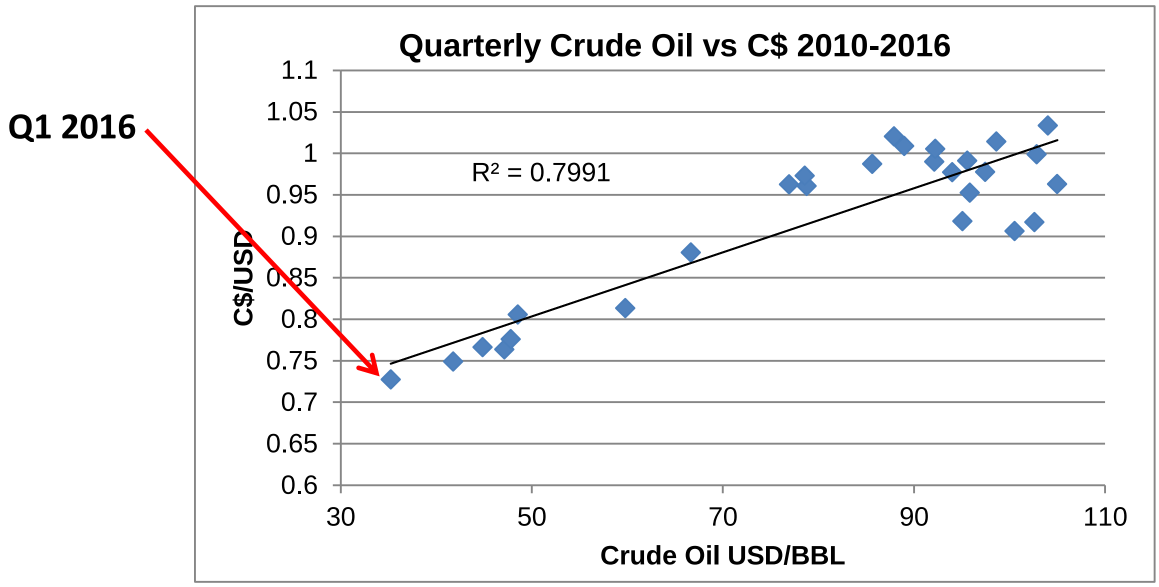
The Dollar and Oil in 2016

There is a clear relationship between the C$'s and food prices. There is a direction inverse relationship between the C$ versus the USD and food prices. Depreciation leads to higher food prices and vice versa. With that noted, the direction of the relationship between the C$ and the USD is of course very difficult to predict. The C$ direction is tied to relative interest rates between Canada and the United States as well as relative economic growth and inflation.

One factor that is very important in the appreciation or depreciation of the C$ is world oil prices. That is given Canada's position as a major oil producer. There is a very strong correlation between oil and the C$ as shown on the graph below. The graph regresses quarterly crude oil prices in USD per barrel against the quarterly average C$ value from 2010 to 2016. Each dot on the graph represents a quarter from 2010-2016 in which the combination of the oil and the dollar are matched. As can be seen, the higher the oil price the stronger the Canadian dollar and vice versa.



Oil prices were around US$35 in the first quarter 2016 which corresponded to a very weak C$ in the low 0.70's as shown above. As of mid-December 2016 crude oil futures prices show summer 2017 values at US$54/bbl. That compares to about US$47 in mid-November. That US$54 would correspond to a C$ near 0.80 compared to the current 0.75.

In the meantime, as noted above, relative interest rates between Canada and the United States are also very important to the exchange rate. In that regard, the USD strengthened broadly in December 2016 following the December 14 Federal Reserve meeting which delivered a widely anticipated rate increase along with a more hawkish message on rate prospects into 2017.

The bottom line is that the two key factors of influence on the Canadian dollar are moving in opposite directions as of late 2016. If the interest rate differential remains wider after the Federal Reserve meeting, it will place downward pressure on the C$ and upward pressure on food prices. If oil prices continue to firm it will have an appreciating impact on the C$ and a downward influence on food prices. The main question for food prices is whether the Bank of Canada can live with the weaker C$ based on interest spreads.