

**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	2018		2019			2018	2019			
	Jun	Jul	Aug	Sep	Oct	Nov	Q4	Q1	Q2	Q3	Q4
BoC overnight	1.25	1.50	1.50	1.50	1.75	1.75	1.75	1.75	2.00	2.25	2.25
10-yr Canadas	2.21	2.20	2.30	2.40	2.45	2.50	2.50	2.60	2.65	2.75	2.80
Fed funds	1.88	1.88	1.88	2.13	2.13	2.13	2.38	2.63	2.88	2.88	2.88
10-yr Treasuries	2.91	2.85	2.95	3.00	3.05	3.05	3.05	3.15	3.20	3.20	3.25
C\$ per US\$	1.312	1.306	1.300	1.294	1.288	1.281	1.281	1.271	1.265	1.258	1.252
US\$/€	1.17	1.18	1.19	1.19	1.20	1.21	1.21	1.23	1.23	1.24	1.25
US\$/£	1.33	1.34	1.34	1.35	1.36	1.36	1.36	1.38	1.40	1.41	1.43
¥/US\$	110	110	109	109	109	108	108	108	107	106	105

## Since the previous issue of Rates Scenario (on June 15<sup>th</sup>):

- **The risks of a full-blown global trade war and an emerging markets crisis are rising in the market's mind**, fuelling “flight to liquidity” flows into Treasuries and U.S. dollar strength. This is the backdrop for some minor tweaking of our forecasts.
- **We still look for the Bank to Canada to raise rates on July 11<sup>th</sup>**, with a follow-up move in October. However, we've pared back our call for next year, with two rate hikes instead of three, and the Bank hitting the bottom of its 2.50%-to-3.50% estimated neutral range only in 2020. The adjustment is in recognition of the heightened economic risk posed by potential U.S. trade policy (e.g., tariffs on Canadian vehicles and parts were unthinkable just a couple months ago). And, the cloud of NAFTA uncertainty over business investment now looks like it could hover well into next year.
- **We still expect the Fed to follow a quarterly rate-hike pattern**, pausing once it hits its current longer-run median projection of 2.875% (the 2.75%-to-3.00% range) in June 2019, before shifting into a net restrictive gear (2020). With respect to the above-mentioned risks, given where growth and inflation are on the ground—the former trending well-above potential and the latter already at-or-above target—we judge the Fed will put more weight on the inflation implications of tariffs than on the growth consequences in its assessment of the risks. An emerging markets crisis could potentially exacerbate weakness and volatility in U.S. equity prices and credit spreads, along with fuelling further appreciation of the U.S. dollar. We could soon see “*global economic and financial conditions*” returning to the Fed's risk lexicon. However, we doubt they will have the same potential to stay the Fed's policy hand as in 2015 and 2016.
- In the Treasury market, we still anticipate a (slow) ratcheting uptrend in longer-term yields. A mounting positive output gap, a super-low jobless rate that's primed to move lower, and inflation rates that are poised to push further above the FOMC's 2% target all argue for higher yields, along with surging supply to fund trillion-dollar deficits and Fed redemptions alleviating some of the compression pressure on term premiums. However, it's clear that flight-to-liquidity flows can be formidable; and in recognition of them, we've scaled back our call for 10-year Treasuries (3.10% by 2018-end and 3.25% by the end of next year vs. 3.25% and 3.50%,

respectively, before). While the risk of inversion (2s, 10s) is also increasing, we still judge that it will persist only if the Fed feels compelled to push policy rates above neutral in 2019H2. Longer-term Canadas should underperform as the Bank of Canada re-enters the tightening game (10 years around 2.55% by 2018-end and 2.85% by 2019-end vs. 2.65% and 3.05%, respectively, before).

