The Canadian dollar

High-flying bird
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The pros and cons of Canada's strong currency

IN THE 15 years since America and Canada signed their first free-trade deal, the world's biggest two-way trading relationship has trebled in scale. Canada's giant neighbour now buys 84% of its exports—equivalent to one-fifth of GDP—and supplies 72% of its imports. Little wonder that a recent surge in the Canadian dollar has become a hot issue north of the border.

The loonie, named after the loon (an aquatic bird known outside North America as the diver) on the one-dollar coin, is not the only currency that has taken flight against the American dollar. However, its rise—from an all-time low of C$1.61 to the American dollar to a ten-year high of C$1.30—reflects more than the greenback's weakness. In contrast to the frail state of America's finances, Canada has had six years of budget surplus and is set for a seventh. A whiff of inflation scared the Bank of Canada into raising its key interest rate five times in a year, beginning in April 2002. Although the rate has since fallen, it remains, at 2.75%, well above America's Fed funds rate, which was kept at 1% this week.

Now the central bank's governor, David Dodge, is under pressure to cut rates further. Inflation, having peaked at 4.6% in February, fell to 2.2% in September and is no longer a threat. Several of Canada's biggest companies, such as Alcan (aluminium and packaging) and Abitibi-Consolidated (forest products), have blamed the loonie for pecking away their third-quarter profits. Manufacturers have already cut 80,000 jobs this year. Trade unions have given warning of more to follow if Canadian firms lose their edge in America.

Mr Dodge is in no hurry, believing that Canadian exporters will gain more as the American economy accelerates than they will lose from a strong currency. The central bank predicts that Canada's growth rate will rise from about 2% this year to 3.25% in 2004. It even thinks that the economy may have no spare capacity left by early 2005.

Some are quietly pointing out the benefits of a strong currency. Cheaper machinery and technology imports could help manufacturers close the nagging productivity gap with their American rivals: so far they have bridged it only with a weak currency. And the loonie has flown higher, reaching C$1.12 in the early 1990s. Reid Farrell of CIBC World Markets in Toronto thinks it will take two or three interest rate cuts to stop the loonie this time. Meanwhile, retired Canadians packing for a winter in Florida or Arizona aren't complaining.