The broad USD index has started the year firmer. Its recovery, however, is still modest and narrowly based. It has strengthened against the currencies of advanced economies but not against those of emerging economies, which are rebounding strongly. We see some upside to the USD in the coming weeks on the back of rising volatility in financial markets and a reduction in record speculative short positions against the U.S. currency. After that, we expect another bout of weakness as quantitative easing continues to accommodate Washington’s new large fiscal stimulus.

The euro began February with some weakness after touching a 32-month high just a month earlier. In December it had been buoyed by a trade deal with the U.K. and a weakened U.S. dollar. Now it must contend with a new macroeconomic turn and skittish central bankers. All in all, we see the euro trading in a range of US$1.23–1.25 in the second half of the year. This forecast assumes no further ECB rate cuts.

The performance of the Canadian dollar over the past few weeks has accorded with our script. We still see the CAD weakening modestly through March before rallying in Q2 on the back of QE tapering by the Bank of Canada and stronger commodity prices. Our target for year-end 2021 remains C$1.20 to the USD.

### NBF Currency Outlook

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian Dollar</td>
<td>1.28</td>
<td>1.29</td>
<td>1.26</td>
<td>1.25</td>
<td>1.20</td>
<td>1.19</td>
<td>(2%) / (2.4%)</td>
</tr>
<tr>
<td>United States Dollar</td>
<td>0.78</td>
<td>0.78</td>
<td>0.79</td>
<td>0.80</td>
<td>0.83</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Euro</td>
<td>1.21</td>
<td>1.20</td>
<td>1.24</td>
<td>1.25</td>
<td>1.23</td>
<td>1.42</td>
<td>1.9% / 2.4%</td>
</tr>
<tr>
<td>Japanese Yen</td>
<td>105</td>
<td>103</td>
<td>104</td>
<td>105</td>
<td>106</td>
<td>102</td>
<td>2.9% / 3.2%</td>
</tr>
<tr>
<td>Australian Dollar</td>
<td>0.76</td>
<td>0.74</td>
<td>0.77</td>
<td>0.78</td>
<td>0.81</td>
<td>0.69</td>
<td>1.8% / (0.1%)</td>
</tr>
<tr>
<td>Pound Sterling</td>
<td>1.37</td>
<td>1.35</td>
<td>1.37</td>
<td>1.38</td>
<td>1.39</td>
<td>1.47</td>
<td>(2%) / (3.8%)</td>
</tr>
<tr>
<td>Chinese Yuan</td>
<td>6.46</td>
<td>6.50</td>
<td>6.40</td>
<td>6.20</td>
<td>6.00</td>
<td>4.2</td>
<td>1.9% / 2.4%</td>
</tr>
<tr>
<td>Mexican Peso</td>
<td>20.5</td>
<td>21.0</td>
<td>20.0</td>
<td>19.0</td>
<td>18.0</td>
<td>9.3</td>
<td>1.2% / (0.1%)</td>
</tr>
<tr>
<td>Broad United States Dollar</td>
<td>112.4</td>
<td>113.3</td>
<td>110.5</td>
<td>108.4</td>
<td>106.3</td>
<td></td>
<td>-</td>
</tr>
</tbody>
</table>

1) PPP data from OECD, based in Local Currency per USD
2) Current Account Balance data from IMF, as a % of GDP (2020 & 2021 IMF estimates)
3) Federal Reserve Broad Index (26 currencies)

### Canadian Dollar Cross Currencies

<table>
<thead>
<tr>
<th>Currency</th>
<th>Current</th>
<th>Q1 2021</th>
<th>Q2 2021</th>
<th>Q3 2021</th>
<th>Q4 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro</td>
<td>1.55</td>
<td>1.55</td>
<td>1.56</td>
<td>1.56</td>
<td>1.48</td>
</tr>
<tr>
<td>Japanese Yen</td>
<td>82</td>
<td>80</td>
<td>83</td>
<td>84</td>
<td>88</td>
</tr>
<tr>
<td>Australian Dollar</td>
<td>0.98</td>
<td>0.95</td>
<td>0.97</td>
<td>0.98</td>
<td>0.97</td>
</tr>
<tr>
<td>Pound Sterling</td>
<td>1.75</td>
<td>1.74</td>
<td>1.73</td>
<td>1.73</td>
<td>1.67</td>
</tr>
<tr>
<td>Chinese Yuan</td>
<td>5.04</td>
<td>5.04</td>
<td>5.08</td>
<td>4.96</td>
<td>5.00</td>
</tr>
<tr>
<td>Mexican Peso</td>
<td>16.0</td>
<td>16.3</td>
<td>15.9</td>
<td>15.2</td>
<td>15.0</td>
</tr>
</tbody>
</table>
USD: The Marshall Plan times two!

The broad USD index has started the year firmer. Its recovery, however, is still modest and narrowly based. The greenback has strengthened against the currencies of advanced economies but not against the currencies of emerging economies (chart).

