

Michael Gregory, CFA, Deputy Chief Economist • michael.gregory@bmo.com • 416-359-4747

Jennifer Lee, Senior Economist • jennifer.lee@bmo.com • 416-359-4092

Forecast Summary (averages)

	Actual	Forecasts				2018		2019			
	2018 Apr	2018 May	Jun	Jul	Aug	Q3	Q4	Q1	Q2	Q3	Q4
BoC overnight	1.25	1.25	1.25	1.50	1.50	1.50	1.75	2.00	2.25	2.50	2.50
10-yr Canadas	2.25	2.30	2.40	2.40	2.40	2.40	2.50	2.60	2.75	2.90	3.00
Fed funds	1.63	1.63	1.88	1.88	1.88	2.13	2.38	2.63	2.88	2.88	2.88
10-yr Treasuries	2.87	2.95	3.00	3.00	3.05	3.05	3.10	3.20	3.30	3.40	3.50
C\$ per US\$	1.273	1.270	1.267	1.265	1.262	1.262	1.253	1.245	1.238	1.230	1.223
US\$/€	1.23	1.21	1.22	1.22	1.23	1.23	1.24	1.26	1.26	1.27	1.28
US\$/£	1.41	1.38	1.39	1.40	1.40	1.40	1.42	1.44	1.45	1.46	1.47
¥/US\$	108	109	108	108	107	107	106	105	104	104	103

Since the last issue of Rates Scenario:

- Ten-year Treasury yields closed above 3% in late April for the first time since the turn into 2014. Back then, the market was still reeling from the “*taper tantrum*”, when a Bernanke-led Fed first hinted at ending quantitative easing. For now, yields are unable to break past their prior peak (under 3.05%), and have since been consolidating in a narrow range around 2.95%.
- Meanwhile, the **Bank of Canada’s** policy announcement on April 18th looked past the economic softness so far this year (due to new mortgage rules and export transportation bottlenecks). The economic growth forecast was revised net stronger (upgraded 2019 greater than downgraded 2018), and the potential growth range was also revised up to a 1.8% midpoint for both 2018 and 2019 (up 4/10s and 3/10s, respectively). The Bank still indicated that “*higher interest rates will be warranted over time, although some monetary policy accommodation will still be needed to keep inflation on target.*” Although “*some progress has been made*” on inflation and wage growth (hawkish), the Bank also (dovishly) argued that it “*will take longer to assess*” the economy’s sensitivity to interest rates and that firms “*are hesitating to invest in new capacity given the uncertain future of the North American Free Trade Agreement, transportation bottlenecks and a shortage of skilled workers.*” We still forecast Bank of Canada policy will remain on pause until the second half of this year, with moves in July and October, and a quarterly cadence continuing into 2019 until the Bank hits the bottom of its 2.50%-to-3.50% estimated neutral range. But, as April’s policy announcement reiterated, they “*will remain cautious with respect to future policy adjustments, guided by incoming data.*”
- We still forecast the **Fed** to raise policy rates another three times this year: at the June, September and December meetings. And, we see rate hikes continuing at a quarterly cadence until the FOMC pauses once it hits its current longer-run median projection of 2.875% (the 2.75%-to-3.00% range) in June 2019—just in time to herald the longest business expansion in U.S. history (the second longest moniker was bestowed this month). How long the current cycle lasts will depend critically on whether the Fed feels compelled to lift rates in the second half of next year (and in 2020) to counter inflation pressures. At this point, we judge there are net upside

risks to our 2019 Fed call. However, these net upside risks are more modest than they otherwise would be owing to the policy-tightening influence of the Fed's steadily shrinking balance sheet.

