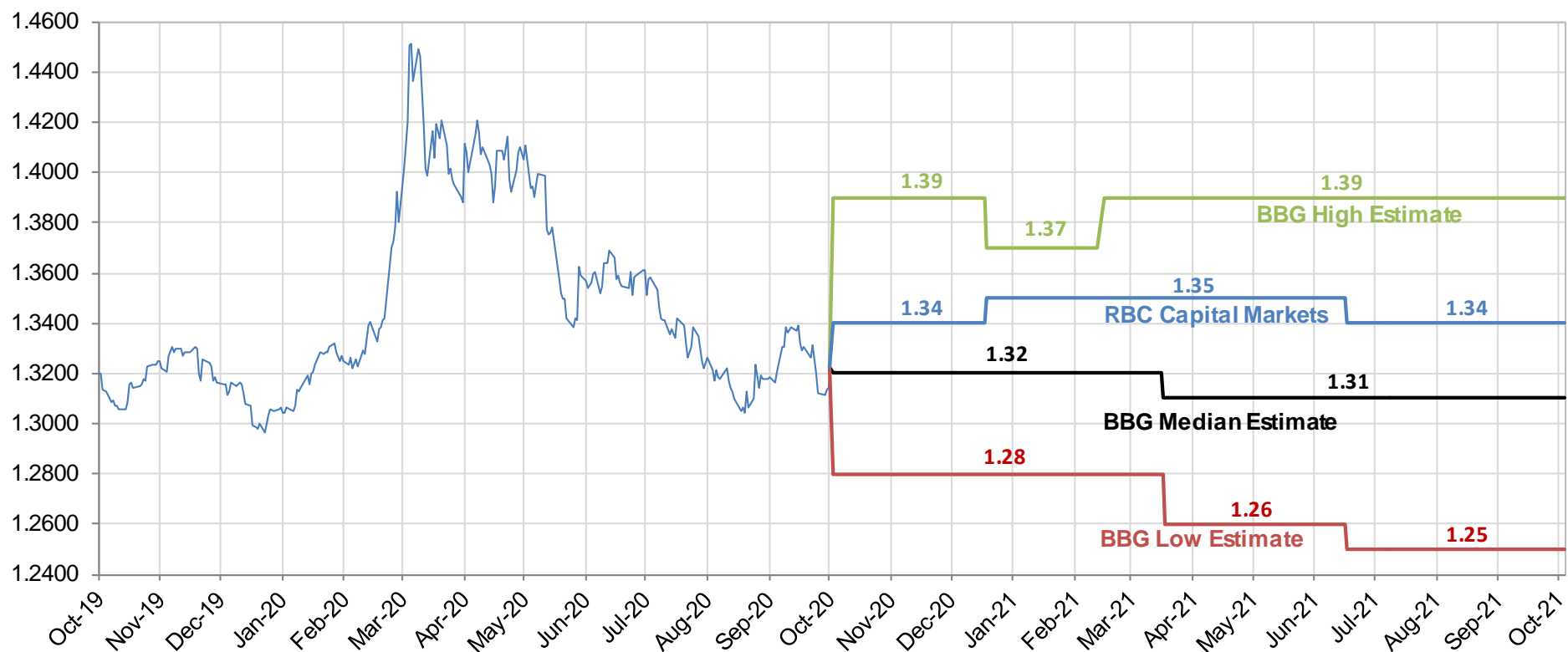
Near-term economic challenges and COVID risks to weigh on CAD

