

Highlights

By Stéfane Marion/Kyle Dahms

- The appreciation of the trade-weighted US dollar index has stalled over the past month as the impetus provided by a bearish disinversion of the yield curve has run out of steam. If you believe, as the Fed does, that a soft landing for the economy is on the horizon, this scenario would imply a weaker USD going forward. This is not our forecast. In our view, the greenback is likely to strengthen on fears of a global recession and renewed geopolitical tensions in the Middle East, which will drive safe-haven demand until the Fed is able to pivot and announce an easing of monetary policy.
- The Canadian dollar has been treading water since last July. The loonie's slide has been exacerbated by a series of weak economic reports. Market expectations have recently moved in the direction of our forecast of monetary easing. As a result, the CAD is currently facing the double whammy of a widening interest rate differential with the US and weaker commodity prices due to a slowing global economy. We expect USD/CAD to converge towards 1.42 in the coming months. We don't see much room for CAD appreciation until the second half of 2024.
- The euro experienced another month of volatility, having fallen below the 1.05 mark in October only to appreciate at the beginning of November to slightly above the 1.07 level. It would be fair to say that the current improvement is not predicated on a sizeable enhancement of the economic situation. Moreover, the central bank has almost assuredly reached the endpoint for tightening monetary policy. While the euro has edged up recently, it was underpinned by a weaker US dollar. We continue to see weakness for the European currency in the coming quarters with the potential for some improvement later in 2024.

NBF Currency Outlook

Currency		Current	Forward Estimates				PPP ⁽¹⁾
		November 3, 2023	Q4 2023	Q1 2024	Q2 2024	Q3 2024	
Canadian Dollar	<i>(USD / CAD)</i>	1.37	1.38	1.42	1.40	1.37	1.25
<i>United States Dollar</i>	<i>(CAD / USD)</i>	<i>0.73</i>	<i>0.72</i>	<i>0.70</i>	<i>0.71</i>	<i>0.73</i>	-
Euro	<i>(EUR / USD)</i>	1.07	1.04	1.03	1.05	1.07	1.45
Japanese Yen	<i>(USD / JPY)</i>	149	148	146	142	138	99
Australian Dollar	<i>(AUD / USD)</i>	0.65	0.63	0.62	0.64	0.65	0.67
Pound Sterling	<i>(GBP / USD)</i>	1.24	1.20	1.18	1.21	1.23	1.48
Chinese Yuan	<i>(USD / CNY)</i>	7.32	7.28	7.26	7.20	7.15	4.2
Mexican Peso	<i>(USD / MXN)</i>	17.4	18.7	20.0	18.9	18.5	9.7
Broad United States Dollar ⁽³⁾		122.0	125.0	127.5	124.5	122.3	-

1) PPP data from OECD, based in Local Currency per USD

2) Current Account Balance data from IMF, as a % of GDP (2020 & 2021 IMF estimates)

3) Federal Reserve Broad Index (26 currencies)

Canadian Dollar Cross Currencies

Currency		Current	Forward Estimates			
		November 3, 2023	Q4 2023	Q1 2024	Q2 2024	Q3 2024
Euro	<i>(EUR / CAD)</i>	1.47	1.44	1.46	1.47	1.47
Japanese Yen	<i>(CAD / JPY)</i>	109	107	103	101	101
Australian Dollar	<i>(AUD / CAD)</i>	0.89	0.87	0.88	0.90	0.89
Pound Sterling	<i>(GBP / CAD)</i>	1.69	1.66	1.68	1.69	1.69
Chinese Yuan	<i>(CAD / CNY)</i>	5.35	5.28	5.11	5.14	5.22
Mexican Peso	<i>(CAD / MXN)</i>	12.7	13.6	14.1	13.5	13.5

USD: Appreciation stalls

The appreciation of the trade-weighted US dollar index against a basket of 26 currencies has stalled over the past month as the impetus provided by a bearish dis-inversion of the yield curve (i.e. 10-year Treasury yields rising faster than 2-year yields) has run out of steam. Nevertheless, the greenback remains close to its 2023 high. - chart.

