Canada and the Loonie Just Got Some Great News

Description

It looks like Canadian investors can enjoy a sigh of relief: the U.S. Federal Reserve signaled today that it wouldn't raise rates.

It also introduced an increasingly cautious approach by cutting the number of rate increases expected in 2017 and 2018. The long-run interest rate forecast was also reset lower to 2.9% from 3%.

Why is this such a big deal?

The loonie has faced an onslaught of pressures in recent months and years.

First, the currency is strongly linked with oil, so when crude prices collapsed, the Canadian dollar plummeted. Now at $0.77 to US$1.00, it still hasn't fully recovered, especially with oil prices languishing under US$50 a barrel.

Things aren't looking better over the next year.

According to the International Energy Agency, global oil demand growth is slowing at a faster pace than initially predicted. OPEC supply also continues to flow, not to mention preliminary data showing that North American shale oil is primed for a resurgence.

The second major pressure on the loonie has been the divergence between U.S. and Canadian interest rates.

The Bank of Canada's key lending rate stands at 0.5% after it cut the figure twice earlier this year. Meanwhile, the U.S. raised rates to 0.5% last December. Typically, currencies with higher interest rates tend to have stronger values versus those with lower borrowing rates.

You can do the math: if the current situation continues, it will be nearly impossible for the Canadian dollar to maintain any semblance of strength.

Trouble still brews

The recent news out of the U.S. Federal Reserve will temper the pessimism surrounding Canadian markets, but it shouldn't eliminate it.

Of the three major data points tracking the health of an economy—job growth, wages, and hours worked—Canada is doing terribly.

As of the latest jobs report, employment grew by an annual rate of just 0.4%. Canadians also saw an annual decline in hours worked, down 0.4% from a year ago. Annual wage growth, which has been slowing since February, fell yet again in August to just 1.5%. Adjusted for inflation, wages rose just 0.2%.

David McKay, the CEO of **Royal Bank of Canada** (TSX:RY)(NYSE:RY), believes it could take 15 years for Canada to "reinvent itself" after its manufacturing and service sectors began to shrink following the 2009 financial crash.

The troubles have been pushed down the road a bit, but they still roil on the horizon.

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Author
rvanzo