

Canada: 2019, a year for the loonie?

With a year-end USD/CAD forecast of 1.20, next year should be a big year for the loonie - though there may be some political headwinds along the way...



A positive CAD story will compete for some of the spotlight next year and here's three reasons why...

1 USD is set to peak mid-2019

Our Global Head of Strategy Chris Turner sees a bearish dollar narrative developing throughout 2019 as US rates end their highs and US growth converges lower to the rest of the world - expect investors to move out of US asset markets ([see our FX outlook for an in-depth peak dollar analysis](#)).

2 Swap differentials shouldn't see USD strength

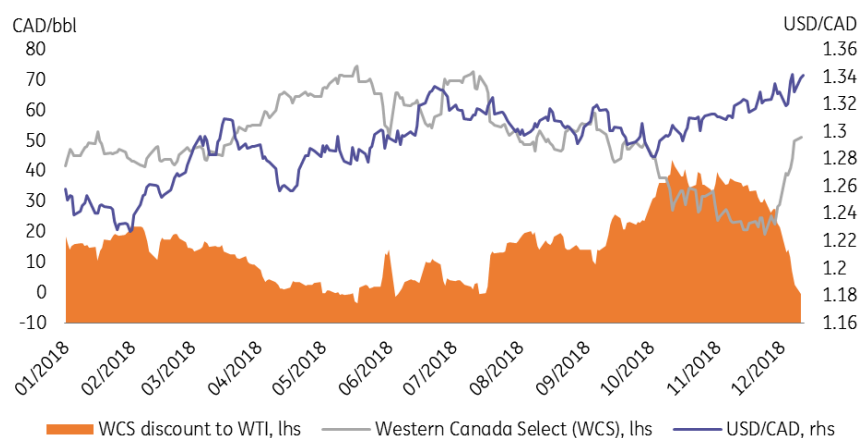
US-Canada swap differentials, particularly on the two-year part, are closely related to USD/CAD movements. Swap differentials between two countries are more prone to variation if we see a divergence between the two central bank's monetary policies.

For US-Canada differentials there's limited scope for them to widen further; we aren't ruling out the prospect of three Bank of Canada (BoC) hikes next year, which would match our expected number of Fed hikes - [read our four reasons that will keep the BoC pushing rates higher in 2019](#). (We should be able to discount a USD/CAD upside in this area.)

Alberta production cuts: A glimpse of hope for Canadian crude prices...and the CAD?

It's clear the hefty Western Canada Select (WCS) discount to West Texas Intermediate (WTI) has weighed on the CAD (see chart below). Pipeline constraints have dragged WCS lower, but the recent Alberta curb on oil production has seen its price surge and thus has narrowed the price differential versus WTI.

The WCS discount to WTI is weighing on the CAD



Source: Macrobond

This is only a short-term solution to lifting prices. Pipeline capacity constraints still haven't been resolved. Planned projects – which are still undergoing legal battles, will get underway in the medium-term so we can be certain that a heavy WCS downturn is ruled out for good.

Keystone XL – one of the major pipeline projects to be delayed – may see construction start mid-2019. This may help the CAD, further supporting our forecast that USD/CAD will trend lower next year.

However, construction on the Keystone XL pipeline was brought to a halt by US courts. Getting things back up and running is contingent on the State Department's review early next year, and whether they'll address the drawbacks – namely environmental issues. In the meantime, production cuts should support WCS until we see further pipeline progress.

Wildcard: Canadian politics

With a federal election scheduled 21 October 2019, next year is a busy one for Canadian politics. Some recent provincial election results have shown new, smaller parties (both left and right) gain ground. This suggests Canada isn't immune to the global trend of established parties coming under pressure. We expect some sizeable electorate swings which could see FX fluctuations in both directions. That said, another Liberal government appears likely; CBC analysts have calculated that, if the election was held today, the probability of another Liberal majority is around two-thirds, and if it's anything like 2015, the Liberal's loose fiscal stance should see a positive leaning CAD reaction.

2019, a year for the loonie? We think so.

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