Source: Bank of Canada, EIA, RBC Economics

RBC's CAD forecasts versus consensus estimates

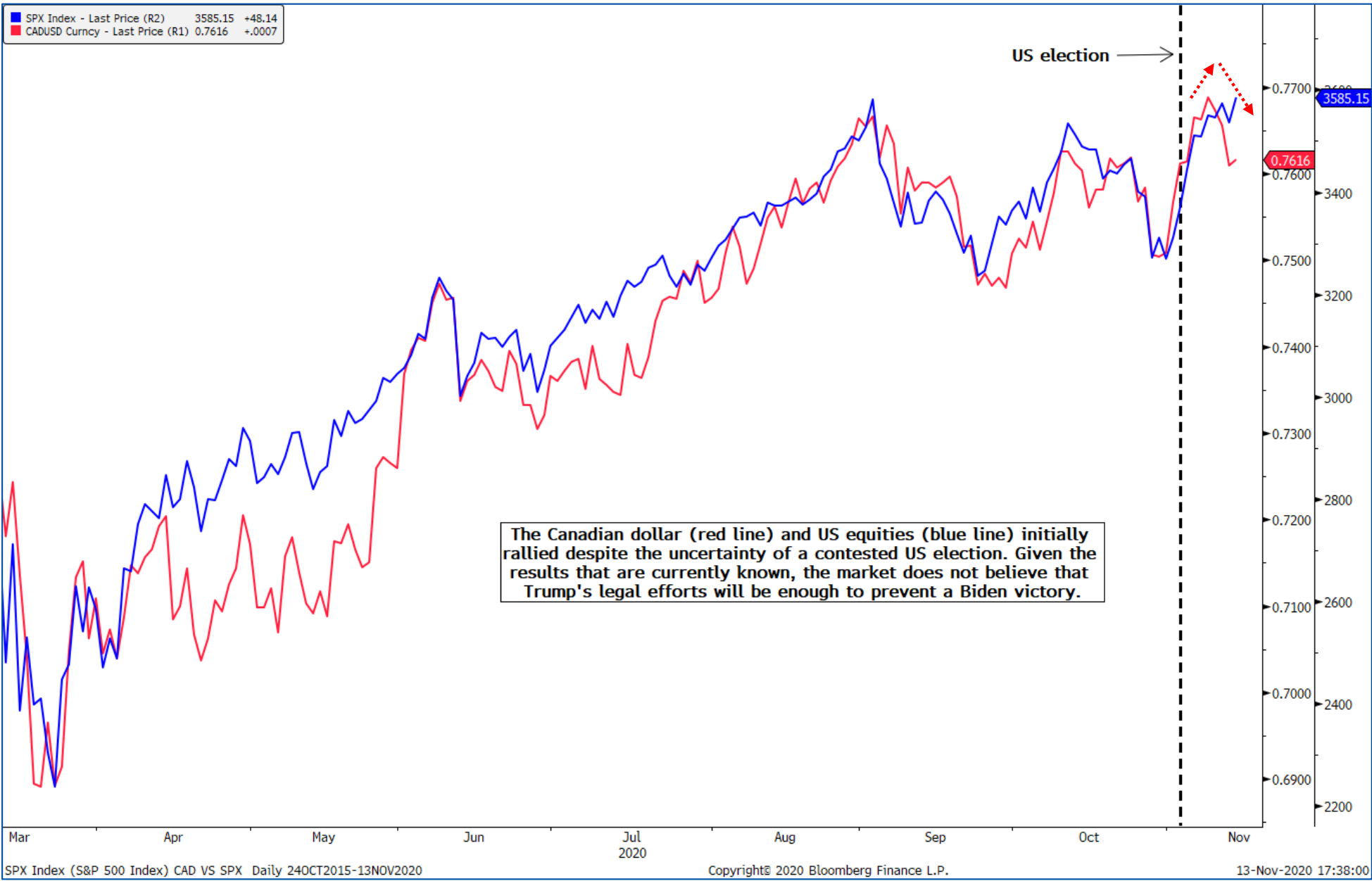
  CAD per USD	As of 12-Nov-20	Quarterly Average				Annual Average			
		Q4 20	Q1 21	Q2 21	Q3 21	2020	2021	2022	2023
Median		1.32	1.32	1.31	1.31	1.32	1.30	1.29	1.28
Mean		1.32	1.32	1.31	1.30	1.32	1.30	1.30	1.28
High		1.39	1.37	1.39	1.39	1.39	1.36	1.39	1.36
Low		1.28	1.28	1.26	1.25	1.28	1.24	1.24	1.21
RBC Capital Markets		1.34	1.35	1.35	1.34	1.34	--	--	--

