Forex

Economics and Strategy

December 2024

Highlights

By Stéfane Marion and Kyle Dahms

- The outcome of the U.S. election, which saw President Trump win the presidency and the Republican Party take control of both the Senate and the House, has been a significant boost for the trade-weighted U.S. dollar which now trades near a record high. A more resilient inflationary environment, coupled with the prospect of additional fiscal stimulus from the incoming President, presents a challenge for the Federal Reserve. In this context, we continue to anticipate upside potential for the U.S. dollar through the first half of 2025
- The Canadian dollar has faced persistent challenges in Q4, declining 3.6% against the U.S. dollar over the past two months. The latest wave of weakness has been further intensified by U.S. political developments with President-elect Donald Trump threatening to impose a 25% tariff on imported goods from Canada. Considering that the majority of Canada's trade surplus with the U.S. comes from energy commodities, the prospect of imposing blanket tariffs on Canadian imports appears highly improbable. At this point, we remain optimistic that Canada will avoid blanket tariffs. However, the Canadian dollar is not entirely in the clear, as it continues to face downward pressure from cyclical forces. We maintain our USD/CAD target of 1.45 for the first half of 2025
- The Mexican peso has faced a challenging month, recently slipping to its weakest level in over two years. This downward trajectory has been driven by a confluence of political, economic, and monetary factors, with key developments in the U.S. playing a pivotal role. From heightened uncertainty surrounding the incoming U.S. administration's policies to domestic monetary easing by the Bank of Mexico, the peso's struggles reflect broader dynamics at play in North America. As trade tensions mount, particularly with the prospect of sweeping tariffs under the new U.S. presidency, the peso remains under pressure.

NBF Currency Outlook

Currency		Current December 3, 2024	Forward Estimates Q4 2024	Q1 2025	Q2 2025	Q3 2025
Canadian Dollar	*(USD / CAD)*	**1.41**	**1.41**	**1.45**	**1.42**	**1.39**
United States Dollar	*(CAD / USD)*	*0.71*	*0.71*	*0.69*	*0.70*	*0.72*
Euro	*(EUR / USD)*	1.05	1.05	1.02	1.03	1.05
Japanese Yen	*(USD / JPY)*	149	148	145	142	140
Australian Dollar	*(AUD / USD)*	0.65	0.65	0.63	0.65	0.66
Pound Sterling	*(GBP / USD)*	1.27	1.27	1.24	1.26	1.28
Chinese Yuan	*(USD / CNY)*	7.28	7.30	7.29	7.27	7.20
Mexican Peso	*(USD / MXN)*	20.3	20.7	22.0	23.0	22.0
Broad United States Dollar [1]		**126.2**	**126.7**	**129.7**	**129.5**	**126.8**

1) Federal Reserve Broad Index (26 currencies)

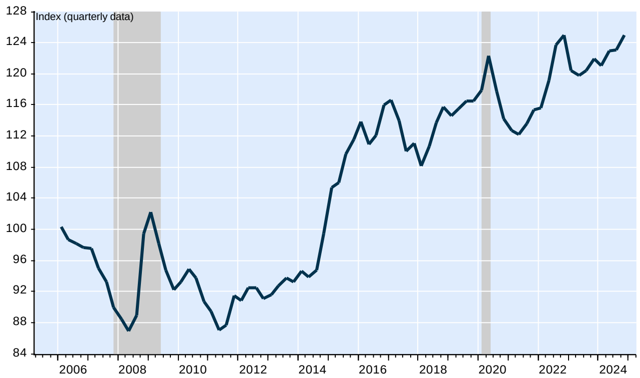
Canadian Dollar Cross Currencies

Currency		Current December 3, 2024	Forward Estimates Q4 2024	Q1 2025	Q2 2025	Q3 2025
Euro	*(EUR / CAD)*	1.48	1.48	1.48	1.46	1.46
Japanese Yen	*(CAD / JPY)*	106	105	100	100	101
Australian Dollar	*(AUD / CAD)*	0.91	0.92	0.91	0.92	0.92
Pound Sterling	*(GBP / CAD)*	1.78	1.79	1.80	1.79	1.78
Chinese Yuan	*(CAD / CNY)*	5.18	5.18	5.03	5.12	5.18
Mexican Peso	*(CAD / MXN)*	14.4	14.7	15.2	16.2	15.8

USD: Post-election surge

The outcome of the U.S. election, which saw President Trump win the presidency and the Republican Party take control of both the Senate and the House, has been a significant boost for the U.S. dollar. The trade-weighted broad-dollar index, which measures the greenback's value against a basket of 24 currencies, stand near a record high so far in Q4 (chart).

