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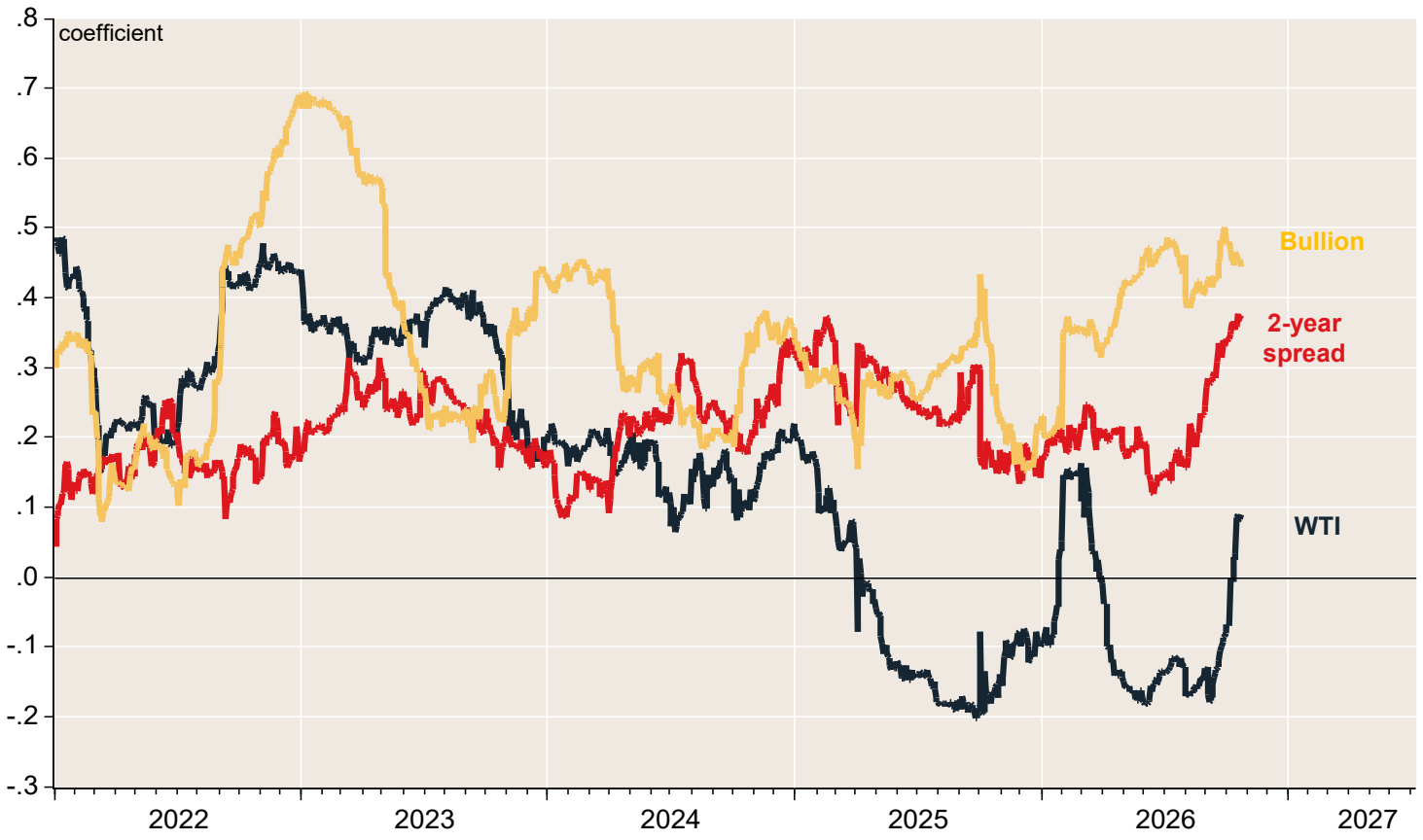
Canada Watch

By Kyle Dahms

The Canadian dollar has whipsawed in recent months as rising oil prices competed with shifting interest rate differentials against the U.S., and volatility in gold prices (see our previous **correlation analysis**). As today's Hot Chart shows, the loonie's six-month correlation with WTI has recently turned positive after months in negative territory. At a little less than a 0.1 correlation coefficient, however, the relationship remains modest and considerably weaker than those with bullion and two-year yield spreads. In our view, the narrowing rate gap offers a more convincing explanation for the recent recovery. Expectations of a Bank of Canada hike this Wednesday, alongside a Federal Reserve hold, have accompanied a narrowing of Canada's yield disadvantage and a partial reversal of the loonie's earlier losses. With a Canadian hike already substantially anticipated, further support may depend more on guidance about subsequent moves than on the decision itself. The recovery nevertheless remains vulnerable to changes in the rates and commodity backdrop. Gold's retreat toward US$4,000 an ounce highlights the risk of fading commodity support. A more hawkish repricing of Fed policy could widen Canada's yield disadvantage and weigh on bullion, particularly if U.S. real yields continue rising. Meanwhile, softer global growth or an easing of risk premia in the Strait of Hormuz could pull crude prices lower, although reduced geopolitical uncertainty is double-edged as it could provide some offset through improved risk appetite. We therefore remain cautious on the Canadian dollar through year-end. More durable appreciation, in our view, will require an easing of trade tensions and a sustained narrowing of Canada's yield disadvantage.

CAD: Support with strings attached

Moving correlation of the loonie (USD per CAD) with WTI, 2-year yield spreads and bullion*



* Six-month (130 days) moving correlation of daily changes
NBC Economics and Strategy (data via Refinitiv)

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