U.S.: Greenback appreciation has stalled

Trade-weighted USD* vs. a basket of 26 currencies vs yield curve (2s10s)

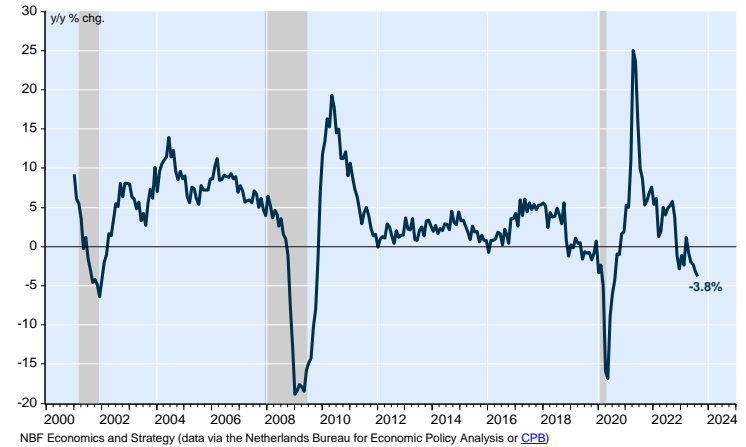


USD appreciation is currently being held in check in part by the Federal Reserve. Although the decision to leave the Fed Funds rate unchanged on the 1st of November was widely expected, there seemed to be a dovish tone from Jerome Powell. As our fixed income strategists [point out](#), "the Chairman acknowledged that the recent rise in long-term interest rates could influence future decisions to the extent that it's: (1) persistent and (2) don't simply reflect the expected path of policy rates. In his view, higher short-term policy rates were not the cause of the rise in yields in recent months. That's one of two criteria. Logically, then, if these elevated rates persist into December, the Fed probably won't want/need to follow through with the remaining 25bp hike signaled in the September dot plot (assuming other economic data are generally in line with expectations). It doesn't seem that the Chairman (and perhaps most other FOMC participants) expect to have to tighten further. Thus, the probability of a December hike being priced in by the market (around 20%) seems broadly appropriate". If you believe, as the Fed does, that a soft landing for the economy is on the horizon, this scenario would imply a weaker USD going forward. This is not our forecast. In our view, the dollar is likely to strengthen on fears of a global recession, which will drive safe-haven demand until the Fed is able to pivot and announce an easing of monetary policy.

There are signs that the global economy is slowing. Global trade flows are already contracting at an annual rate of 4%, the first time this has happened outside a recession in 20 years (chart).

World: Global trade flows are in decline

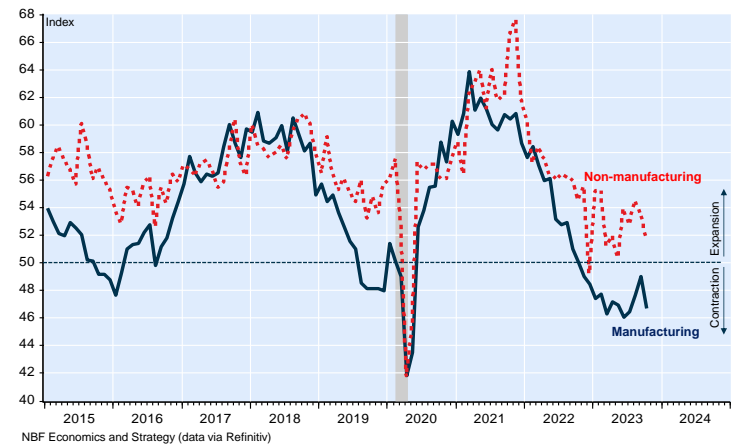
International merchandise trade. Last observation: August 2023



This dynamic does not bode well for US manufacturers. The ISM manufacturing index surprised to the downside in October, pointing to contraction for the 12th consecutive month. This comes at a time when the service sector is losing momentum (chart).