- In the Treasury market, reduced Fed demand will coincide with a surge in supply to fund ballooning budget deficits caused by tax cuts and spending hikes. The fiscal stimulus, with the economy essentially at full employment and soon sporting a positive output gap, should augment wage growth and inflation (to slightly above 2% for the headline and core PCE readings). And, with the Fed likely to raise rates more than the market currently expects, inflation expectations likely to creep up, and Fed redemptions alleviating some of the compression pressure on term premiums, Treasury yields should continue on a moderate ratcheting ascent. We're sticking to our 2018-end call for 10-year yields averaging around 3.10%, and for the curve (2s10s) to not persistently invert (unless, of course, the Fed does indeed feel compelled to push policy rates well above neutral in 2019H2). Longer-term Canadas should hold their own, with Canada-U.S. yield spreads staying around current levels and potentially moving even more negative, until the Bank of Canada begins raising rates again. This should then trigger some underperformance relative to Treasuries. By 2018-end, we look for 10-year Canadas to average just above 2.50%.
- Over the past month, the view on the **BoE** has changed significantly. **Real GDP** only inched up 0.1% in Q1 (not annualized), and the **rate of inflation** eased to 2.5% y/y, the slowest pace in a year. Those two indicators on their own would not have fully justified taking a May rate hike completely off the table (weather issues hit activity, inflation is still above target). But, throw in a **sudden dovish turn from Governor Carney** ("*I don't want to get too focused on the precise timing, it is more about the general path*", and the Bank is "*conscious that there are other meetings over the course of this year*") along with **greater Brexit uncertainty** and we now look for the BoE to take a pass in May and to hike in August 2018. These factors will weigh on the **GBP** in the short-term, but we still look for the currency to rally into year-end.
- After dropping its easing bias in March, the **ECB** is likely feeling some regret as the region's economy has slowed. **Real GDP** rose 0.4% in Q1 (not annualized), the slowest pace in nearly two years, although weather and strikes in Germany and France had a negative influence. Inflation also remains stubbornly lacklustre: the flash reading for April showed **consumer prices** slowing to a 1.2% y/y pace, while core prices were up just 0.7%. The **EUR** has consequently softened to below \$1.20, a 9-month low. We continue to look for asset purchases to be reduced in the fall, from €30 bln per month to €15 bln, before coming to an end by the turn of the year. However, if inflation refuses to show more than just a spark, extending QE is possible.
- The **BoJ** looks to continue on its very accommodative path for the foreseeable future. In the April press release, the Bank **dropped its estimated date for hitting the 2% inflation target**, suggesting that the Board has no idea when they will reach that goal. **Governor Kuroda** quickly defended the omission, saying that they remain committed to achieving that inflation rate at the earliest date possible and they still believe there is a "*high chance*" they can get there by "*around fiscal 2019*". However, refusing to put the goal in writing doesn't instil confidence. Meantime, the **Minutes from the March meeting** showed very clearly the leanings of most of the board members, even before dovish incoming Deputy Governor Wakatabe began. According to the Minutes, some felt that "*the economy had not yet reached a phase where it should consider the timing and measures of a so-called exit from monetary easing*" although normalization "*could become a topic for consideration in the future*". We no longer expect the BoJ to tweak policy this year.

Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual	Forecasts					2018		2019			
	2018 Apr	2018 May	Jun	Jul	Aug	Q3	Q4	Q1	Q2	Q3	Q4	
Canadian Dollar												
C\$ per US\$	1.273	1.270	1.267	1.265	1.262	1.262	1.253	1.245	1.238	1.230	1.223	
US\$ per C\$	0.785	0.787	0.789	0.791	0.793	0.793	0.798	0.803	0.808	0.813	0.818	
Trade-weighted	97.5	98.1	98.3	98.5	98.6	98.6	98.9	99.3	99.8	100.3	100.7	
U.S. Dollar												
Trade-weighted ¹	118.1	119.8	119.9	119.4	119.0	119.0	117.3	116.4	115.8	115.3	114.7	
European Currencies												
Euro ²	1.23	1.21	1.22	1.22	1.23	1.23	1.24	1.26	1.26	1.27	1.28	
Danish Krone	6.07	6.25	6.20	6.15	6.15	6.15	6.00	5.95	5.90	5.85	5.85	
Norwegian Krone	7.85	8.00	7.95	7.90	7.85	7.85	7.65	7.55	7.55	7.50	7.45	
Swedish Krone	8.46	8.80	8.75	8.65	8.60	8.60	8.40	8.25	8.20	8.15	8.05	
Swiss Franc	0.969	1.000	0.994	0.989	0.983	0.983	0.966	0.963	0.967	0.971	0.975	
U.K. Pound ²	1.41	1.38	1.39	1.40	1.40	1.40	1.42	1.44	1.45	1.46	1.47	
Asian Currencies												
Chinese Yuan	6.30	6.33	6.31	6.29	6.27	6.27	6.22	6.18	6.16	6.13	6.11	
Japanese Yen	108	109	108	108	107	107	106	105	104	104	103	
Korean Won	1,068	1,075	1,070	1,065	1,060	1,060	1,045	1,040	1,035	1,030	1,025	
Indian Rupee	65.7	66.0	65.7	65.4	65.1	65.1	64.2	63.7	63.4	63.2	62.9	
Singapore Dollar	1.32	1.33	1.32	1.32	1.31	1.31	1.30	1.29	1.28	1.28	1.27	
Malaysian Ringgit	3.89	3.95	3.95	3.90	3.90	3.90	3.85	3.80	3.75	3.75	3.70	
Thai Baht	31.3	31.7	31.6	31.4	31.3	31.3	30.8	30.6	30.5	30.4	30.2	
Philippine Peso	52.1	52.0	51.8	51.7	51.6	51.6	51.3	51.0	50.8	50.6	50.4	
Taiwan Dollar	29.4	30.0	29.8	29.7	29.5	29.5	29.0	28.8	28.6	28.5	28.4	
Indonesian Rupiah	13,814	13,950	13,890	13,835	13,775	13,775	13,605	13,425	13,240	13,055	12,870	
Other Currencies												
Australian Dollar ²	0.768	0.760	0.764	0.767	0.771	0.771	0.781	0.788	0.791	0.795	0.799	
New Zealand Dollar ²	0.724	0.710	0.713	0.716	0.719	0.719	0.727	0.733	0.738	0.743	0.748	
Mexican Peso	18.38	19.10	19.80	19.75	19.65	19.65	19.20	18.90	18.80	18.65	18.55	
Brazilian Real	3.41	3.55	3.50	3.45	3.40	3.40	3.30	3.25	3.25	3.30	3.30	
Russian Ruble	60.9	63.0	62.0	61.0	60.0	60.0	57.0	55.8	55.5	55.1	54.8	
South African Rand	12.1	12.7	12.6	12.5	12.4	12.4	12.1	11.9	11.8	11.7	11.5	
Cross Rates												
Versus Canadian Dollar												
Euro (C\$/€)	1.56	1.54	1.54	1.54	1.55	1.55	1.56	1.56	1.56	1.56	1.56	
U.K. Pound (C\$/£)	1.79	1.75	1.76	1.77	1.77	1.77	1.78	1.79	1.79	1.79	1.79	
Japanese Yen (¥/C\$)	85	86	86	85	85	85	84	84	84	84	84	
Australian Dollar (C\$/A\$)	0.98	0.97	0.97	0.97	0.97	0.97	0.98	0.98	0.98	0.98	0.98	
Versus Euro												
U.K. Pound (£/€)	0.87	0.88	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	
Japanese Yen (¥/€)	132	132	132	132	132	132	131	131	132	132	132	

¹ Federal Reserve Broad Index ² (US\$ per local currency)

Interest Rate Forecasts

Percent (averages)

