Financial Post – October 29, 2024

Posthaste: Canadian dollar at risk of falling to lows only seen during economic shocks

Forces are once again lining up against the loonie, warn economists

Pamela Heaven || October 29, 2024

The Canadian dollar could fall below 70 U.S. cents if the gap between Bank of Canada and Federal Reserve policy rates widens, say analysts. PHOTO BY JONATHAN HAYWARD /The Canadian Press

The Canadian dollar is at risk of falling to lows only seen during big economic shocks as forces once again line up against the currency, economists warn.

The Bank of Canada cut its interest rate by half a percentage point this month, widening the gap between it and the United States Federal Reserve, which puts pressure on the loonie.

The Fed made its own large cut in September, but the resilience of America's economy since then has led to speculation that it won't ease as much as expected, said Benjamin Reitzes, Canadian rates and macro strategist with BMO Capital Markets.

The Canadian economy, on the other hand, is showing no signs of momentum, suggesting that more rate cuts are to come.

"The BoC seems ready to do whatever it takes to reflate an economy running below its potential, even leaving the door wide open to another outsized move at the next meeting. On the other end the Fed is unlikely to repeat its 50 bp move of September," said Scotiabank analysts led by Hugo Ste-Marie in a report.

"Again we have two central banks heading in the same direction: one is walking, the other is running."

The current 125-basis-point spread between the two policy rates is the widest it's been in at least two decades, and it could widen in months to come, putting more pressure on the Canadian dollar, said Ste-Marie.

Recent cuts to immigration targets by Ottawa could cool inflation, especially in housing, and slow growth, pushing the Bank of Canada to cut rates even further, said Reitzes.

Then there is the U.S. election. The tariffs promised by Republican candidate Donald Trump and the possibility of friction with Canada's biggest trading partner would not bode well for the economy or the loonie, he said.

A disorderly election result, which can't be ruled out, would also hit the Canadian dollar as markets fled risk.

"Markets are already pricing in a meaningful policy divergence, and we wouldn't rule out a further push on that front," Reitzes said.

"Unfortunately, that puts the loonie at risk of weakening to levels only seen during large economic shocks over the past few decades."

The Canadian dollar has so far held up fairly well, trading in a range of 72 to 76 U.S. cents.

But if that range breaks Ste-Marie and his team believe the loonie could retest lows of the past two decades near 68 U.S. cents, last seen in 2016 and 2020.

"Frankly, we hope we're wrong on that call," said the Scotiabank report.

"Sure a weaker loonie would benefit exporters and provide a small boost to TSX earnings … but an even weaker currency would not help Canadian businesses to invest in machinery/equipment/IT, which are all imported and badly needed to solve weak Canadian productivity issues."