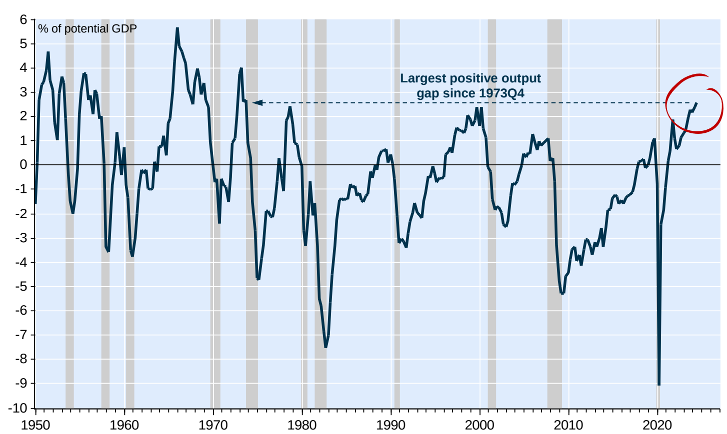
USD: The greenback near a record high
Trade-weighted broad USD index (24 currencies)



NBC Economics and Strategy (Federal Reserve data via Refinitiv)

The "red wave" and the promise of reduced regulation and tax cuts have driven investors to increase their demand for U.S. financial assets, despite concerns over a potentially protectionist agenda. As long as U.S. economic growth continues to outpace the rest of the world, the USD is likely to remain strong, supported by a divergence in monetary policy. Notably, with GDP expanding at an annualized rate of 3% in Q3, the U.S. economy is estimated to be in excess demand territory to the greatest extent since 1973 (chart).

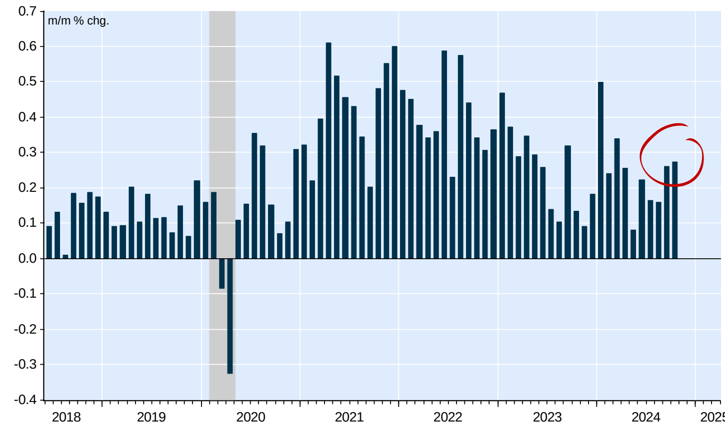
U.S.: The economy operating far above its potential
Output gap (% gap between GDP and potential GDP)



NBC Economics and Strategy (data via Bloomberg and Fred St. Louis)

A positive output gap of this magnitude typically indicates persistent or increasing inflation, and that's precisely what we are observing. The Federal Reserve's preferred inflation measure, the PCE Core Deflator, increased by more than 0.2% for the second consecutive month in October (chart).

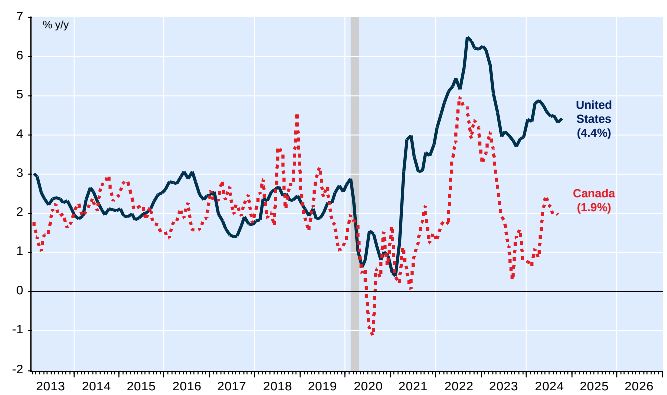
U.S.: Underlying inflation gathering momentum
Core personal consumption expenditures deflator (PCE)



NBC Economics and Strategy (data via Refinitiv)

Further evidence of persistent inflation is visible in the CPI for core services excluding housing, where prices continue to rise at an annual rate exceeding 4%. This stands in stark contrast to Canada, where economic growth remains lackluster, and the output gap is negative (chart).

Canada-US: Widely divergent domestic inflationary pressures
CPI services excluding food, energy and housing



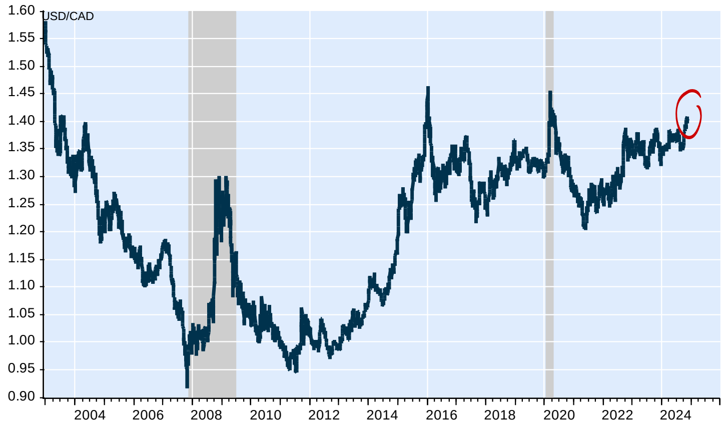
NBC Economics and Strategy (data from Statistics Canada and Bloomberg)

A more resilient inflationary environment, coupled with the prospect of additional fiscal stimulus from the incoming President, presents a challenge for the Federal Reserve. With the economy already operating above its potential and the unemployment rate at 4%, these factors are likely to complicate the Fed's guidance and slow the pace at which U.S. monetary policy can transition to a neutral stance. In this context, we continue to anticipate upside potential for the U.S. dollar through the first half of 2025.

CAD: Tariff threats weigh on the Loonie

The Canadian dollar has faced persistent challenges in Q4, declining 3.6% against the U.S. dollar over the past two months. The latest wave of weakness, which has driven USD/CAD above 1.40 for the first time since 2020, has been further intensified by U.S. political developments.