	Actual 2018 Apr	Forecasts 2018				2018 Q3	2018 Q4	2019			
		May	Jun	Jul	Aug			Q1	Q2	Q3	Q4
Cdn. Yield Curve											
Overnight	1.25	1.25	1.25	1.50	1.50	1.50	1.75	2.00	2.25	2.50	2.50
3 month	1.16	1.20	1.30	1.40	1.40	1.45	1.70	1.95	2.15	2.35	2.35
6 month	1.33	1.35	1.45	1.55	1.55	1.60	1.80	2.05	2.25	2.40	2.40
1 year	1.64	1.65	1.75	1.85	1.85	1.85	2.05	2.25	2.40	2.55	2.55
2 year	1.86	1.90	1.95	2.00	2.05	2.05	2.20	2.35	2.50	2.65	2.65
3 year	1.98	2.05	2.10	2.15	2.15	2.15	2.30	2.45	2.60	2.70	2.75
5 year	2.09	2.15	2.20	2.25	2.30	2.30	2.40	2.50	2.65	2.80	2.85
7 year	2.16	2.20	2.30	2.30	2.35	2.35	2.45	2.55	2.70	2.85	2.95
10 year	2.25	2.30	2.40	2.40	2.40	2.40	2.50	2.60	2.75	2.90	3.00
30 year	2.37	2.45	2.50	2.50	2.55	2.55	2.65	2.75	2.90	3.05	3.20
1m BA	1.63	1.65	1.75	1.85	1.85	1.90	2.10	2.30	2.50	2.65	2.65
3m BA	1.74	1.75	1.85	1.95	1.95	2.00	2.20	2.40	2.60	2.75	2.75
6m BA	1.91	1.95	2.00	2.10	2.10	2.15	2.30	2.50	2.65	2.80	2.80
12m BA	2.12	2.15	2.20	2.30	2.30	2.30	2.45	2.60	2.75	2.85	2.90
Prime Rate	3.45	3.45	3.45	3.70	3.70	3.70	3.95	4.20	4.45	4.70	4.70
U.S. Yield Curve											
Fed funds	1.63	1.63	1.88	1.88	1.88	2.13	2.38	2.63	2.88	2.88	2.88
3 month	1.79	1.85	1.95	1.95	2.05	2.05	2.20	2.35	2.55	2.65	2.65
6 month	1.98	2.05	2.15	2.15	2.20	2.20	2.40	2.55	2.70	2.80	2.80
1 year	2.15	2.25	2.35	2.35	2.40	2.40	2.55	2.70	2.85	2.90	2.90
2 year	2.38	2.60	2.70	2.75	2.75	2.75	2.85	3.00	3.10	3.15	3.15
3 year	2.52	2.60	2.70	2.75	2.75	2.75	2.85	3.00	3.10	3.15	3.15
5 year	2.70	2.80	2.85	2.90	2.90	2.90	3.00	3.10	3.20	3.30	3.35
7 year	2.82	2.90	2.95	2.95	3.00	3.00	3.05	3.15	3.30	3.35	3.45
10 year	2.87	2.95	3.00	3.00	3.05	3.05	3.10	3.20	3.30	3.40	3.50
30 year	3.07	3.15	3.20	3.20	3.25	3.25	3.30	3.40	3.55	3.60	3.70
1m LIBOR	1.90	1.95	2.05	2.05	2.10	2.10	2.25	2.40	2.55	2.60	2.60
3m LIBOR	2.35	2.40	2.50	2.50	2.55	2.55	2.70	2.85	3.00	3.10	3.10
6m LIBOR	2.49	2.55	2.65	2.65	2.70	2.70	2.90	3.05	3.20	3.25	3.25
12m LIBOR	2.74	2.80	2.90	2.90	3.00	3.00	3.10	3.25	3.40	3.45	3.45
Prime Rate	4.75	4.75	5.00	5.00	5.00	5.10	5.35	5.60	5.85	6.00	6.00
Other G7 Yields											
ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25
10yr Bund	0.55	0.60	0.65	0.70	0.75	0.75	0.95	1.10	1.20	1.35	1.45
BoE Repo	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00
10yr Gilt	1.44	1.50	1.55	1.60	1.65	1.65	1.80	1.95	2.10	2.30	2.45
Boj O/N	-0.07	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	0.00
10yr JGB	0.04	0.05	0.05	0.06	0.07	0.07	0.09	0.10	0.11	0.12	0.12

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