Trade Idea – Foreign Exchange

Volatile path higher for commodity currencies

15th July 2016

**CAD and NOK range bound**

- After leading the CAD and NOK to decade lows in January, oil prices have subsequently lifted both currencies higher against major counterparts for the past five months. Robust oil demand growth from the likes of India and the US, coupled with a series of supply outages have improved the fundamental balance within the global crude market and have seen economic prospects for oil exporting nations (like Canada and Norway) improve markedly. However, since reaching the psychologically important $50/bbl level in early June, oil prices (and in turn the CAD and NOK) have become more range bound, as mixed market sentiment and concerns over resurgent oil production have generated pronounced price swings in both directions. For the CAD and NOK prospects for the oil price will likely be a key driver of future movements as monetary policy in both countries looks unlikely to alter course in the near future. On balance, over the next few months we see upside for both the oil price and corresponding oil linked currencies (CAD & NOK), but we believe that the path higher will likely be a volatile one.

![Figure 1: Oil market remains tight](image)

**Oil prices to stay bid**

- As oil benchmarks have climbed higher, fears have grown that increasingly attractive economics will prompt the flexible US shale industry to boost production, with companies tapping the significant backlog of drilled but uncompleted wells as a convenient source of short term output. However, we believe that this scenario is more likely to come into play nearer to the $55/bbl level and even then the effects are likely to be relatively short term in nature as these sources are well known to deplete quickly. Recently, negative sentiment from the UK’s decision to leave the EU has pushed oil prices lower, but we believe this effect to be transitory and the recent decline to present a potential entry point for buyers of the CAD and NOK. The fundamental picture for oil prices remains price positive as global supply outages remain elevated and OPEC spare capacity look stretched (see Figure 1). Therefore, we retain our bullish view on oil, but see trading turning increasingly volatile as the $55/bbl level draws near.

*All figures quoted are sourced from Bloomberg unless stated otherwise.

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Resistance levels approach

In coming months, we prefer expressing a long view on the CAD and NOK against the EUR, as accommodative monetary policy and positive risk sentiment are likely to keep the common currency pressured. The EUR/CAD and EUR/NOK currency pairs are both approaching their 50dma and 100dma respectively, both of which could act as key resistance levels against future EUR gains.

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- ETFS Short CAD Long GBP (CAGB)  
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