



CAD Flow Picture Very Negative

We are more bearish CAD. Speculative shorts are building, but on the portfolio flow side, the balance of payments is characterized by a large overhang of fixed income inflow positions as a by-product of Fed QE (chart 4). Canada benefitted from close to 280bn of "excess" inflows over the 2010-2013, which have plugged a sharply wider current account deficit similar in size to the UK. The UK, in contrast, has suffered from a lack of inflows in recent years (chart 4). While FDI and underweight fixed income positions have the potential to "plug" the UK deficit, the risks appear skewed the other way in Canada.

On the monetary policy side, Canada doesn't appear well placed to benefit from an improving US cycle either. Rate expectations are already running ahead of the Fed and BoE by a quarter, and given the BoC's renewed dovishness there is limited potential of these happening sooner. Indeed, the correlation between US and Canadian data surprises has dropped off sharply over the last few years, pointing to the divergent trends in local housing markets and domestic leverage. To boot, Canadian terms of trade have clearly peaked (chart 6), with the currency moderately expensive versus non-energy commodity prices and supply glut in North America oil production providing an additional headwind.

Big picture, GBP/CAD is a dollar-neutral cross, with correlations with other USD crosses all lying below 50% over 1-3 year time horizons and zero correlation with the broad USD TWI since 1995. The relative performance between UK financials and Canadian stocks does a decent job of explaining big picture turns since the early 1990s. The cross remains more than 20% below its pre-crisis average suggesting plenty of potential for upside as the respective domestic stories play out.

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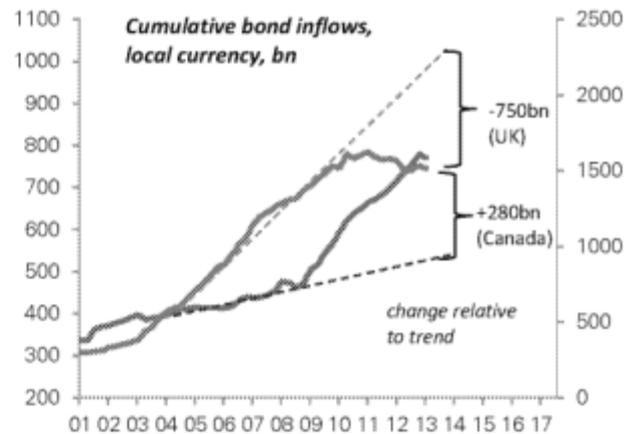
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GBP/CAD a Beta Neutral Cross



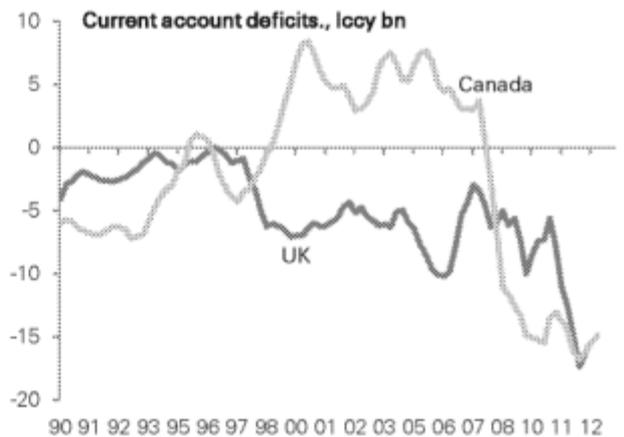
Source: Deutsche Bank

UK Inflows Could Improve. Opposite of Canada



Source: Global Markets Research, IMF

GBP/CAD 'Current Account Neutral' Cross



Source: Deutsche Bank, Bloomberg Finance LLP

USD/CAD Following Commodity Prices Lower



Source: Deutsche Bank, Bloomberg Finance LLP