U.S.: Manufacturing sector contracts while services weakens

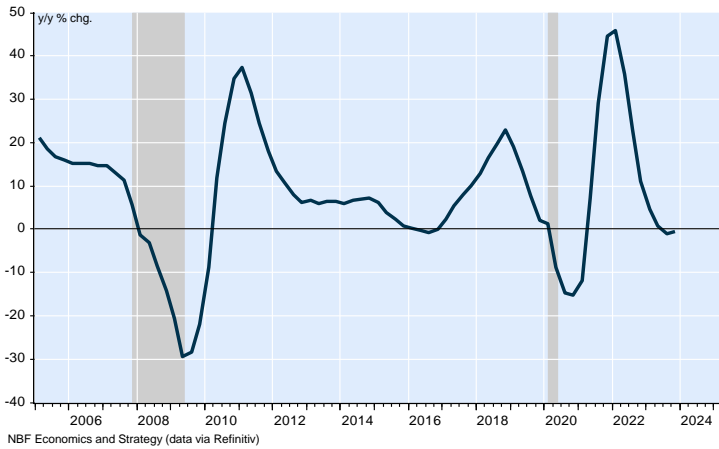
ISM Manufacturing and non-manufacturing PMIs (October)



This dynamic, combined with tighter lending standards at US commercial banks, is taking its toll on profits, which fell in Q3 for the second time in as many quarters (chart).

U.S.: Weaker growth = weaker profits

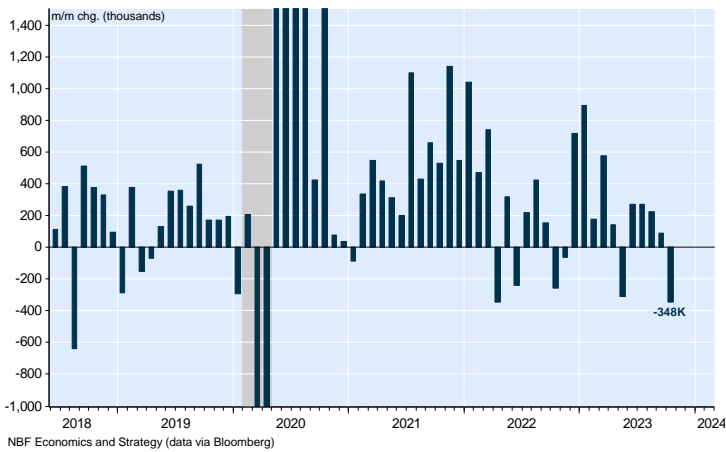
Earnings per share for the S&P 500



As companies try to protect themselves from eroding profit margins, we should expect weaker labour markets. Payrolls disappointed in October with a monthly gain of 150K jobs. While this low number was partly due to the strike that hit the auto sector this autumn, it should be noted that the BLS also reported a negative revision of 101K to the previous months' payroll data. As disappointing as the establishment survey was, it was the household survey that was more worrying. The latter showed job losses of 348,000 in October (chart).

U.S.: Household survey shows biggest job losses since the pandemic

Employment



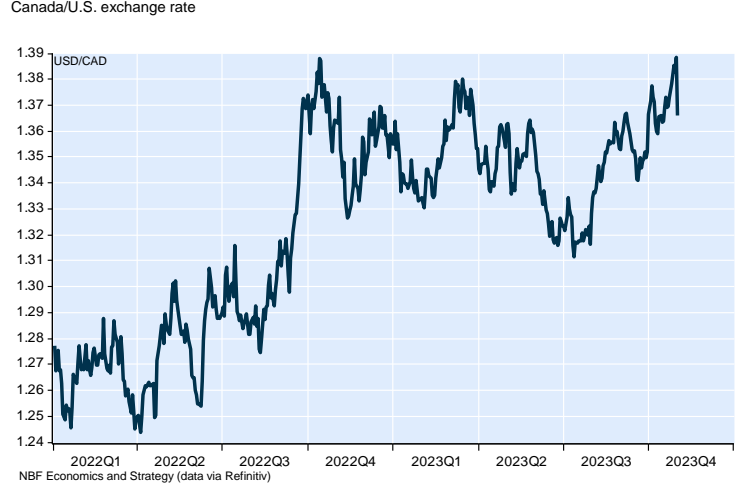
This suggests a hard rather than a soft landing for the economy. As a result, we still expect some USD appreciation until early 2024, which could be further boosted by renewed geopolitical tensions in the Middle East. As our geopolitical analyst recently [pointed out](#), the longer the Israel-Hamas conflict continues, the greater the risk of some form of confrontation between Iran and Israel. This adds a layer of uncertainty at a time when the world is already grappling with other challenges such as the ongoing war in Ukraine, great power rivalries and escalating tensions over Taiwan.

