



## Seeking a CAD angle on June's hefty cashflows

By Warren Lovely

As is customary, we offered a detailed [In Focus](#) report a few days back exploring the ins and outs of Canada's outsized bond market cashflows. The overwhelming skew of coupons/maturities to a handful of days in June has notable implications for rates and credit markets. But what about the Canadian dollar? This *Addendum* extends our analysis with an eye to how the loonie might fair in the coming days and weeks.

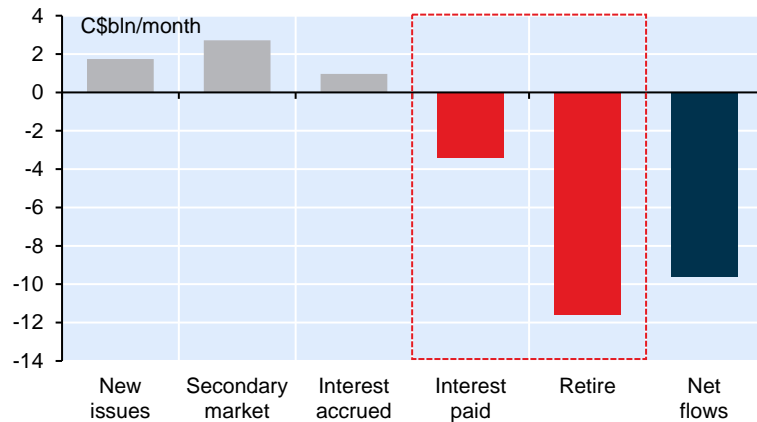
We loosely identify a 'performance window' for the Canadian dollar, one that spans 14 workdays straddling June 1<sup>st</sup>. Canada's effective exchange rate has gained ground in 10 of the past 12 years during this window (i.e., 83% success). Gains have been most consistently registered vs. the U.S. dollar. If history is any guide, this year's window opens May 25<sup>th</sup> and runs through June 14<sup>th</sup>. Before you go 'all-in' on seasonal tendencies, spare a thought for some special factors. Every year has unique elements and that's certainly true of 2022. The Bank of Canada's next interest rate decision—a potential CAD catalyst if there ever was one—is scheduled for, you guessed it, June 1<sup>st</sup>. Our central bank is also engaged in a first-of-its-kind Quantitative Tightening exercise. QT will make a hefty slug of GoC bonds available to end investors, with non-residents inflows a potential source of absorption (even if domestics were more seriously crowded out). Refer to our detailed [report](#). To further keep us on our toes, we'll be sifting through important Canadian data in the lead up to June. That includes CPI (May 18<sup>th</sup>) and monthly/quarterly GDP (May 31<sup>st</sup>). These releases are critical to assessing underlying capacity pressures. So yes, this time is different, with plenty to factor in.

Importantly, we take comfort in market location. If we had to offer a loose qualitative valuation assessment of the Canadian dollar, it would read as 'very cheap'—at least based on traditional metrics/models. Our analysis suggests the CAD is roughly a dozen big figures removed from 'fair value'. That's one of the more pronounced undervaluations in the post-GFC era. If you believe, as we do, that Canada's economy (circa 2022) could prove relatively resilient, a 'buy the loonie' strategy could make fundamental sense, our noted seasonals a marginal plus.

*Note: Our latest issue of FOREX is available [here](#). While conceding that near-term volatility/uncertainty could delay Canadian dollar strength, we nonetheless see CAD taking aim at the low 1.20s before the year is out.*

### Chart 1: June's ultra lumpy coupon/maturity effect...

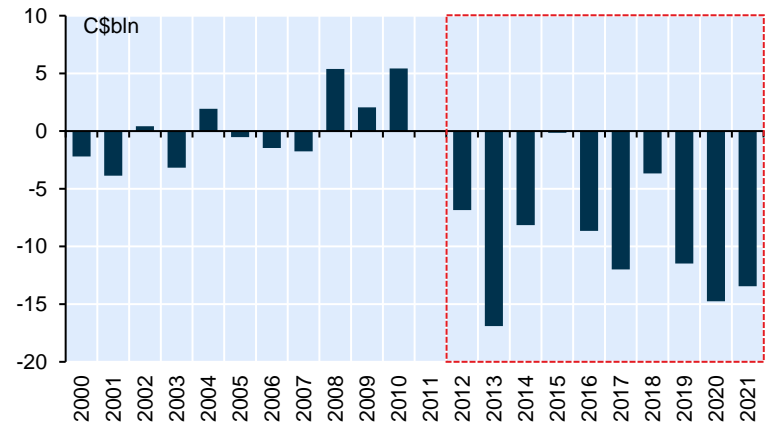
Average net foreign investor flows in CAD bonds during month of June