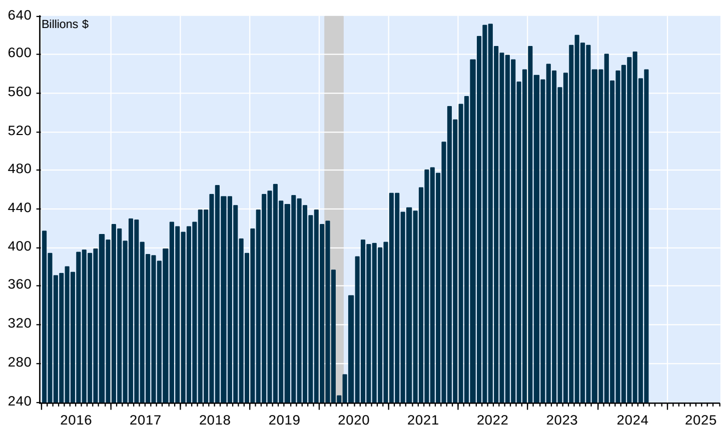
CAD: The Loonie breaches 1.40
CAD per USD



NBC Economics and Strategy (data via Refinitiv)

On November 25, President-elect Donald Trump shocked the political establishment by threatening to impose a 25% tariff on imported goods from Canada and Mexico, the United States' two trading partners under the USMCA free trade agreement. It is worth noting that Canadian annual goods exports to the U.S. currently total approximately $600 billion (just under 20% of Canada's GDP), a significant increase from $400 billion in 2016 – chart.

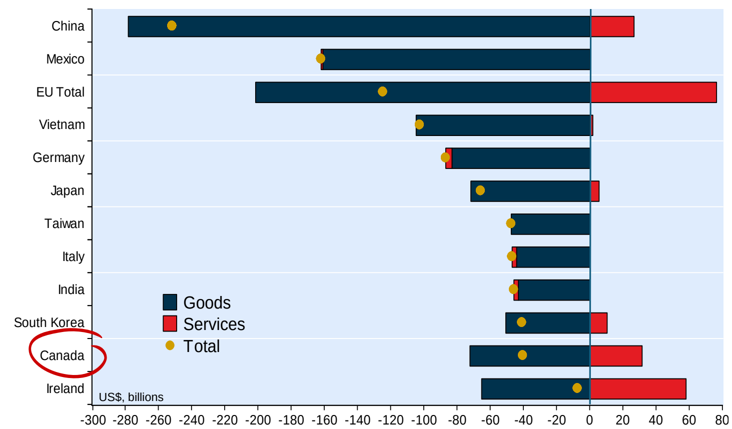
Canada: Exports to the US are a big deal
Goods exports to the U.S.



NBC Economics and Strategy (data via Bloomberg)

Imposing such a steep tariff on this volume of trade would place immense strain on our already fragile economy. The good news is that with some flexibility by both sides, it seems unlikely President Trump will impose a 25% tariff on Canadian imports. For one, such a move would likely provoke significant political backlash from Republican- and Democratic-led states, businesses, and members of both parties in Congress. It would also almost certainly lead to a protracted legal battle over whether the president has the authority to impose tariffs unilaterally on all imports without congressional approval. Further, imposing such sweeping tariffs would risk damaging U.S. economic activity via financial markets disruption and higher inflation. In fact, using the threat of mass tariffs as leverage is a more effective strategy for advancing Mr. Trump's geopolitical goals without jeopardizing the economy (although targeted actions against specific sectors are expected to remain part of his approach). The bad news is that if the threat of mass tariffs lingers over the long term, it could undermine Canada's reliability as a destination for companies seeking guaranteed access to the U.S. market. Additionally, Canada's close economic and political ties to the U.S. mean we cannot afford to diverge too far from its regulatory, tariff, defence, or fiscal policies. While Washington may express concern over a trade deficit of just over USD 70 billion in goods with Canada, it's important to acknowledge that the U.S. enjoys a surplus of over USD 30 billion in services. Overall, the U.S. trade deficit with Canada remains relatively modest at approximately USD 40 billion (chart).

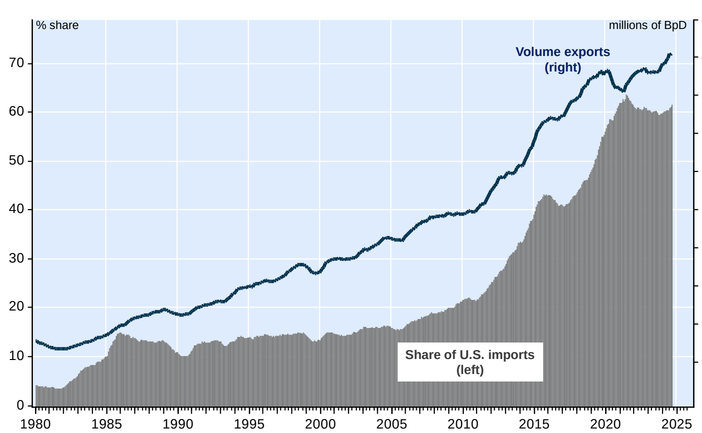
Canada: Trade surplus is modest when accounting for services
Trade deficit with the United States in 2023, balance of payment basis, by order of magnitude



NBF Economics and Strategy (data via the Census Bureau)

Considering that the majority of Canada's trade surplus with the U.S. comes from energy commodities, the prospect of imposing blanket tariffs on Canadian imports appears highly improbable. Targeting Canadian energy would harm the U.S. economy by increasing costs for refineries, squeezing their profit margins, and driving up prices for refined products. It's essential to note that Canada supplies 100% of U.S. natural gas imports and over 60% of its crude oil imports (chart).