CAD: Coping with a weak economy

The Canadian dollar has been trading water since last July, rising from 1.31 to a high of 1.39 before falling sharply to below 1.37 on 3 November on the back of general USD weakness (chart).

CAD: A volatile quarter

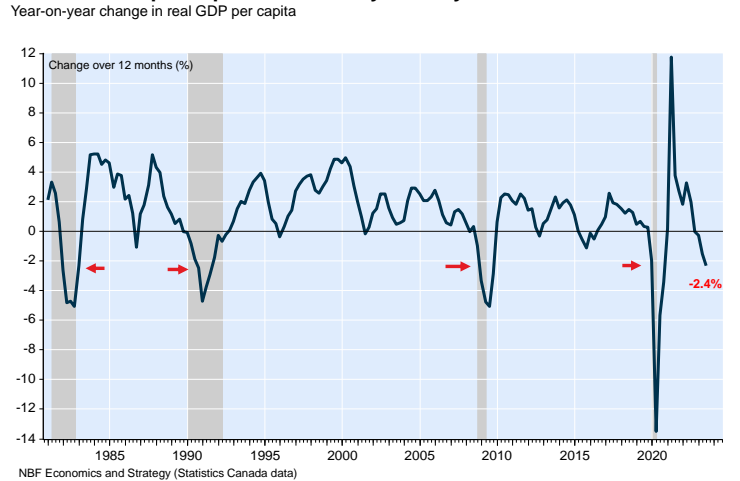
Canada/U.S. exchange rate



The loonie's slide has been exacerbated by a series of weak economic reports. GDP growth fell short of economists' consensus expectations for the fifth consecutive month in August. Including the preliminary estimate for September, the economy essentially stagnated for a second consecutive quarter (-0.1% annualized). When you factor in the demographic boom, the sluggishness of the Canadian economy becomes more apparent, as evidenced by GDP per capita, which plunged in the third quarter, posting a 2.4% year-on-year decline, the first time this has occurred outside of a recession (chart).

Canada: GDP per capita down 2.4% year-on-year

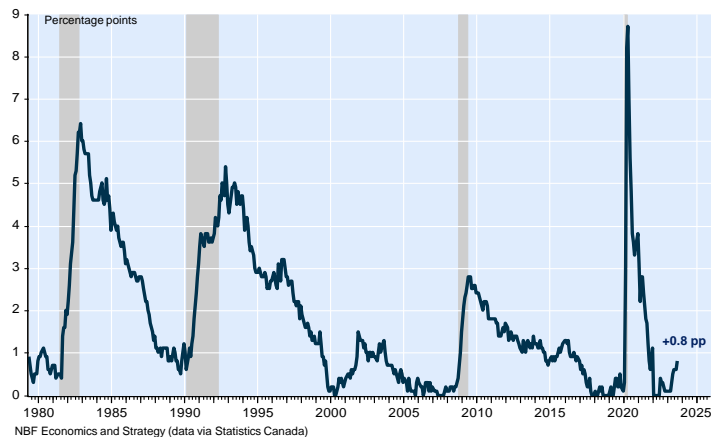
Year-on-year change in real GDP per capita



While the working-age population continues to swell, hiring simply isn't keeping pace. As a result, the unemployment rate has risen sharply since April to 5.7% in October. Since the cyclical low of 4.9%, the unemployment rate has risen by eight-tenths of a percentage point. Since the 1980s, only one increase of this magnitude has been observed outside a Canadian recession (in the early 2000s)- chart

Canada: Rapid increase in the unemployment rate

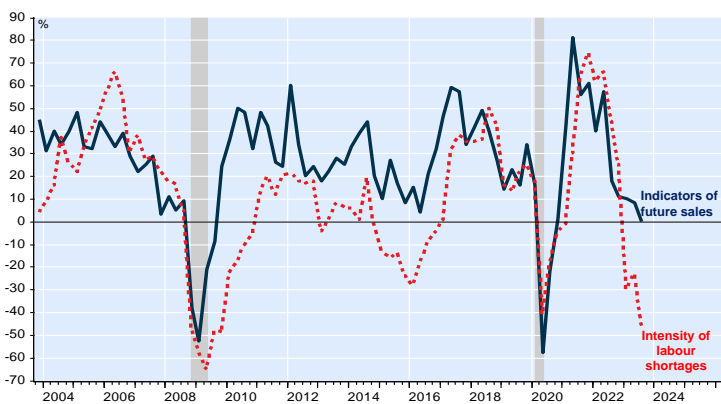
Increase in unemployment rate from trough (percentage points)