Historical CAD per USD spot exchange rate & 1-year forecast



Source: Bloomberg, RBC Capital Markets

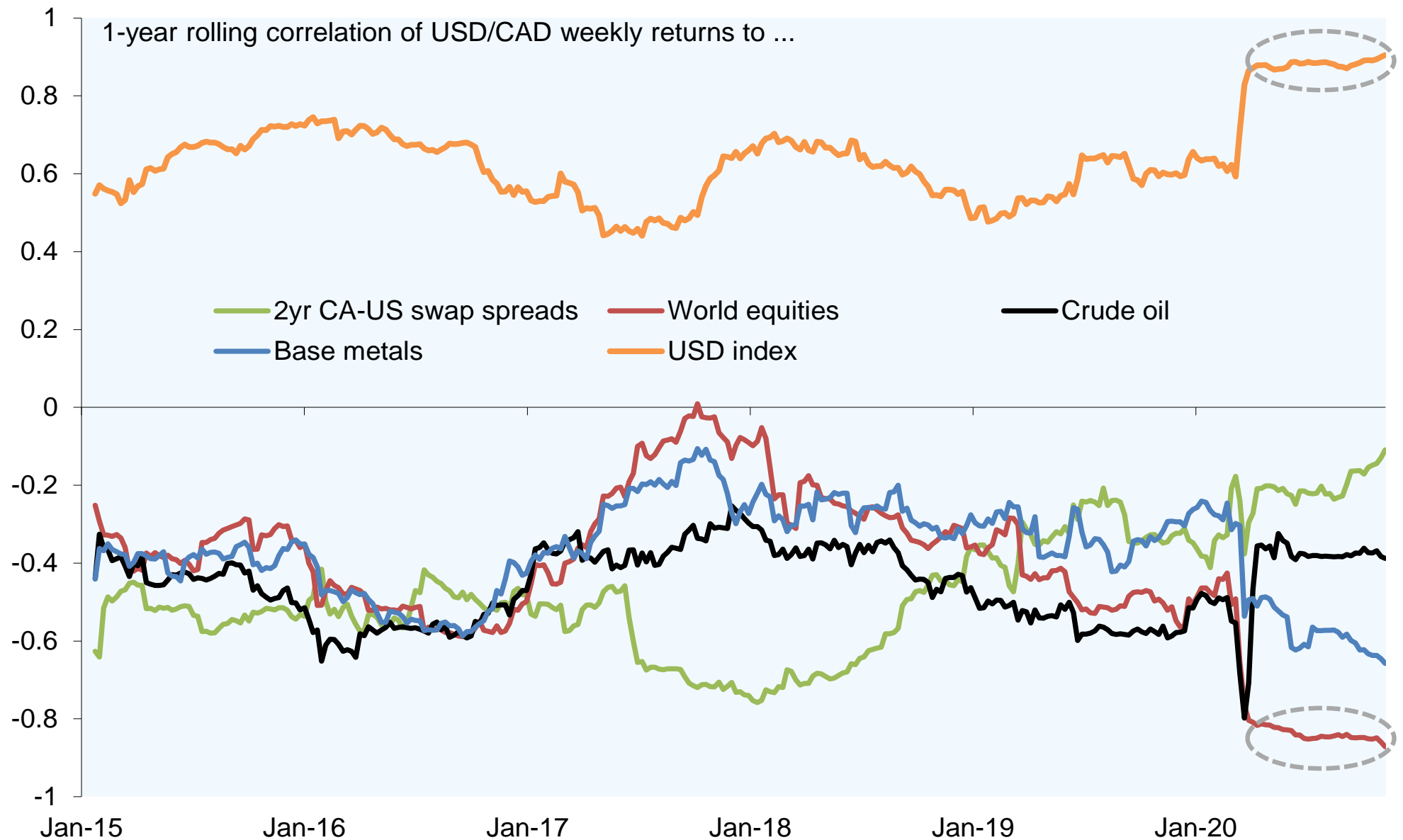
The Canadian dollar has returned to pre-US election levels after a brief rally



A split Congress will have implications for elements of Biden’s election platform such as taxation, regulatory and environmental policy

Source: Bloomberg, RBC Capital Markets

Equities and broad USD direction overtake crude oil as the primary cross asset drivers of CAD



Direction in equities and the USD are linked to each other through risk sentiment. An increase in risk sentiment has seen equities rally and the USD decline and vice versa.

Summary and Key Considerations

The Challenges and Risks of Balancing Containment Versus Recovery

- COVID scarring suggests that **the Canadian economy will not return to pre-pandemic levels until late 2021 or early 2022.**
- The Canadian dollar has maintained its summer gains through the US election results – **equity markets should be watched closely as the main driver of the currency.**
- **A number of risks and challenges serve as headwinds for both the economy and currency going forward**, including: (1) a second wave of COVID cases, (2) high unemployment levels, (3) an uneven recuperation phase, (4) immigration levels, (5) business sentiment and trade barriers and (6) elevated government debt levels.
- Economic slack and a limited inflationary impulse will cause **the Bank of Canada to keep interest rates at the effective lower bound (0.25%) for the foreseeable future.**
- **Negative interest rates are in the BoC's policy toolbox**, but are **not** a preferred alternative at this juncture.
- With interest rates at the zero bound, **fiscal policy will be forced to do the heavy lifting in order to offset any future growth or COVID-related setbacks to the economy.**
- **The timing of a COVID vaccine and large scale immunization will be a critical inflection point for the long-term recovery.** Until then, it will be a **delicate balancing act between containment and recovery.**



Capital
Markets

Disclaimer

IMPORTANT DISCLOSURE: THIS COMMUNICATION HAS BEEN GENERATED BY AN EMPLOYEE OF RBCCM AND IS BEING CONVEYED TO YOU AS A SOLICITATION (FOR PURPOSES OF 17 CFR §§1.71(a)-(c) AND 23.605) FOR ENTERING INTO A DERIVATIVES TRANSACTION.

