Despite the recently agreed production cuts, oil prices have dropped more than 50% year-to-date, weighing on the CAD.

The CAD is also exposed via its typical ‘risk-on’ status in a ‘Risk On-Risk Off’ world.

Given this double whammy, the CAD is likely to remain weak, in our view.

The CAD is down about 8% against the USD year-to-date, while oil prices have also dropped more than 50% year-to-date (as of 15 April 2020, source: Bloomberg). The Organization of the Petroleum Exporting Countries (OPEC) and its allied producers including Russia, a grouping known as OPEC+, agreed on 12 April 2020 to reduce output by 9.7 million barrels per day, but the production cuts, which come into effect on 1 May, will only partially offset the gaping hole in demand being created by COVID-19. Oil prices continue to struggle.

It can be hard to disentangle how much of the weakness in the CAD is oil-related or an echo of the drop in risk appetite. According to our analysis based on Bloomberg data, correlations between USD-CAD against the S&P500 Index are somewhat higher than against oil prices over the last month and last quarter, but not materially so. In other words, the CAD is slightly more fixated on risk appetite than oil prices.

G10 currencies have been dominated by ‘Risk On-Risk Off’ (RORO) dynamics, in our view. This has seen the ‘safe haven’ currencies, such as the USD and the JPY perform well. The biggest depreciation pressures have been felt amongst the traditional ‘risk-on’ plays – the AUD, NZD, and CAD. As the outlook around COVID-19 remains unclear and this inherent uncertainty feeds into a binary world where outcomes either look ‘good / risk-on’ or ‘bad / risk-off’, we would expect RORO dominance to persist for the time being.

On the monetary front, the Bank of Canada (BOC) on 15 April left its policy rate unchanged at 0.25%, but announced more asset purchase programs, including its plan to purchase up to CAD50bn of provincial bonds and up to CAD10bn of investment grade corporate bonds. These programs come in addition to previous programs such as the Bankers’ Acceptances Purchase Facility, the Provincial Money Market Purchase Program, the Commercial Paper Purchase Program, and the BOC’s plans to buy Canada Mortgage Bonds, and a minimum of CAD5bn of Government of Canada bonds per week until the economic recovery is “well underway”. Yet, with G10 policy rates stuck at zero or below for the time being and most central banks engaging in asset purchases and balance sheet expansion of some kind, it is hard for individual cyclical stories to come to the fore for any currency, in our view.

Until we see the global health emergency starting to abate, economic data stabilise, and policy measures have an effect, G10 currencies are likely to remain at the behest of the broader RORO phenomenon. As such, we expect the weakness in the CAD to persist in the RORO world, alongside low oil prices.
Disclosure appendix

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