Given the downward earnings trend in Canada over the past four quarters and the gloomy sales outlook, we believe the unemployment rate will rise further in the coming months as labour shortages become a thing of the past - chart.

Canada: Firms report less labour shortages as they anticipate lower sales

Intensity of labour shortages and indicators of future sales*, balance of opinion



*Compared with 12 months ago, have your recent indicators of future sales (order books, advance bookings, sales inquiries, etc.) improved, deteriorated or remained the same?

Under these circumstances, the Bank of Canada (BoC) is managing its monetary policy with increasing caution. For the second meeting in a row, the BoC left its overnight target unchanged at 5.0% on 25 October. The governing council acknowledged "there is growing evidence that past interest rate increases are dampening economic activity and relieving price pressures". Despite the understandable reluctance to discuss rate cuts, our fixed income strategists [see](#) scope for a modest easing process to begin around the middle of next year. Market expectations have recently moved in the direction of this forecast. As a result, the CAD is currently facing the double whammy of a widening interest rate differential with the US and weaker commodity prices due to a slowing global economy (chart).

CAD: A double whammy

CA-US 2-year Treasury rate spread vs. WTI oil price



Given our very cautious view on the Canadian economy, we expect USD/CAD to converge towards 1.42 in the coming months. We don't see much room for CAD appreciation until the second half of 2024.

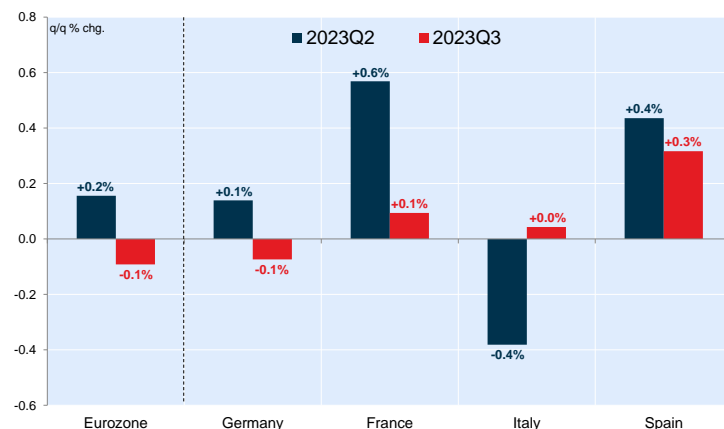
EUR: Generalized weakness

The euro experienced another month of volatility, having fallen below the 1.05 mark in October only to appreciate at the beginning of November to slightly above the 1.07 level. It would be fair to say that the current improvement is not predicated on a sizeable enhancement of the economic situation. Moreover, the central bank has almost assuredly reached the endpoint for tightening monetary policy. Lastly, geopolitical risk has risen in the last month on the back of conflict between Palestine and Israel and adds a layer of uncertainty to the energy component, an element that the European economy is particularly exposed to.

The economic situation in Europe is showing continued signs of weakness. After having edged up 0.2% in the second quarter of the year, the common area saw Q3 growth pull back by 0.1%, a below consensus result. Germany continues to be a drag on growth as the manufacturing economy struggles to find footing.

