



Is the Canadian Dollar Heading to Parity With U.S. Currency Again?

Description

After seeing a sudden jump in the value of Canadian dollar against its U.S. counterpart, many investors might be thinking about how far this move can go, and if the loonie can trade at par with the U.S. dollar again.

Let's find out what's driving the Canadian dollar higher and if those factors which propelled the currency to a 24-month high can support its surge to parity this time.

One of the biggest factors that makes a currency stronger is the interest rate differential. Investors move their funds in jurisdictions where they're able to get the best returns.

That's the main reason fueling gains in the Canadian dollar for the past two months. The Bank of Canada, which has remained on the sidelines for almost seven years, started raising interest rates in July after a strong economic performance.

Surprising many analysts, the Bank of Canada acted again on Sept. 6 and raised its benchmark interest rate to 1%. These moves and the central bank's bullish tone on the economy sent Canadian bond yields soaring.

For the first time since May 2015, the yield on the Canadian two-year government bond rose more than its U.S. counterpart, suggesting that investors are expecting the Bank of Canada will hike interest rates again.

How strong can the Canadian dollar get?

Let's get back to that scenario that could make the Canadian dollar even against the U.S. dollar — a scenario we last saw in early 2013.

In order for the loonie to trade at parity, we need a strong rally in commodities, which make up a major part of Canadian exports. The move in the Canadian dollar has a strong correlation with oil prices.

When the Canadian dollar was at par in early 2013, for example, crude oil was trading close to \$100 a barrel; the current price is \$49 a barrel.

So, if the Canadian dollar isn't headed to parity, then how far will it go? In the short run, it's all about the expectations regarding Canadian interest rates. If the central bank pauses here and inflation remains subdued, I think we're not going to see too much appreciation beyond 82 to 83 cents a U.S. dollar.

For the central bank, an interest rate move that's too aggressive and too quick carries some risk at a time when Canadians are carrying a record level of debt.

Investor takeaway

The rising loonie presents some opportunities for investors looking to take advantage of this situation and re-adjust their portfolios.

Retailers and airline stocks, such as **Dollarama Inc.** ([TSX:DOL](#)), **Canadian Tire Corporation Limited** ([TSX:CTC.A](#)), and **Air Canada** ([TSX:AC](#))([TSX:AC.B](#)), are likely to benefit from a strong currency as their imports become cheaper and as Canadian travelers find their overseas trips more affordable.

Canadian exporters, such as **West Fraser Timber Co. Ltd.** ([TSX:WFT](#)), will find this sudden surge in the value of currency tough to stomach as rising currency eats into their margins.

CATEGORY

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2. [TSX:CTC.A](#) (Canadian Tire Corporation, Limited)
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Date

2025/08/19

Date Created

2017/09/11

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