A Tentative Outlook for the Canadian Economy is Keeping the Loonie Range-Bound

By Asif Imtiaz

This week, there are quite a few important economic data releases from Canada, including the overnight interest rate decision, Purchasing Managers' Index (PMI) from Richard Ivey School of Business, and the national trade balance figure. Moreover, Statistics Canada just released the month-over-month GDP on Tuesday, which came out better than what the market was expecting, at 0.3% against a previous forecast of 0.2%.

Under the current global economic climate of ever looming deflation worries and the dangerous precedents of negative interest rates from several European central banks, the Canadian economy has performed rather well. Such performance was underlined by a healthy level of inflation, at 1% in January 2015 as well as the latest 0.3% GDP growth (m/m/). As a result, the Bank of Canada has managed to keep its overnight interest rate in the positive territory.

In January, the BOC cut its overnight rate for the first time since September 2010, from 1.0% to 0.75% to provide ample expansionary monetary policy support for the recovering economy. A few weeks ago, the market was speculating that Bank of Canada governor Stephen Poloz might announce another round of rate cut in March. However, as the unemployment rate dropped to 6.6% and the GDP growth rate remained at par with the BOC's expectations, the forecast for the overnight rate has remained at 0.75%.

On Thursday at GMT 3:00 p.m., the Richard Ivey School of Business will be releasing its Purchasing Managers Index (PMI) figure, which measures the level of a diffusion index created by surveying 175 purchasing managers from all major geographic locations in Canada. Since the survey asks the purchasing managers to rate their perception regarding some key issues, such as the level of business conditions including employment, production, new orders, prices, supplier deliveries, and inventories, it is considered as an important leading indicator of the Canadian economy.

Regardless of the optimistic fundamental data, the Ivey PMI has remained dovish. In February, the Ivey PMI reading came out at only 45.4 and the forecast for March is set at a slightly higher figure, at 46.2. It is important to keep in mind that a reading below 50 indicates industry contraction. Furthermore, the trade balance figure is due on Friday, which is directly correlated to the currency demand in the interbank market. Currently, the forecast for the Canadian trade balance is set at 0.3 billion. Still a positive sign, but it is significantly lower compared to the 2.1 billion trade balance from September 2014.

It appears that the market is still tentative regarding the first quarter performance of the Canadian economy. A senior economist from the Bank of Montreal, Robert Kavcic, [commented](#) on the current market sentiment about the Canadian economy by saying that "We just haven't had the full impact of lower oil prices filter through the economy yet." Therefore, the BOC is "going to stand aside and see how the first quarter plays out," he added.

USD/CAD Outlook

Although the USD/CAD has been trending upwards since August 2014. However, the recent tentative market sentiment kept the pair trading within a narrow price range for last two months, between 1.2400 and 1.2800. Currently, the USD/CAD is trading at the lower end of this range, near the intermediate uptrend line.

Unless the Bank of Canada surprises the market by further cutting its overnight rate to boost the economy in Q1'15, the 1.2800 level should provide ample resistance over the course of the next few weeks. On the other hand, if the Ivey PMI reading comes above 50 amid the recent better than expected GDP growth rate, there is a strong possibility that the USD/CAD will gain additional bearish momentum and test the support around the intermediate trend line in next few days.