- **We now look for the BoE to raise rates in August**, instead of holding off until November, for a number of reasons. The British economy continues to improve (example: the services PMI hit an 8-month high in June), supporting the central bank's thesis that the Q1 slowdown was temporary; 3 of the 9 MPC members were itching for a rate hike last month, which is one more than at the previous two meetings; one of those hawkish members is leaving and a more dovish policymaker will be taking his place in September; and finally, the BoE does not want to tighten too close to the March 2019 Brexit date and November is cutting it close. It was also interesting that the BoE updated its guidance on the Asset Purchase Program at the June meeting. The stock of purchased assets won't be reduced until the Bank Rate, currently at 0.50%, reaches "*around 1.5%*" (prior to this, it was 2.0%). The GBP will likely struggle to gain traction before the end of 2018, but the rate hike will help.
- **No changes to our ECB call.** It was only a few weeks ago that the central bank outlined the path it expects to take over the next 12 months—trimming its monthly bond purchases to €15 bln starting in October, and making the final purchase in December, but leaving rates "*at present levels at least through the summer of 2019*". While there are a number of interpretations of what exactly the rate guidance means, given the threat of a global trade war and President Draghi's cautious comments made in Sintra, Portugal about this threat ("*It's very worrisome and again, I can't see any positive*"), we don't expect the ECB to touch rates until next September. The euro will be given a boost as the QE program winds down and in anticipation of a rate hike in 2019, but political concerns (Germany and Italy) and a tariff war will keep a rally in check.
- **No changes to our BoJ call.** We once expected the central bank to tweak its bond purchases so that 10-year yields would not remain around 0%, but the BoJ has made it clear that it will retain its highly accommodative stance until inflation reaches the 2% target. Global trade uncertainty will keep the JPY below ¥110 over the next year.
- **No changes to our RBA call.** Sluggish wage growth and high levels of household debt, along with the potential for a global trade war, are keeping the RBA on the sidelines. No rate hike is expected until the second half of 2019. **Banxico**, meantime, is expected to nudge rates higher to control inflation, but policymakers are also keeping an eye out for what incoming-President Andrés Manuel López Obrador's new government has in store for the economy. Mexico's central bank deputy governor stated that "*As soon as the electoral process is concluded, specific details will be required regarding the economic policy actions that the incoming administration intends to take*".
- The currency market is volatile but particularly so these days, with the uncertain backdrop of a global tariff war, mixed in with domestic, or country-specific, issues. These trade concerns are having a notable impact on the **Chinese yuan**. Given the rising risk of a trade war with the U.S., we now see the currency weakening to 6.75 by year-end (from under 6.3 in April).

## Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual	Forecasts					2018	2019	Q2	Q3	Q4
	2018	2018	Aug	Sep	Oct	Nov					
	Jun	Jul									
<b>Canadian Dollar</b>											
C\$ per US\$	1.312	1.306	1.300	1.294	1.288	1.281	1.281	1.271	1.265	1.258	1.252
US\$ per C\$	0.762	0.766	0.769	0.773	0.777	0.780	0.781	0.787	0.791	0.795	0.799
Trade-weighted	95.7	96.1	96.4	96.8	97.2	97.6	97.6	98.2	98.4	98.7	99.0
<b>U.S. Dollar</b>											
Trade-weighted <sup>1</sup>	123.4	123.9	123.9	123.9	123.9	123.8	123.8	123.3	122.5	121.7	120.9
<b>European Currencies</b>											
Euro <sup>2</sup>	1.17	1.18	1.19	1.19	1.20	1.21	1.21	1.23	1.23	1.24	1.25
Danish Krone	6.38	6.35	6.30	6.25	6.20	6.15	6.15	6.10	6.05	6.00	5.95
Norwegian Krone	8.11	8.05	8.00	7.95	7.90	7.85	7.85	7.75	7.70	7.65	7.60
Swedish Krone	8.80	8.75	8.70	8.60	8.55	8.50	8.50	8.40	8.40	8.35	8.35
Swiss Franc	0.990	0.989	0.988	0.987	0.986	0.985	0.985	0.986	0.990	0.995	0.999
U.K. Pound <sup>2</sup>	1.33	1.34	1.34	1.35	1.36	1.36	1.36	1.38	1.40	1.41	1.43
<b>Asian Currencies</b>											
Chinese Yuan	6.47	6.60	6.63	6.66	6.69	6.72	6.72	6.73	6.69	6.65	6.61
Japanese Yen	110	110	109	109	109	108	108	108	107	106	105
Korean Won	1,094	1,100	1,110	1,115	1,120	1,125	1,125	1,130	1,125	1,115	1,110
Indian Rupee	67.8	68.1	68.5	68.8	69.2	69.5	69.5	69.7	69.4	69.0	68.7
Singapore Dollar	1.35	1.36	1.38	1.39	1.41	1.42	1.42	1.44	1.44	1.44	1.43
Malaysian Ringgit	4.00	4.05	4.15	4.20	4.25	4.30	4.30	4.40	4.40	4.40	4.45
Thai Baht	32.5	32.9	33.4	33.8	34.2	34.7	34.7	35.0	34.9	34.8	34.7
Philippine Peso	53.1	53.8	54.6	55.3	56.0	56.7	56.7	57.3	57.3	57.2	57.1
Taiwan Dollar	30.1	30.4	30.7	31.1	31.4	31.7	31.7	32.0	31.9	31.8	31.7
Indonesian Rupiah	14,007	14,205	14,400	14,595	14,795	14,990	14,990	15,185	15,185	15,185	15,180
<b>Other Currencies</b>											
Australian Dollar <sup>2</sup>	0.750	0.753	0.757	0.760	0.763	0.767	0.767	0.773	0.778	0.783	0.788
New Zealand Dollar <sup>2</sup>	0.694	0.700	0.706	0.712	0.718	0.724	0.724	0.733	0.736	0.740	0.744
Mexican Peso	20.29	20.20	20.10	20.00	19.95	19.85	19.85	19.60	19.25	18.95	18.60
Brazilian Real	3.77	3.80	3.85	3.90	3.90	3.95	3.95	4.00	4.00	3.95	3.95
Russian Ruble	62.8	63.0	63.1	63.2	63.3	63.4	63.3	63.1	63.2	63.2	63.2
South African Rand	13.3	13.3	13.2	13.2	13.1	13.1	13.1	13.0	13.1	13.2	13.2
<b>Cross Rates</b>											
<b>Versus Canadian Dollar</b>											
Euro (C\$/€)	1.53	1.54	1.54	1.54	1.55	1.55	1.55	1.56	1.56	1.56	1.56
U.K. Pound (C\$/£)	1.74	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.76	1.77	1.78
Japanese Yen (¥/C\$)	84	84	84	84	84	85	85	85	84	84	84
Australian Dollar (C\$/A\$)	0.98	0.98	0.98	0.98	0.98	0.98	0.98	0.98	0.98	0.99	0.99
<b>Versus Euro</b>											
U.K. Pound (£/€)	0.88	0.88	0.88	0.88	0.89	0.89	0.89	0.89	0.88	0.88	0.88
Japanese Yen (¥/€)	129	129	130	130	131	131	131	132	132	131	131

<sup>1</sup> Federal Reserve Broad Index    <sup>2</sup> (US\$ per local currency)

## Interest Rate Forecasts

Percent (averages)