USD: Greenback appreciation not widespread in early 2021
Trade-weighted USD vs. broad basket of 26 currencies of advanced and emerging economies

This decoupling reflects stronger economic growth in emerging markets, where industrial production recently hit a new record (chart). Since emerging economies account for almost 60% of global GDP, this is very significant for the global economy.

World: Financial stress ebbing faster in emerging markets
OFR Financial Stress Index: U.S. vs. emerging markets

We see this situation persisting if Joe Biden has his way with his $1.9-trillion stimulus package skewed to support household spending. This stimulus (equivalent to 10% of GDP) will start at a time when the federal debt-to-GDP ratio already tops 105%, the highest since the end of the Second World War. By way of comparison, the Biden proposal amounts to two times the share of the economy budgeted to the Marshall Plan that the U.S. Congress approved in 1948 for the reconstruction of Western Europe after the war.

U.S.: How high will Biden go?
Debt-to-GDP ratio

Fiscal stimulus of this magnitude would obviously require the Federal Reserve to maintain its quantitative easing for the foreseeable future. Notwithstanding the recent comments of new Treasury Secretary Janet Yellen that the U.S. would not seek to weaken its currency, more QE is unlikely to foster USD appreciation.

Growth in emerging markets is supported by strong demand for goods from the OECD economies as well as by favourable domestic conditions fostered by historically low financial stress (charts).
Euro weakness: A new trend?

The euro began February with some weakness after touching a 32-month high of US$1.23 just a month earlier. In December it had been buoyed by a trade deal with the U.K. and a weakened U.S. dollar. Now it must contend with a new macroeconomic turn and skittish central bankers.

The latest report on 12-month headline inflation in the Eurozone showed it at 0.9%, up significantly from the −0.3% of December. Although likely to be transitory, this spike could alleviate concern about deflationary pressure coming from the exchange rate. Our view remains that the euro is likely to be weaker in the first quarter of the year given weakening of the global economy (broad-based USD increase) and statements made by central bankers. Further down the road, we expect some euro appreciation going into the second and third quarters of 2021 due to economic rebound (think: end of second wave, vaccines, etc.). All in all, we see the euro trading in a range of US$1.23-1.25 in the second half of the year. This forecast assumes no further ECB rate cuts.

CAD: Spring QE tapering?

The CAD has lost a couple of cents after hitting a three-year best of 1.26 against the USD January 21 (charts). This recent weakness probably reflects the Bank of Canada’s decision to leave its QE program unchanged at “at least $4 billion per week” as well as the overall strength of the USD against the currencies of the major economies.
In our view, CAD weakness is likely to be transient. GDP might disappoint in the coming months as a result of recent government-ordered shutdowns and short-term disruption of vaccine availability. However, it is important to note that the Canadian economy has not been hit harder than other economies by the pandemic and that programs to encourage people to stay in the work force have so far worked reasonably well – the participation rate of prime-aged workers is back to its pre-pandemic high (charts).

This picture would explain why inflationary pressure has built up more acutely on this side of the border. The housing market is a case in point. As of December 2020, 65% of the 32 urban markets were reporting 12-month home-price inflation of 10% or more, a new record (chart). This development, coupled with increased vigour of CPI inflation adjusted for the changing consumption patterns of Canadians during the pandemic (similarly to the U.S. personal consumption deflator), suggests somewhat less slack in the economy than is currently assumed by the Bank of Canada. Under these conditions, we find it hard to justify the Bank’s current pace of quantitative easing. As recently pointed out by our colleagues, the BoC’s QE program is much more aggressive as a share of GDP than that of the Federal Reserve. Concern for financial stability would argue for QE tapering in the coming months (April or May), provided of course that the global economy continues to recover. Such a move would provide some support for appreciation of the CAD.

1 See our December 2020 Fixed Income Monitor.
Canada: Price surge is more pervasive on this side of the border

Share of regional markets where prices rose by 10% or more in the last 12 months

Canada: Inflationary pressures seem higher in Canada

Headline Canadian CPI and CPI-adjusted to reflect pandemic impact vs. PCE deflator
Appendix: Spot rates

EUR / USD

USD / CAD

USD / JPY

AUD / USD

GBP / USD

USD / CNY
Forex
Economics and Strategy

Montreal Office
514-879-2529
Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca
Paul-André Pinsonnault
Senior Economist
paulandre.pinsonnault@nbc.ca
Daren King
Economist
daren.king@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca
Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca
Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Toronto Office
416-869-8598
Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca
Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca
Matthew Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca
Kyle Dahms
Economist
kyle.dahms@nbc.ca
Camille Baillargeon
Intern Economist
camille.baillargeon@nbc.ca

General
This Report was prepared by National Bank Financial, Inc. (NBF), a Canadian investment dealer, member of IIROC, an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient’s individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents
NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.
UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 71 Fenchurch Street, London, EC3M 4HD.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates’ businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments which may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.