Source: NBF, StatCan | Note: 10Y average level from 2012-21

### Chart 2: ... makes non-res divestment a consistent June story

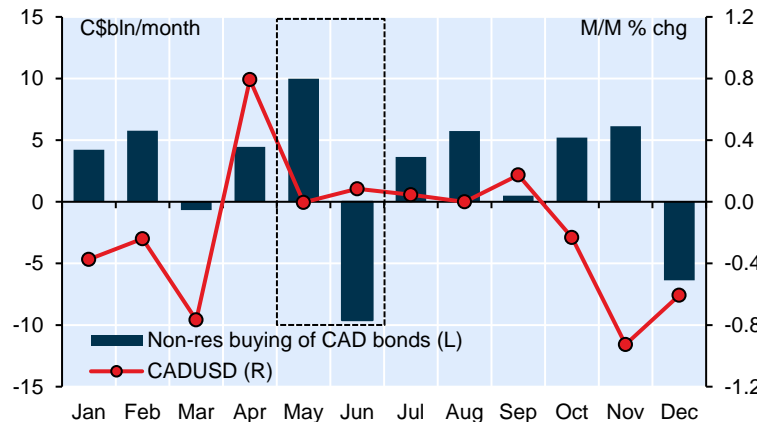
Net foreign investment/(divestment) in CAD bonds during month of June



Source: NBF, StatCan

### Chart 3: June's net divestment hasn't typically hurt CAD...

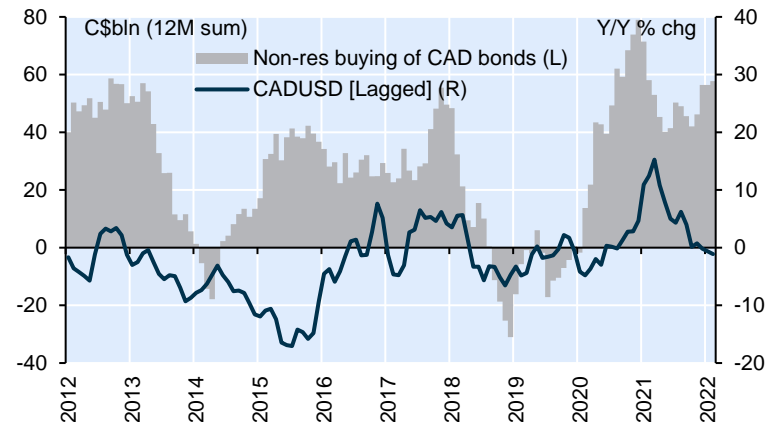
Net foreign investment in CAD bonds & CAD performance: Monthly pattern



Source: NBF, StatCan, Bloomberg | Note: 10Y average level/change from 2012-21

### Chart 4: ... as relationship between flows & CAD tenuous

Net foreign investment in CAD bonds & CAD performance: 10Y history

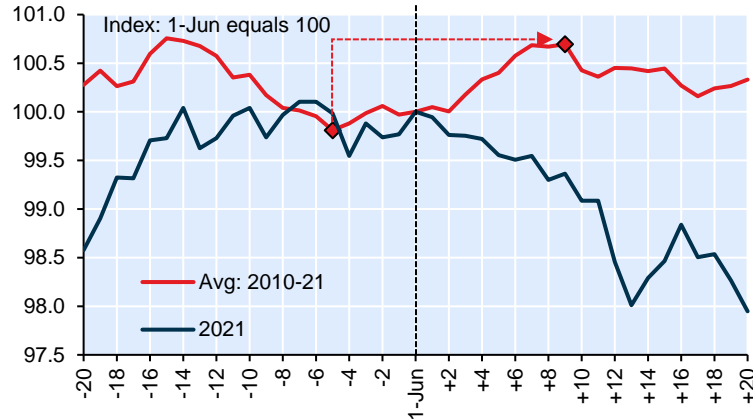


Source: NBF, StatCan, Bloomberg | Note: Change in CADUSD lagged 2 months

Charts 1-4 acknowledge that non-resident flows in the domestic bond market show material 'divestment' in June, since there's simply not enough new supply to absorb all the cash paid out/redeemed. Mind you, May inflows hint that some foreign investors deploy their cash early. And note that the statistical relationship between non-res bond flows and CAD is tenuous in 2022 and longer term.

