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Expert Commentary

Benjamin Tal, Deputy Chief Economist, at CIBC Capital Markets on Canadian economy

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Benjamin Tal
Deputy Chief Economist
CIBC Capital Markets
Canada

Some economists say with the overnight rate already at 0.5 %, further cuts would not do that much to boost the economy while Canada's exporters have yet to see the full benefits of the weak currency. Do you expect any cuts by the BoC in the foreseeable future?

I believe the statement is absolutely right, because the ability of the Bank of Canada to influence activity is very limited. As you mentioned, the interest rates are extremely low already, whilst it is not clear to what extend another cut will stimulate activity in terms of credit, what we can see in Western Canada, where most of the damage is due to the oil price volatility. Hence, I believe that there is a growing consensus that the BoC is limited in its ability to influence the economy, which is why even the bank will admit that the more reasonable course of action is actually fiscal policy as opposed to monetary policy.

The Bank of Canada suggested that they are not going to cut anytime soon, but if things get worse they will cut again. Therefore, the likelihood of a cut is not quite high, but it is also not zero. The key reason why they are cutting or might even cut again is the US Dollar – it is not really credit or what is happening in Alberta, but rather to lower the value of the Dollar. However, the BoC suggested that the Loonie decelerated so quickly, and we have to wait for the positive effects now. Usually, the impact of the Canadian Dollar is more visible with a lag, which is why everybody is expecting a movement in the second half of 2016 and 2017.

I can name two reasons why the CAD is unable to lift the economy the way it used to. One is that they lost 10% capacity when the Dollar was elevated at above parity, and as for now there is not enough capacity to take the advantage of a lower Loonie. Second, a lot of the things that Canada sells today goes directly to the US manufacturing sector, but not to the consumer. Given that the US manufacturing sector is lagging due to the strong Greenback, it is another reason why we cannot totally get a full advantage of the lower CAD. However, I suggest that 2017 will be a much better year for Canada and we are going to see the full impact of the Loonie.

The drop in oil and other commodity prices constitutes a significant setback for the economy and is disrupting the lives of many Canadians, whether through job losses or higher prices for imported goods.

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Nevertheless, the BoC stated that it expects a 1.5 % growth this year and 2.5 % in 2017, whilst the analysts are less sanguine in this regards. Do you consider this outlook to be rosy?

To an extent a bit – yes, I believe it is quite optimistic, but in this case the composition is more than the number. Namely, when you say Canadians are suffering – they really suffer in Alberta, but you cannot say the same about Ontario, where a lower oil price has more of a positive impact. The whole story behind the oil price is a big transfer of funds from producing countries like OPEC to consuming countries like the US and Europe. However, Canada is both a producing and a consuming oil country, which is why you can say that we have "pain and gain". The "pain" is always effecting faster than the gain, and in Canada's case, you really must look on the composition of growth as opposed to just a number.

Hence, the data might be a bit optimistic, but it is not that significant, due to the fact that it means if the market is right, then Alberta will do worse than what the Bank of Canada is expecting, but you cannot say that about the country in general. Therefore, the damage in Alberta is narrow, but very deep, and will eventually have a positive impact on Ontario and Quebec later in the year, since gasoline prices will be translated into increased spending and the Dollar will drop, which is good for the manufacturing sector in Ontario. This is something that the oil market does not really comprehend and in many ways if you look at the stock market and the correlation with the emerging markets – it is almost 1.

Therefore, in many ways the global market is treating Canada as an EM, which is not quite fair, and that is why the market overshooting on the downside. I suggest you cannot really talk about the impact of the oil prices and look at GDP on average, because at this point it is totally meaningless.

What will be the major headwinds for the Loonie in the short and long term?

One is that we can get another down leg on oil, but it is hard to predict at this point. There are talks about the $20 per barrel, which will obviously have a major negative impact on the Canadian Dollar. Another drag factor is that to what extent the market will start speculations in regards of the Bank of Canada cutting possibility, while the Fed is actually rising.