Eurozone: Economy slips back into contraction in Q3

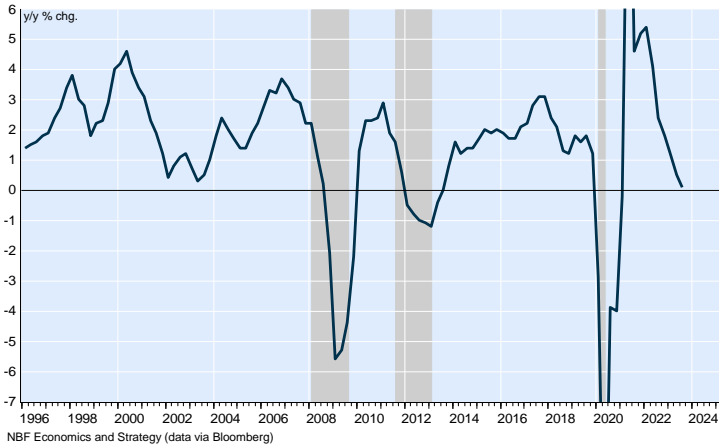
Change in real GDP



Perhaps most telling of the non-performance of the Old Continent was the annual figure which suggested that GDP had advanced a meagre 0.1% in the last twelve months.

Eurozone: Economy stalled over past 12 months

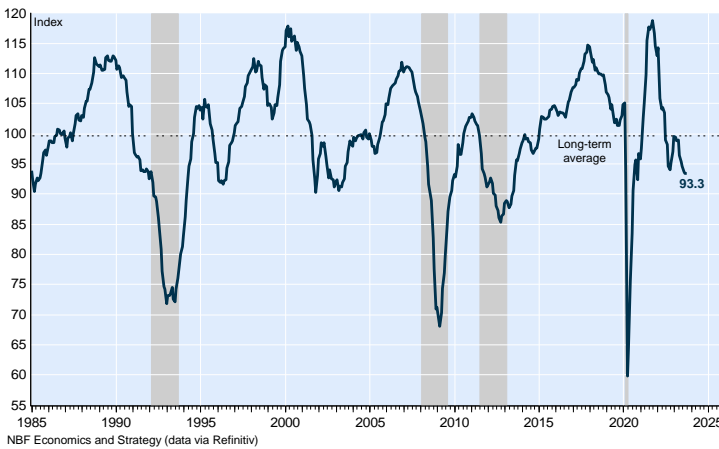
Change in real GDP



The prospective numbers for the eurozone are tilted to the downside as the effects of monetary tightening suppress economic activity while credit conditions remain restrictive. The consequences are twofold as both businesses and households absorb the impacts. Indeed, the European Commission's Economic Sentiment Indicator has contracted for the sixth month in a row in October reaching a post pandemic low in the process.

Eurozone: Economic sentiment at post-pandemic low

European Commission's Economic Sentiment index. Last observation: October 2023



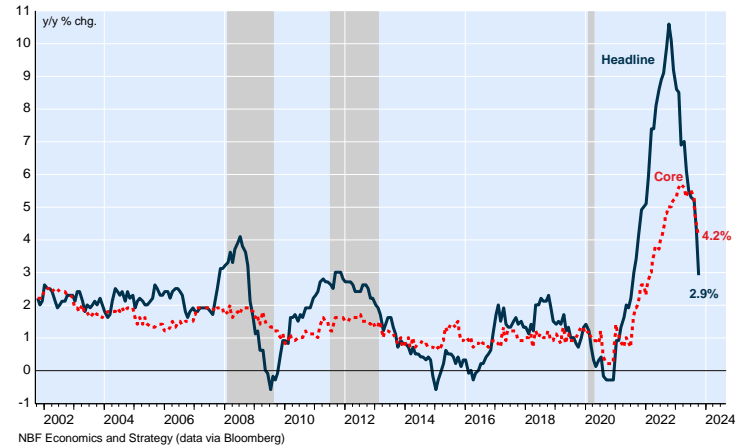
While the Employment Expectations Indicator continues to run above its long-term average, that may be challenged by recent employment data. The unemployment rate in the common-currency area rose one tick in September (to 6.5%) from the recent record low, surprising forecasters. This is a first sign of what will likely be a softening labour market. Combined with the growth picture, we continue to hold the view that Europe could slip into recession by the end of this year.

The aforesaid data can be added to the European Central Bank's quiver of reasons to maintain rates at their current level. At the very least it helped them break a streak of 10 consecutive

increases. Although the central bank continues to be worried about price pressures, "most measures of underlying inflation ha[d] continued to ease". The Governing Council also expected that maintaining rates at the current level for a sufficient amount of time would lead to achieving its inflation target. Perhaps hoping to avoid the pricing of easing, ECB President Christine Lagarde hammered that rate cuts were "totally premature" at this time and that further tightening was not off the table. That remains tenuous in light of the recent growth and employment figures. Additionally, the October flash estimate for the Consumer Price Index showed that prices rose 2.9% y/y in October, down from 4.3% y/y in the prior month and two ticks below consensus expectations. Core CPI for its part fell two ticks to 4.2% y/y. Although rising geopolitical risk adds a layer of uncertainty for the energy market (read: higher prices), it remains relatively contained for the time being.