Canada: A vital energy partner to the U.S.
Crude oil imports from Canada: Volume and share of total US imports*



* Monthly data shown as 12-month MA
BNC Économie et Stratégie (data from EIA)

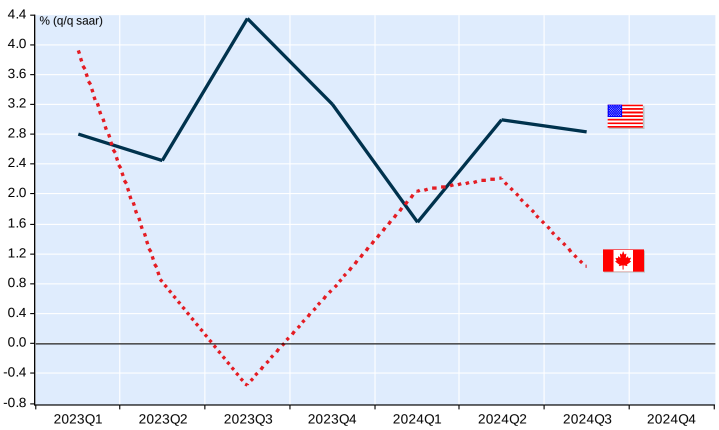
The Midwest (PADD 2), reliance on Canadian oil effectively reaches 100% due to the lack of substitutes for heavy sour crude. Any increase in refinery feedstock costs would cascade through the economy, raising the prices of key consumer goods like gasoline, diesel, and jet fuel.[1] This would not only be inflationary but also run counter to the policy priorities of the Trump administration. It is also crucial for investors to recognize that Mr. Trump's tariff threats are part of a broader economic security agenda. This agenda encompasses stricter border controls, energy security, protectionist trade measures, and reindustrialization driven by tariffs and subsidies. Adapting to this

[1] PADD2 or Petroleum Administration for Defense District 2, is one of five regional hubs in the U.S. designated for managing petroleum distribution and logistics.

reality will require careful navigation of Canada's economic priorities and policies. The upside is that the sooner Canada recognizes its role within what many analysts describe as a "Fortress North America" economy—amid a world increasingly divided into spheres of influence—the sooner it can implement the economic reforms necessary to secure long-term benefits. These reforms include better aligning some of our economic policies with those of the United States and increasing defence spending, with a particular focus on border security. This is a relatively small price to pay to protect and preserve our critical access to the U.S. economy.

At this point, we remain optimistic that Canada will avoid blanket tariffs. However, the Canadian dollar is not entirely in the clear, as it continues to face downward pressure from cyclical forces. Economic growth in Q3 fell short of expectations, with real GDP increasing by a modest 1%, well below both the Bank of Canada's forecast of 1.5% and its estimated potential GDP growth rate of 2.4%.

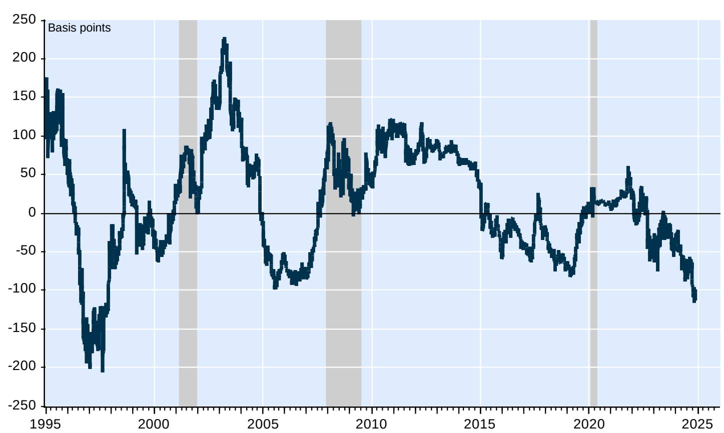
Canada: GDP growth disappoints in Q3
Real GDP: Canada vs the U.S.



NBC Economics and Strategy (data via Statistics Canada and Refinitiv)

Below-trend growth in Canada points to the likelihood of prolonged lower inflation, softer labor markets, and interest rate spreads exceeding 100 basis points relative to the U.S. persisting for some time (chart).

Canada: Negative spread in excess of 100 bps to persist
Canada-US spread differentials on 2-year Treasury yields



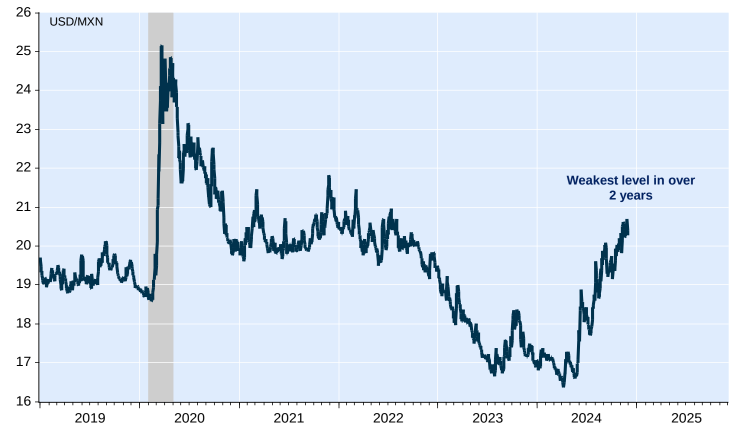
NBC Economics and Strategy (data via Refinitiv)

The continued divergence in economic performance between Canada and the U.S. indicates a likely short-term depreciation of the Canadian dollar. We maintain our USD/CAD target of 1.45 for the first half of 2025.