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We expect the CAD/USD to trade at the 0.75 levels by the end of this year and 0.75 in 2017

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Therefore, these two momenta clearly can lead to depreciation of the Lonnie to another few cents. However, I think that the CAD is already overshooting on the downside and we belong to the 0.75-0.80 as opposed to 70 cents. However, it will take a while to get there.

When the Bank of Canada did not cut the key lending rate, it marked a vote of confidence in the Loonie, which rose to 68.89 cents US. However, within an hour of the rate announcement, the CAD was back in the red at 68.63 cents US. What are your forecasts for the USD/CAD and GBP/CAD in the short and long term?

We expect the CAD/USD to trade at the 0.75 levels by the end of this year and 0.75 in 2017, and we see the EUR/USD trading at 1.14 and 1.16 levels for the same periods. As concerns the GBP/CAD we anticipate the pair to reach 1.56 by the end of this year and 1.57 is our forecast for 2017.

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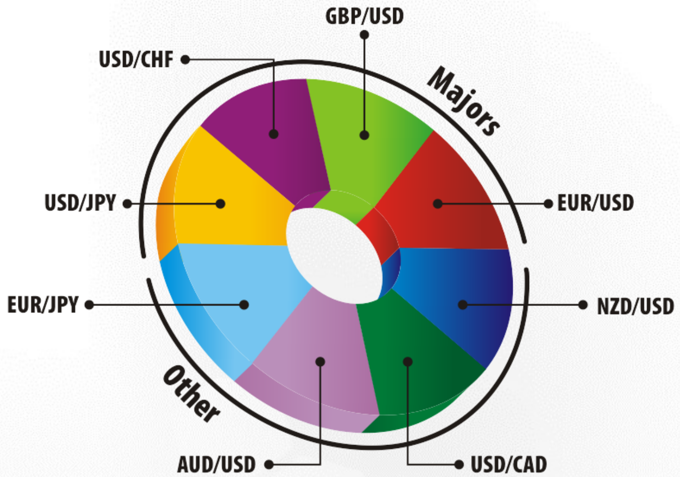

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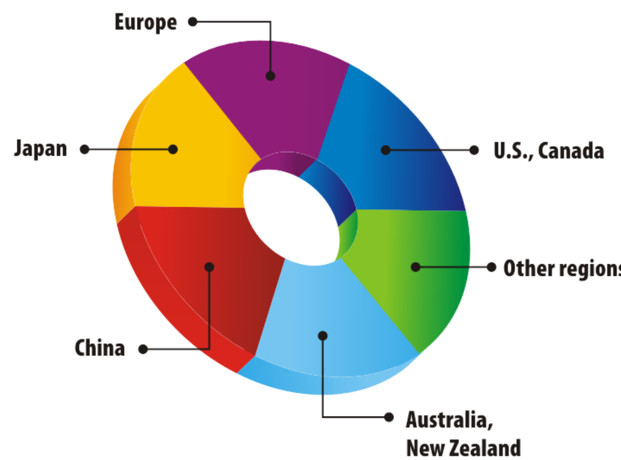

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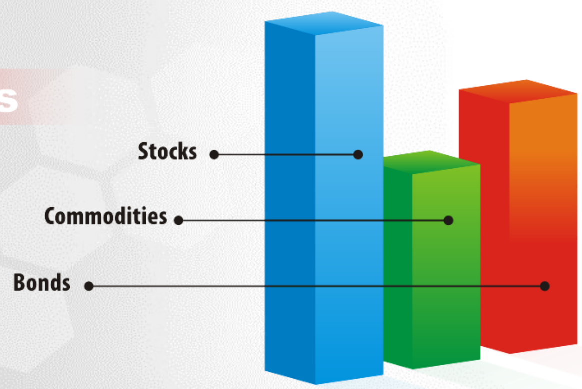

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