This communication has been prepared by RBC Capital Markets (“RBCCM”) sales personnel for institutional clients and your information only and is not a research report prepared by the RBCCM Research Department. Unless otherwise specified, the views expressed herein are the author’s and may differ from the views of RBCCM’s Research Department and from the views of others within RBCCM. The information in the body of this communication is intended to provide general company and/or market commentary, is not intended to provide a sufficient basis for an investment decision and should not be considered a research report. This material may include references to recently published research notes and reports by RBCCM’s Research Department. Complete research notes and reports, including important conflicts disclosures, are available at www.rbcinsight.com. **You should assume that trading desks at RBCCM or its affiliates makes markets and/or hold positions, and may have conducted underwriting or other investment banking work in any of the securities referenced herein.** Information contained herein has been compiled by RBCCM from sources believed to be reliable, but no representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. Every province in Canada, state in the U.S., and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this communication may not be eligible for sale in some jurisdictions. To the full extent permitted by law neither RBCCM nor any of its affiliates or any other person accepts any liability whatsoever for any direct, or indirect or consequential loss or damage arising from any use of the information contained herein. No matter contained in this communication may be reproduced or copied by any means without the prior consent of RBCCM.

Disclaimer

RBC Capital Markets is the global brand name for the capital markets business of Royal Bank of Canada and its affiliates. **United States:** This communication has been approved by RBC Capital Markets, LLC (member FINRA, NYSE, SIPC), which is a U.S. registered broker-dealer and which accepts responsibility for this communication and its dissemination in the United States. Any U.S. recipient of this communication that is not a registered broker-dealer or a bank acting in a broker or dealer capacity and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this communication, should contact and place orders with RBC Capital Markets, LLC. **This communication is not a research report or a product of RBCCM's Research Department.** **Canada:** RBC Dominion Securities Inc. (member IIROC and CIPF). **United Kingdom:** This publication has been approved by RBC Europe Limited, which is authorised by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority and PRA. **Hong Kong:** Royal Bank of Canada, Hong Kong (regulated by HKMA and SFC. Financial Services provided to Australia: Financial services may be provided in Australia in accordance with applicable law. Financial services provided by the Royal Bank of Canada, Hong Kong Branch are provided pursuant to the Royal Bank of Canada's Australian Financial Services Licence ("AFSL") (No. 246521). **Australia:** Royal Bank of Canada, Sydney Branch (regulated by the Australian Securities & Investments Commission and the Australian Prudential Regulation Authority; AFSL 246521; ABN 86 076 940 880). This document is distributed only to persons who satisfy the definition of wholesale client for the purposes of the Corporations Act 2001 and not intended for distribution to retail clients. **Japan:** Securities business (as defined under the Financial Instruments and Exchange Law) in Japan will be carried out by RBC Capital Markets (Japan) Ltd. in compliance with all applicable laws and regulations. RBC Capital Markets (Japan) Ltd. is a Financial Instrument Dealer registered with the Kanto Financial Bureau (Kinsho #203) and a member of Japan Securities Dealers Association ("JSDA") and the Financial Futures Association of Japan ("FFAJ"). Banking business (as defined under the Banking Law) in Japan will be carried out by Royal Bank of Canada, Tokyo Branch in compliance with applicable laws and regulations. **Singapore:** Royal Bank of Canada, Singapore Branch (regulated by the Monetary Authority of Singapore). The document is distributed only to persons who satisfy the definition of institutional investors as defined in the Securities and Futures Act (Chapter 289 of Singapore).

For non-institutional investors in the U.S., Canada, nothing in this report constitutes legal, accounting or tax advice or individually tailored investment advice. This material is prepared for general circulation to clients and has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Interest rates, market conditions, special offers, tax ruling and other investment factors are subject to change. You are advised to seek independent advice from your financial adviser before purchasing any product or if you are in doubt about any of the contents of this document. If you do not obtain independent advice, you should consider whether the product is suitable for you.

This content relies on tracking technologies to monitor, understand and improve our electronic communication and your online experience, to customize marketing, and to track your usage of RBC content, websites and services. Tracking technology may identify when you visit specific RBC content and may be shared with third parties involved in customizing RBC marketing on RBC or digital channels. RBC does not sell your information to third parties, nor do we track your interaction with a third party website. For more information, see our privacy policy at <http://www.rbc.com/privacysecurity/ca/index.html>.

® Registered trademark of Royal Bank of Canada. Used under license.

© 2020. All rights reserved.