Eurozone: Energy prices drive headline inflation lower, core also improved

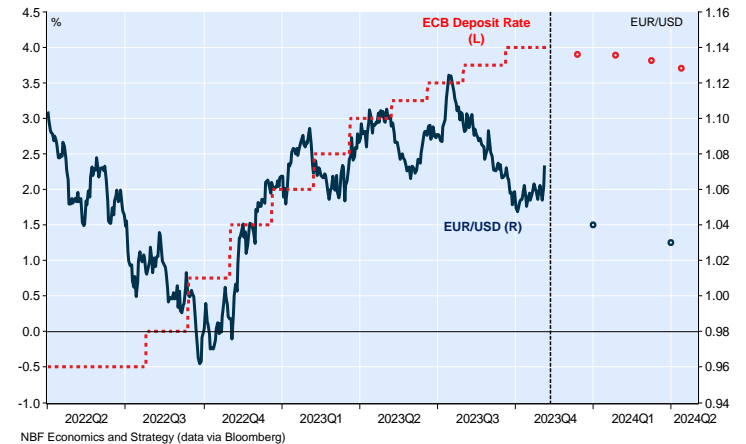
Harmonized Index of Consumer Prices



All told, we think the ECB could be forced to ease more than current market anticipations.

Europe: Currency set to weaken on slow economy and rate cuts

EUR/USD and ECB Deposit Rate (Forecasts: WIRP & NBF)



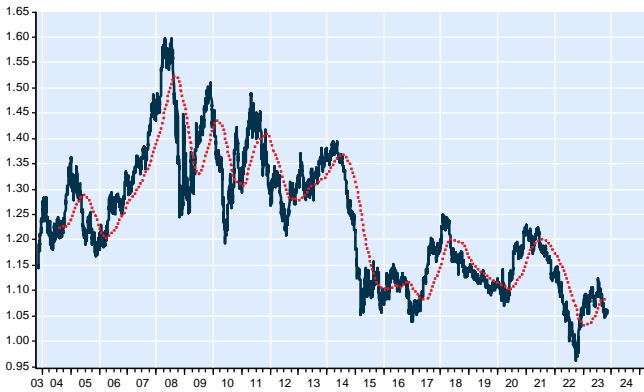
While the euro has seen some appreciation recently, it was reflective of a weaker US dollar. We continue to see weakness for the European currency in the coming quarters with the potential for some improvement later in 2024.

Regional Overview

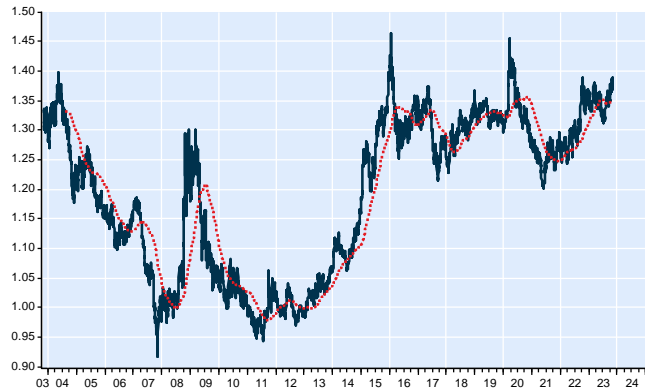
Region	\$	USD FX	1M Prior	Current	Relative to UST	Current	Upcoming	
			USD FX	2Y Yield	2Y Spread	Policy Rate	Next MP Meeting	
Canada	CAD	(USD/CAD)	1.37	1.37	4.39	-45.6	5.00	2023-12-06
United States	USD	-	-	-	4.84	-	5.50	2023-12-13
Eurozone	EUR	(EUR/USD)	1.07	1.06	2.96	-188.2	4.50	2023-12-14
Japan	JPY	(USD/JPY)	149	149	0.15	-469.5	-0.10	2023-12-19
Australia	AUD	(AUD/USD)	0.65	0.64	4.35	-49.3	4.10	2023-11-06
United Kingdom	GBP	(GBP/USD)	1.24	1.22	4.68	-16.6	5.25	2023-12-14
China	CNY	(USD/CNY)	7.28	7.30	2.37	-247.3	1.88	2023-12-14
Mexico	MXN	(USD/MXN)	17.5	18.2	10.74	590.0	11.25	2023-11-09