**Chart 5: History hints at a June 1<sup>st</sup> 'performance window'**

Canadian Effective Exchange Rate before/after 1-Jun: Trend & 2021

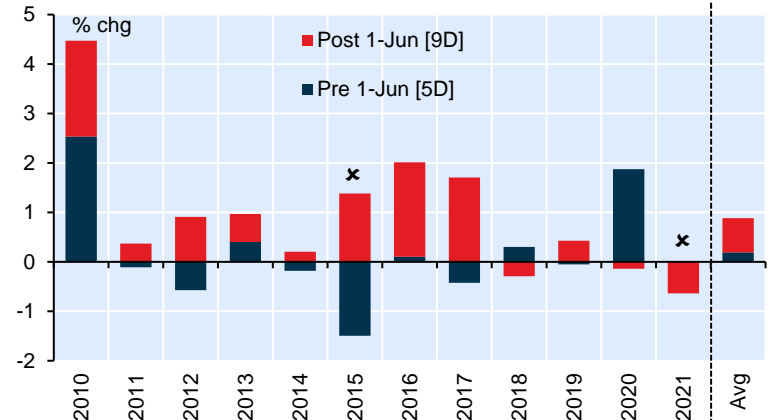


Source: NBF, BoC | Note: Based on daily performance vs. 17 trading partners

Scan the past dozen years and you might identify a 'performance window' for the Canadian dollar kicking off 5 days prior to June 1<sup>st</sup> and extending 9 days after the cash starts to flow. Keying on this 14-day window, Canada's effective exchange rate has gained ground in 10 of 12 years (i.e., 83% success). The last time it didn't work? Well, that was last year. So interpret with some caution.

**Chart 6: Gains in 10 out of 12 years, although 2021 was a 'miss'**

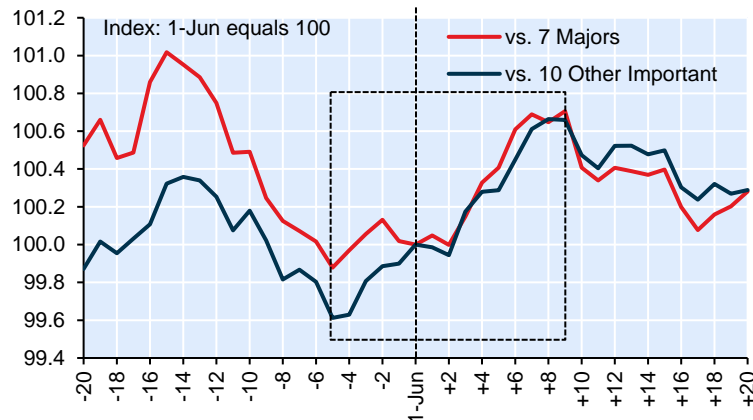
Canadian Effective Exchange Rate during notional 14D 'performance window'



Source: NBF, BoC | Note: Based on 17 trading partners; 'x' denotes loss over 14D window

**Chart 7: While loonie's gains appear broadly based...**

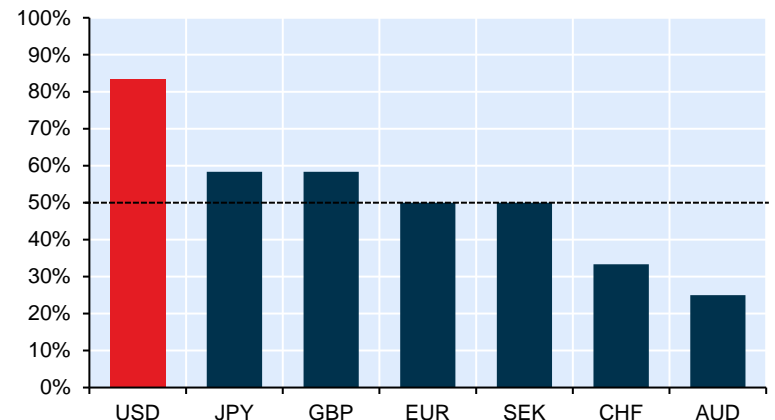
Canadian Effective Exchange Rate before/after 1-Jun by currency group



