Why a Weak Loonie Is Great News for Canada

Description

It was only last week that the loonie hit a decade low of $0.74 against the U.S. dollar. While this may be alarming for some investors, it is a positive for a Canadian economy struggling under the burden of weak oil prices, which tipped Canada into recession at the end of the second quarter.

Now what?

The fortunes of the loonie are very much tied to the outlook for crude because the energy patch is responsible for generating over 6% of Canada's GDP and 14% of the total value of its exports. The West Texas Intermediate—the benchmark North American oil price—has plunged by over 50% since the start of 2015, dragging down the value of the loonie.

This is bad news for consumers and retailers such as **Empire Company Ltd.** (TSX:EMP.A), **Loblaw Companies Ltd.** (TSX:L), and **Metro Inc.** (TSX:MRU), as the prices of consumer goods, particularly those that are imported, are on the rise.

Nonetheless, a weak loonie will be quite beneficial for the Canadian economy.

You see, a weak loonie makes Canadian exports more attractive, and this will help to boost output from Canada's manufacturing sector, picking up some of the economic slack created by declining output from the energy patch.

When we look at the latest export numbers from August, on face value, there is no indication of this occurring. The total value of exports for August dropped by 3.5% month over month and 1.6% year over year to have a value of just under $44 billion.

However, when drilling a little deeper into these numbers, it is possible to see that the key reason for this decline is sharply weak oil prices, with energy exports losing 14% in value month over month and 40% year over year. The value of exports from Canada's manufacturing sector, while remaining flat month over month, have risen by an impressive 16% year over year.

This indicates that a weak loonie is indeed boosting exports of manufactured goods, including electronics and motor vehicles. It has also been a boon for the agricultural sector, with agricultural exports for August growing in value by 2% month over month and 3.5% year over year.

More importantly, I expect this trend to continue. The low loonie will drive an uptick in exports for the manufacturing and agricultural sectors in the foreseeable future.

A weak loonie is also beneficial for struggling miners, such as coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), that have a considerable portion of their cost base located in Canada. In Teck's case, about 50% of its consolidated operating costs are in Canadian dollars, with 40% in U.S. dollars, and the remainder in other currencies.

Potash miners **Agrium Inc.** (TSX:AGU)(NYSE:AGU) and **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) are also set to benefit. This is because, like Teck, a significant portion of their cost base is located in Canada, but potash sales are in U.S. dollars, so any decrease in the value of the loonie will boost their margins.

So what?

It is difficult to predict the outlook for the loonie with any certainty, but what is clear is that for as long as oil prices remain weak, so too will the loonie. While this is perceived to be a negative by some analysts, it will be a positive catalyst for Canada's manufacturing, agricultural, and forestry sectors. This will act as a tailwind for the Canadian economy, helping to pull it out of recession.

CATEGORY

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