Why the Loonie Is Falling and What You Should Be Doing About it

Description

The Canadian dollar, affectionately referred to as the "loonie," was down 3.1% in trading last week against the U.S. dollar, commonly called the "greenback."

While the loonie declined against a basket of international currencies, its relationship with the greenback is particularly important, as about three-quarters, or 75%, of Canada's trade is done with the United States, meaning that exchange rate fluctuations between the two nations' currencies can have meaningful consequences on either country's economy.

Take, for example, a small- to medium-sized Canadian corporation that does most of its business with the U.S.

If that company sold $100 million of goods and services to a buyer in the U.S., last week's decline in the Canadian dollar would end up costing the corporation up to $3 million that would directly hit its bottom line for the year.

In an era of cost cutting and international competition, a 3% hit to the bottom line is more than significant.

What's causing the loonie to fall?

There were a couple of factors at play last week and one more major factor that looms on the horizon.

One is that the Canadian dollar tends to trade in the same direction of oil prices. But as the price of West Texas Instrument crude oil, which is the U.S. benchmark for oil, has trended higher over the past few months, the price of Canadian Western Select, an approximation for the price Canada's oil sands producers realize on their sales, has lagged behind owing to a glut of Canadian inventory.

The second was Friday's Canadian jobs report, which showed that the economy shed 88,000 jobs — the biggest decline in nine years. The decline in employment was largely attributed to wage hikes driven mainly by Ontario introducing a new $14 minimum wage.

The third factor looming on the horizon has to do with U.S. president Donald Trump's threats to withdraw the U.S. from the North American Free Trade Agreement (NAFTA).

Should that happen, it would most likely have a detrimental impact on the loonie, as Canada would stand to lose a significant volume of its exports from its single biggest trading partner.

What should you do about it?

Some companies listed on the Canadian exchanges stand to benefit from a cheaper loonie, while others may be challenged by it.

Metals and mining companies like **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK) stand to benefit from a cheaper Canadian dollar, which will effectively reduce the price that importers like China pay for their products.

Other companies like **Magna International Inc.** (TSX:MG)(NYSE:MGA) that do extensive business south of the border stand to benefit as well; however, if President Trump were to make any major alterations to NAFTA, this could more than offset those gains.

The last word…

The other factor to consider if the current trend of a cheaper loonie is to continue is the effect it will have on Canada's trade balance.

A cheaper dollar also serves to make imports more expensive, which has the undesirable effect of removing wealth from the Canadian economy.

Should this happen, Canadians will be forced to increase their saving, which is the exact opposite of what they've been doing over the past decade; they've been racking up record levels of household debt , so seeing them increase their savings doesn't exactly seem likely.

Foolish readers need look no further than south of the border to get a taste of the unintended consequences of when a company runs an unsustainable trade balance.

This is certainly a story to keep following.

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