MXN: A Mexican standoff

The Mexican peso has had a tough year, depreciating in November to its weakest level in over 2 years. The currency has had trouble stemming losses on the back of the latest developments for its northern neighbour. Part of the sell-off can be traced to uncertainty surrounding the new administration, especially regarding the imposition of tariffs and the potential deterioration of trade relationships. Moreover, a stricter stance on the border and the possibility of mass deportations are also looming threats. At the same time, the Bank of Mexico has cut interest rates and is poised to further ease policy in upcoming meetings. On the other hand, the federal reserve may take more time in its normalization process. The narrowing of yields and political rhetoric should keep the weaker penchant going into 2025.

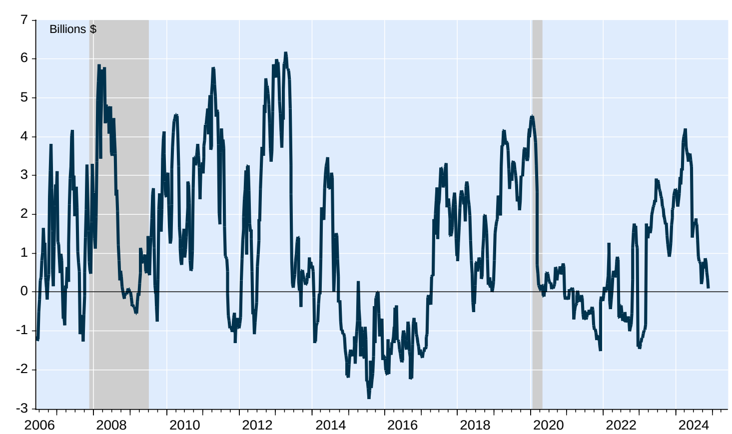
Peso: 2024 has not been kind to the Mexican currency
USD/MSN



NBF Economics and Strategy (data via Refinitiv)

It would be fair to say that the latest weakness is merely a continuation of a trend that has been occurring over the better part of this year. The unwinding of carry trades as monetary policy shifted, and the U.S. dollar made headway, was reflected as speculators vacated their long positions on the MXN. The political landscape in both Mexico and the U.S. has only continued the trend. While speculators have not gone short on the peso, it could be only a matter of time.

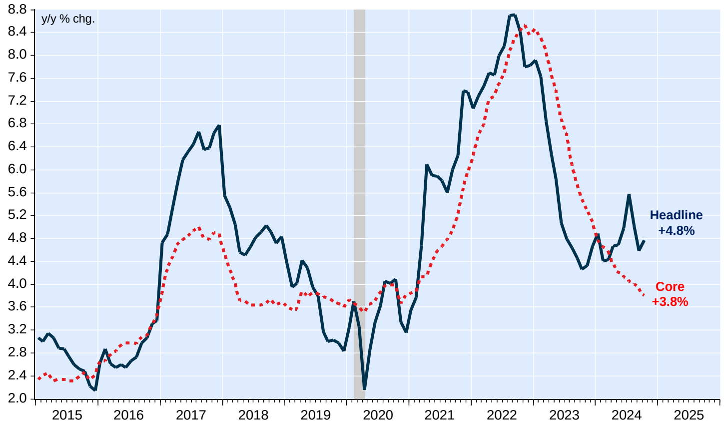
MXN: Perspective on speculative positions
Non-commercial net speculative positions in billions of USD



NBC Economics and Strategy (data via Bloomberg)

The Bank of Mexico cut interest rates at its last meeting and has indicated they will continue to ease as inflation has moderated. True, the progress on core inflation has been more substantial than headline but the latter has been influenced by food prices recently.

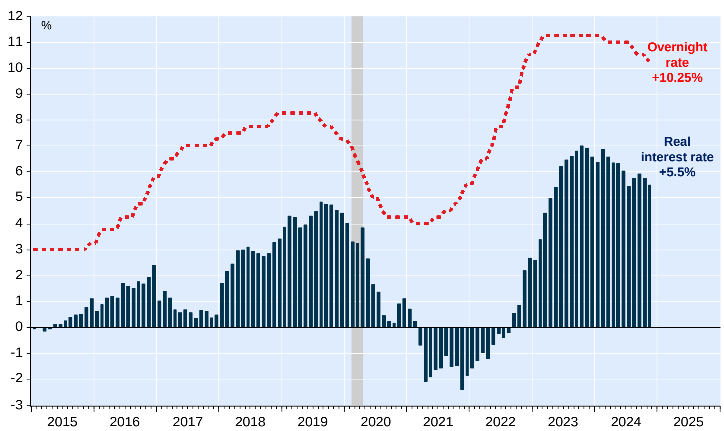
Mexico: Core inflation has moderated
Consumer price index



NBF Economics and Strategy (data via Refinitiv)

In any case, the central bank remains very restrictive on a real interest rate basis and with growth already sluggish in 2024 with nary an analyst expecting a pickup in 2025, the prognostic is for continued easing.