	Actual 2018 Jun	Forecasts 2018					2018 Q4	2019 Q1	Q2	Q3	Q4
		Jul	Aug	Sep	Oct	Nov					
<b>Cdn. Yield Curve</b>											
Overnight	1.25	1.50	1.50	1.50	1.75	1.75	1.75	1.75	2.00	2.25	2.25
3 month	1.23	1.45	1.45	1.60	1.70	1.70	1.70	1.70	1.95	2.15	2.15
6 month	1.44	1.60	1.60	1.70	1.80	1.80	1.80	1.85	2.05	2.20	2.20
1 year	1.68	1.80	1.80	1.90	1.95	1.95	1.95	2.05	2.20	2.35	2.35
2 year	1.87	1.90	1.95	2.00	2.05	2.10	2.10	2.20	2.30	2.40	2.45
3 year	1.95	2.00	2.05	2.10	2.15	2.15	2.15	2.30	2.40	2.50	2.55
5 year	2.07	2.10	2.15	2.25	2.30	2.30	2.30	2.45	2.55	2.60	2.65
7 year	2.13	2.15	2.20	2.30	2.35	2.40	2.40	2.50	2.60	2.65	2.70
10 year	2.21	2.20	2.30	2.40	2.45	2.50	2.50	2.60	2.65	2.75	2.80
30 year	2.26	2.25	2.35	2.45	2.50	2.55	2.55	2.65	2.75	2.85	2.90
1m BA	1.64	1.85	1.85	1.95	2.05	2.05	2.05	2.05	2.25	2.45	2.45
3m BA	1.75	1.95	1.95	2.05	2.15	2.15	2.15	2.20	2.40	2.55	2.55
6m BA	1.92	2.05	2.05	2.15	2.25	2.25	2.25	2.25	2.45	2.60	2.60
12m BA	2.13	2.20	2.20	2.30	2.35	2.35	2.35	2.45	2.60	2.70	2.70
Prime Rate	3.45	3.70	3.70	3.70	3.95	3.95	3.95	3.95	4.20	4.45	4.45
<b>U.S. Yield Curve</b>											
Fed funds	1.88	1.88	1.88	2.13	2.13	2.13	2.38	2.63	2.88	2.88	2.88
3 month	1.94	1.95	2.05	2.15	2.15	2.25	2.25	2.45	2.65	2.75	2.75
6 month	2.11	2.10	2.20	2.30	2.30	2.35	2.35	2.55	2.70	2.80	2.80
1 year	2.33	2.35	2.40	2.50	2.50	2.55	2.55	2.70	2.85	2.95	2.90
2 year	2.53	2.60	2.60	2.65	2.70	2.75	2.75	2.90	3.00	3.05	3.05
3 year	2.65	2.70	2.70	2.75	2.80	2.85	2.85	2.95	3.05	3.10	3.10
5 year	2.78	2.85	2.80	2.90	2.90	2.95	2.95	3.05	3.10	3.15	3.15
7 year	2.87	2.95	2.90	2.95	3.00	3.05	3.05	3.10	3.15	3.20	3.20
10 year	2.91	2.85	2.95	3.00	3.05	3.05	3.05	3.15	3.20	3.20	3.25
30 year	3.05	3.00	3.05	3.15	3.15	3.20	3.20	3.25	3.30	3.35	3.40
1m LIBOR	2.07	2.05	2.20	2.30	2.30	2.45	2.45	2.65	2.90	3.05	3.05
3m LIBOR	2.33	2.35	2.45	2.55	2.55	2.65	2.65	2.85	3.05	3.15	3.15
6m LIBOR	2.50	2.50	2.65	2.75	2.75	2.85	2.85	3.05	3.30	3.40	3.40
12m LIBOR	2.76	2.85	2.90	3.00	3.00	3.10	3.10	3.30	3.55	3.65	3.60
Prime Rate	4.89	4.90	4.90	5.15	5.15	5.15	5.25	5.50	5.75	5.90	5.90
<b>Other G7 Yields</b>											
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	0.39	0.45	0.55	0.60	0.65	0.75	0.80	1.05	1.10	1.15	1.25
BoE Repo	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00
10yr Gilt	1.32	1.40	1.45	1.50	1.55	1.65	1.70	1.90	2.00	2.10	2.20
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	0.03	0.04	0.05	0.06	0.07	0.07	0.08	0.10	0.11	0.12	0.12

## General Disclosure

"BMO Capital Markets" is a trade name used by the BMO Financial Group for the wholesale banking businesses of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K. and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited and BMO Capital Markets Corp are affiliates. This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

## Dissemination of Research

Our publications are disseminated via email and may also be available via our web site <http://economics.bmocapitalmarkets.com>. Please contact your BMO Financial Group Representative for more information.

## Conflict Statement

A general description of how BMO Financial Group identifies and manages conflicts of interest is contained in our public facing policy for managing conflicts of interest in connection with investment research which is available at [http://researchglobal.bmocapitalmarkets.com/Public/Conflict\\_Statement\\_Public.aspx](http://researchglobal.bmocapitalmarkets.com/Public/Conflict_Statement_Public.aspx).

## ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., Member FDIC. Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets. BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A, BMO Ireland Plc, and Bank of Montreal (China) Co. Ltd. and the institutional broker dealer businesses of BMO Capital Markets Corp. (Member SIPC), BMO Nesbitt Burns Securities Limited (Member SIPC) in the U.S., BMO Nesbitt Burns Inc. (Member Canadian Investor Protection Fund) in Canada, Europe and Asia, BMO Capital Markets Limited in Europe, Asia and Australia and BMO Advisors Private Limited in India.

"Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Inc., used under license. "BMO Capital Markets" is a trademark of Bank of Montreal, used under license. "BMO (M-Bar roundel symbol)" is a registered trademark of Bank of Montreal, used under license.

© Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

™ Trademark Bank of Montreal in the United States and Canada.

© COPYRIGHT 2018 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group