Appendix: Spot rates with their 200d MA

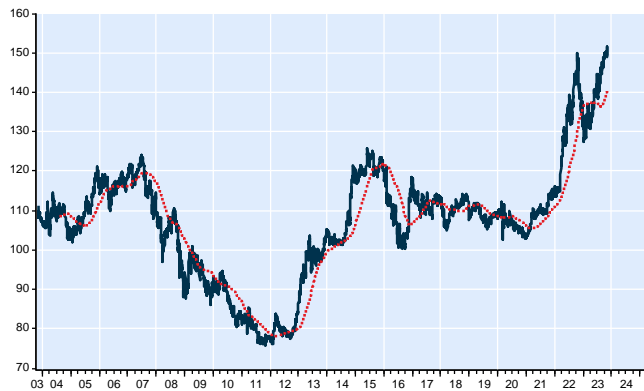
EUR / USD



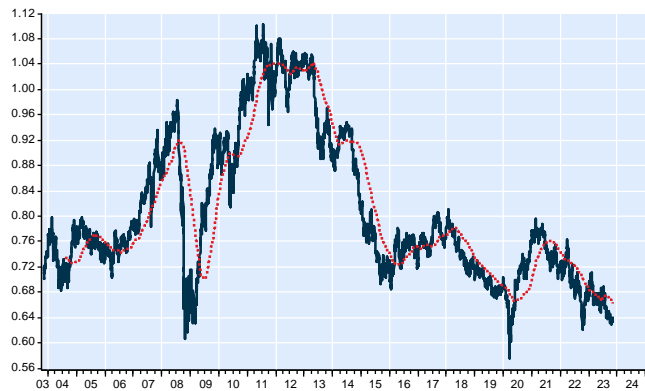
USD / CAD



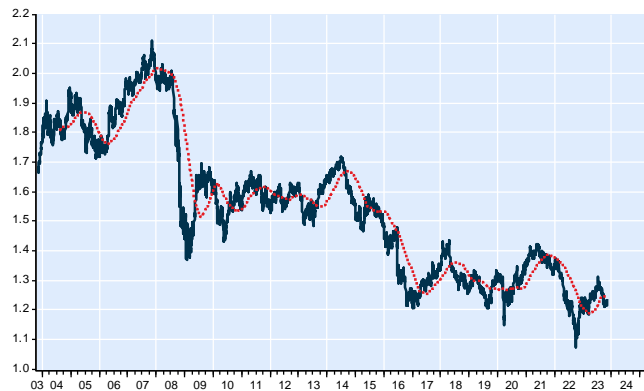
USD / JPY



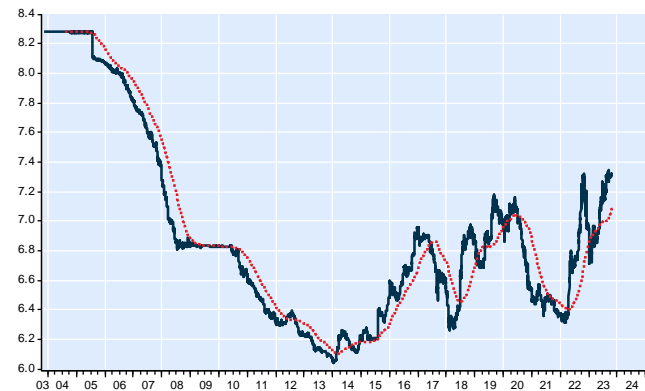
AUD / USD



GBP / USD



USD / CNY



Economics and Strategy

Montreal Office

514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Alexandra Ducharme

Economist
alexandra.ducharme@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Daren King, CFA

Economist
daren.king@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Toronto Office

416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.