Mexico: Rates remain restrictive
Bank of Mexico overnight rate and real interest rate



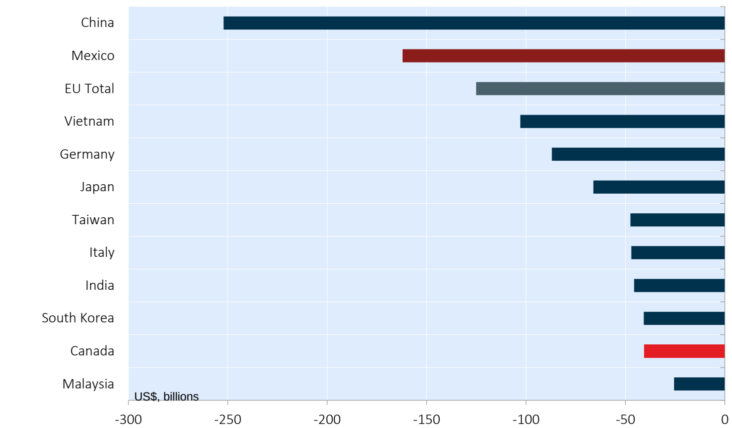
NBF Economics and Strategy (data via Refinitiv)

At the same time, the U.S. federal reserve is starting to signal that they may not be as forceful going forward as the economy is resilient and progress on inflation is starting to become less evident. The narrowing of yields could further depreciate the peso. That scenario is quite possible considering that a Trump presidency will likely see higher spending and larger deficits, which could translate into continued restrictiveness for monetary policy.

The Trump win of the U.S. presidential election was not a desirable outcome for Mexico. President-elect Trump and his team will seek to impose broad tariffs on a range of goods and countries. While Mexico initially appeared to be shielded by the USMCA until negotiations in 2026, that may no longer be the case. Changes made to the constitution, specifically regarding the judiciary, go against provisions in the trade agreement and could be used for immediate remediation.

Moreover, the president-elect has signaled that Mexico would be the recipient of 25% tariffs as soon as the inauguration process was complete. While this confrontation had been suggested to be based on national security matters, there are a slew of reasons why the incoming US administration is hawkish on its southern neighbour. Firstly, the trade balance between Mexico and the U.S. is the second biggest out of all trading partners.

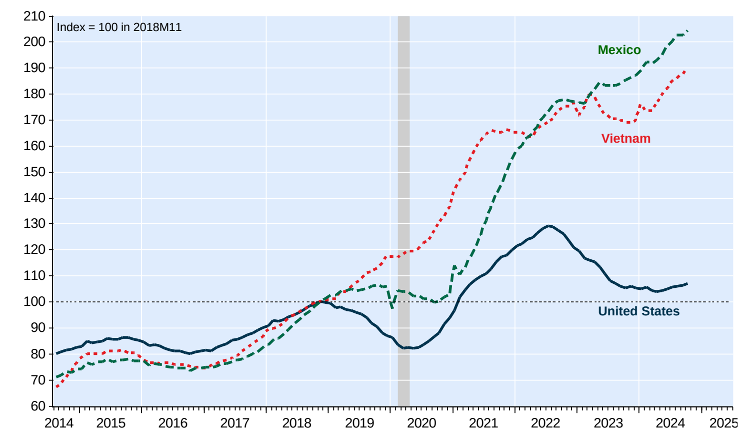
Mexico: In Washington's crosshairs
Trade deficit (goods + services) with the United States in 2023, balance of payment basis, by order of magnitude



NBC Economics and Strategy (data via the Census Bureau)

Some could say that Mexico produces a sizeable amount of goods for American consumers (especially autos), and while that is true, there are growing concerns that the country may be used to reroute Chinese exports. Looking at Chinese trade data, that concern may be justified. Although merchandise trade exports from China to the U.S. are below trend, they have continued to rise for both Mexico and Vietnam at a strong pace.

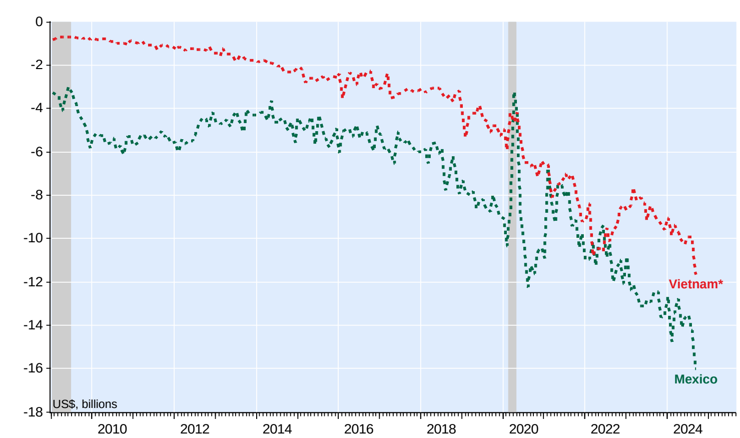
Mexico: Are Chinese exports to the United States being rerouted?
China's merchandise exports, selected countries



NBC Economics and Strategy (data via Refinitiv)

Meanwhile, the trade deficit between those countries and the U.S. have reached record levels.

