Could the Loonie Fall to $0.50 Versus the Dollar?

Description

The fall in the loonie's value has been precipitous and largely unexpected. After trading in parity with the dollar from 2010 to 2013, the loonie has been in a gradual free fall since 2014, now trading at only $0.77 to the U.S. dollar. Last week, it hit a decade low of only $0.74 per U.S. dollar.

What are the major causes of this? Should investors fear yet another steep drop in the loonie's value?

Oil, oil, oil

Since oil prices began a roughly 50% decline, the loonie has dropped over 20%. While there is always a confluence of factors that influence a currency's fluctuations, there is no denying that oil is the chief influencer. The stocks of oil producers such as **Encana Corporation** and **Canadian Oil Sands Ltd** are down over 50% since last year.

"Longer term [the loonie] is going to be very much tied to oil prices—how quickly, or at the moment it seems how unquickly—oil will rebound," said a senior economist at CIBC.

The biggest factor that has depressed oil prices doesn't seem to be abating any time soon. Recently, OPEC double-downed on its strategy of keeping production high to squeeze out high-cost producers. The cartel is convinced that its policy of unconstrained oil output has helped boost demand, curb production from high-cost operations such as U.S. shale operations, and deter investments in big oil projects.

Rising supplies from Iraq, which have stemmed from the possible lifting of western sanctions on Iran's oil exports, could also replace any diminishing supplies from U.S.-based producers: "OPEC has put to one side for the moment the fact that it is producing considerably in excess of its production target," said Lloyd's List Intelligence.

While these moves may provide higher long-term oil prices, the next 12-24 months should see continued oversupply: "The longer oil prices stay fairly depressed, the greater length of time the Canadian dollar would stay weak as well," said a senior economist at CIBC.

How will this affect the economy?

The latest statistics show that Canada's trade deficit increased to $2.5 billion in August as exports fell, primarily due to the sharp drop in oil prices. This is roughly twice the deficit that most analysts expected. Exports in the energy sector fell 14.7% to only $6.3 billion.

And while a cheaper currency should boost exports, that's simply not happening. The latest data shows that consumer prices are rising, pressuring spending on a variety of goods. This could have a negative effect on consumer-oriented companies such as **Metro, Inc.** (TSX:MRU) and **Loblaw Companies Limited** (TSX:L).

Higher prices sent consumer goods exports down 8.0% to $5.9 billion on lower volumes. It's a double-whammy given the cost of imports rose 2.6% in August despite steady volumes.

Until all of this corrects, it looks as if a cheaper loonie is having a bigger negative effect on the economy than most anticipated.

What's next?

It doesn't appear as if the oil glut will disappear any time soon. With that, lower oil prices will be here to stay. Given that this is the biggest pressure on the loonie's valuation, investors shouldn't rule out another drop in the currency. As mentioned, this could be yet another headwind to many of the aspects of the Canadian economy.

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2. Investing

TICKERS GLOBAL

1. TSX:L (Loblaw Companies Limited)
2. TSX:MRU (Metro Inc.)

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