Source: NBF, BoC | Note: Based on 12Y average from 2010-21; '7 Majors' includes USD, EUR, JPY, GBP, CHF, AUD & SEK

**Chart 8: ... most consistent success has come vs. USD**

CAD success rates vs. each of 7 majors during 14D 'performance window'

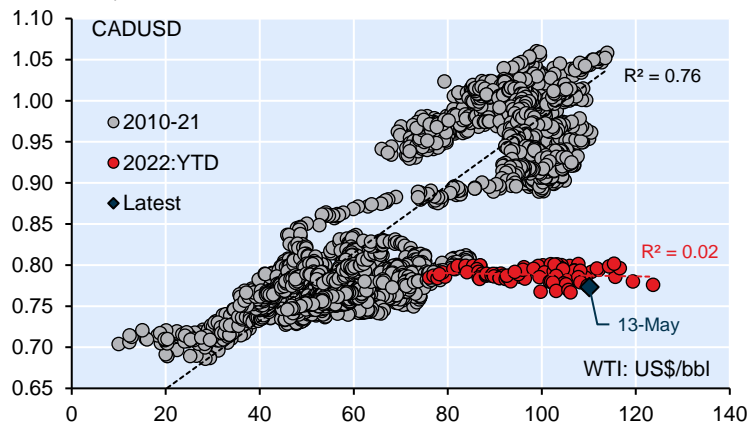


Source: NBF, Bloomberg | Note: Based on 12Y period from 2010-21; in all cases, 'success' reflects CAD gains vs. other major currencies over 14D window (T-5 to T+9)

While the BoC's effective exchange rate data imply broad-based Canadian dollar strength during our 14-day 'performance window', a detailed look at currency pairs shows the loonie's strength has been most consistent against the greenback. Performance against JPY, GBP, EUR and SEK has been a coin flip, while the loonie often lags the Aussie dollar during the notional seasonal sweet spot.

**Chart 9: Oil losing sway as CAD driver?**

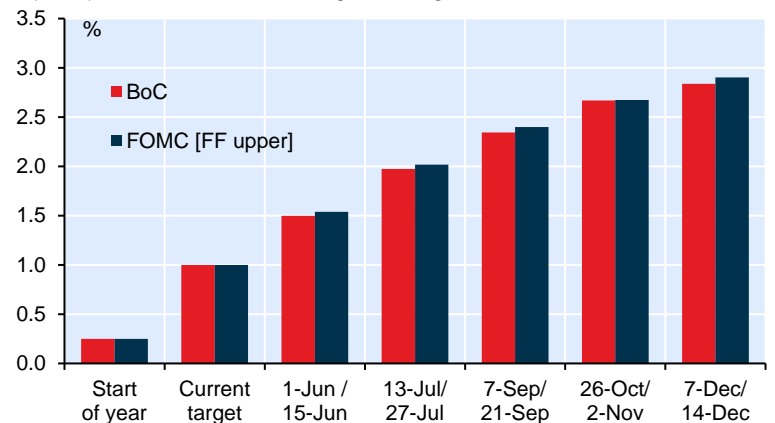
Relationship between crude oil (horizontal) & Canadian dollar (vertical)



Source: NBF, Bloomberg | Note: Based on >3,200 daily observations from 2010 to current

**Chart 10: On the lookout for potential policy rate divergence**

Implied path for BoC & FOMC target overnight rate: 2022



Source: NBF, Bloomberg | Note: Implied target based on WIRP as at 13-May 16:00

If commodity prices still matter for Canada—and to us they do, with the impact on trade and fiscal balances particularly striking—then CAD currently appears attractively priced. True, fair value is informed by more than oil, with rate differentials another long-standing driver. Markets currently see the BoC and FOMC on a similar path. But if Canada's economy ends up proving more resilient (something we're increasingly willing to discount) then GoC yields might ultimately trade at more attractive levels vs. USTs. The jury is still out on this, but it's a thematic we're warming up to.



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