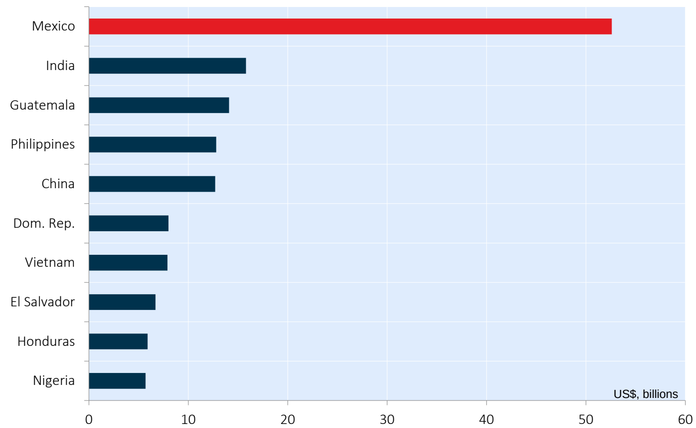
Mexico: Are Chinese exports to the United States being rerouted?
Trade balance with the United States, census basis



*Seasonally adjusted by BNC
NBC Economics and Strategy (data via Refinitiv)

Granting that trade is a pressing issue, any incoming administration in the U.S. was likely to have a harder stance on border issues. The current scenario under Trump will surely be the most severe. A crackdown on illegal immigrants/workers could impact remittances which account for substantial currency flows between the pair. Moreover, mass deportations to Mexico could create a border/political crisis and be used in negotiations.

Mexico: In Washington's crosshairs
Top destinations for remittances coming from the United States, 2021



NBC Economics and Strategy (data via the Migration Policy Institute)

Overall, we remain pessimistic about the peso. The currency could experience a further bout of weakness as the new administration starts enacting its agenda. The narrowing of monetary policy between the U.S. and Mexico will also weigh. Given the fluidity of the situation, there will likely be considerable volatility for the next few months with the possibility of some stabilization in the second half of 2025.

Regional Overview

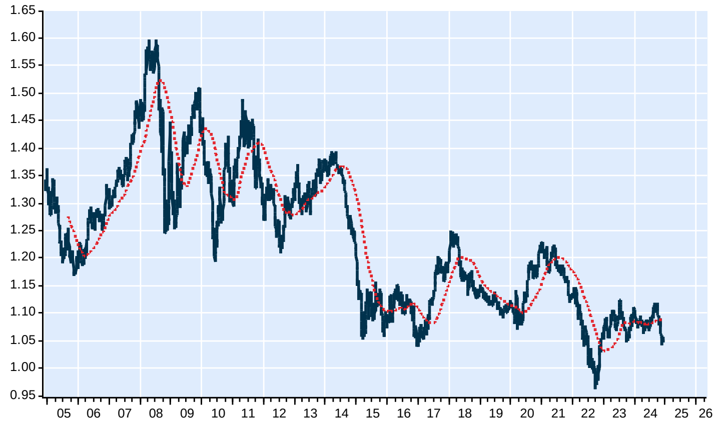
Region	Currency	$		Current USD FX	1M Prior USD FX	% Change 1-Month Performance	Current 2Y Yield	Relative to UST 2Y Spread	Current Policy Rate	Upcoming Next MP Meeting
Canada	**Canadian Dollar**	**CAD**	***(USD/CAD)***	**1.41**	**1.39**	**1.20%**	**3.07**	**-111.1**	**3.75**	**2024-12-11**
United States	*United States Dollar*	*USD*	*-*	*-*	*-*		*4.18*	*-*	*4.75*	*2024-12-18*
Eurozone	Euro	EUR	*(EUR/USD)*	1.05	1.09	-3.39%	1.94	-224.1	3.25	2024-12-12
Japan	Japanese Yen	JPY	*(USD/JPY)*	150	152	-1.66%	0.62	-356.4	0.25	2024-12-19
Australia	Australian Dollar	AUD	*(AUD/USD)*	0.65	0.66	-1.50%	3.96	-21.8	4.35	2024-12-09
United Kingdom	Pound Sterling	GBP	*(GBP/USD)*	1.27	1.30	-2.19%	4.23	4.3	4.75	2024-12-19
China	Chinese Yuan	CNY	*(USD/CNY)*	7.29	7.10	2.60%	1.34	-284.4	3.10	2024-12-19
Mexico	Mexican Peso	MXN	*(USD/MXN)*	20.3	20.1	1.04%	9.69	551.2	10.25	2024-12-19

Country Central Bank		United States Federal Reserve			Canada Bank of Canada			Eurozone European Central Bank	
Current Effective Rate	12/4/2024	4.58	▲ current level	12/4/2024	3.78	▲ current level	12/4/2024	3.16	▲ current level
Next meeting	12/18/2024	4.39	-0.188	12/11/2024	3.402	-0.378	12/12/2024	2.895	-0.269
Subsequent meeting	01/29/2025	4.33	-0.252	01/29/2025	3.171	-0.609	01/30/2025	2.579	-0.585
Subsequent meeting	03/19/2025	4.17	-0.410	03/12/2025	3.074	-0.706	03/06/2025	2.253	-0.911
Subsequent meeting	05/07/2025	4.07	-0.509	04/16/2025	2.952	-0.828	04/17/2025	2.004	-1.160
Subsequent meeting	06/18/2025	3.95	-0.630	06/04/2025	2.908	-0.872	06/05/2025	1.795	-1.369
Subsequent meeting	07/30/2025	3.89	-0.695	07/30/2025	2.824	-0.956	07/24/2025	1.701	-1.463

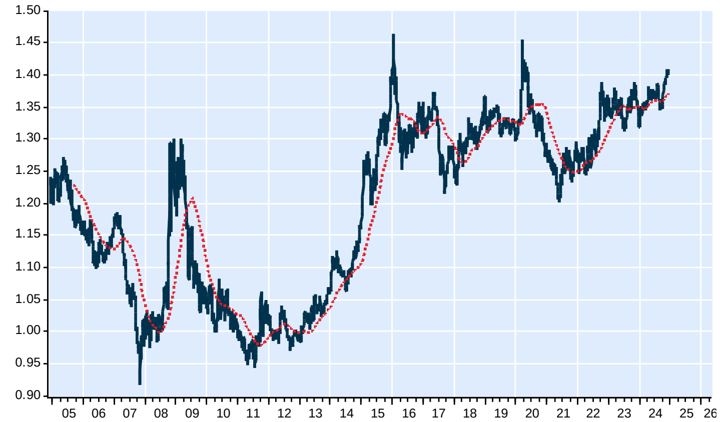
Country Central Bank		Japan Bank of Japan			United Kingdom Bank of England	
Current Effective Rate	12/4/2024	0.227	▲ current level	12/4/2024	4.70	▲ current level
Next meeting	12/19/2024	0.309	0.082	12/19/2024	4.677	-0.023
Subsequent meeting	01/24/2025	0.421	0.194	02/06/2025	4.480	-0.220
Subsequent meeting	03/19/2025	0.466	0.239	03/20/2025	4.392	-0.308
Subsequent meeting	05/01/2025	0.518	0.291	05/08/2025	4.226	-0.474
Subsequent meeting	06/17/2025	0.601	0.374	06/19/2025	4.140	-0.560
Subsequent meeting	07/31/2025	0.632	0.405	08/07/2025	4.009	-0.691

Appendix: Spot rates with their 200d MA

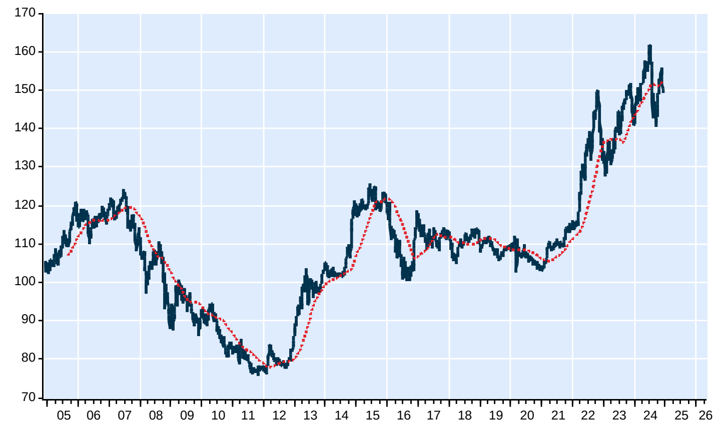
EUR / USD



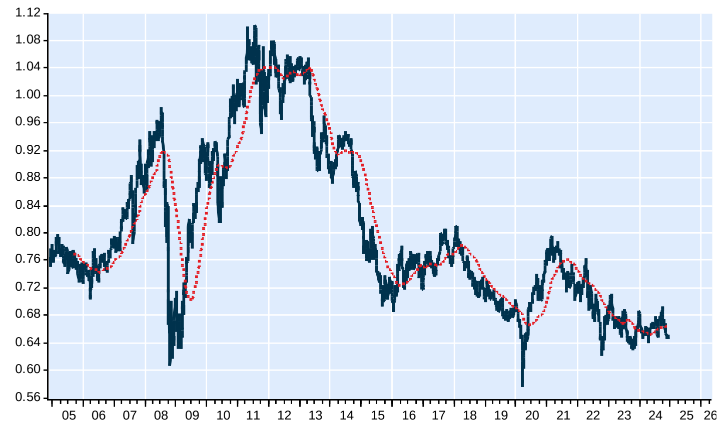
USD / CAD



USD / JPY

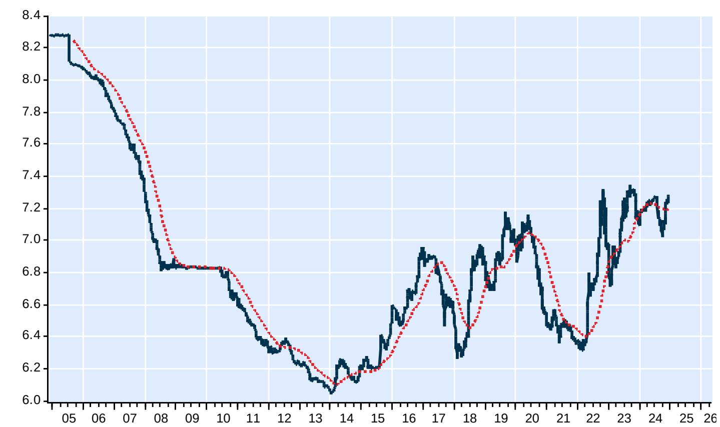


AUD / USD



GBP / USD

USD / CNY



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