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Forecast Summary (averages)

	Actual	Forecasts						2019			
	2018 Jul	2018 Aug	Sep	Oct	Nov	Dec	2019 Jan	2019 Q1	Q2	Q3	Q4
BoC overnight	1.50	1.50	1.50	1.75	1.75	1.75	1.75	1.75	2.00	2.25	2.25
10-yr Canadas	2.19	2.35	2.45	2.45	2.50	2.55	2.55	2.60	2.65	2.75	2.80
Fed funds	1.88	1.88 ¹	2.13	2.13	2.13	2.38	2.38	2.63	2.88	2.88	2.88
10-yr Treasuries	2.89	3.00	3.05	3.05	3.10	3.10	3.10	3.15	3.20	3.20	3.25
C\$ per US\$	1.313	1.306	1.298	1.290	1.283	1.275	1.273	1.271	1.265	1.258	1.252
US\$/€	1.17	1.16	1.17	1.17	1.18	1.18	1.18	1.18	1.20	1.22	1.24
US\$/£	1.32	1.30	1.30	1.29	1.29	1.28	1.27	1.26	1.30	1.34	1.39
¥/US\$	111	111	111	111	110	110	110	110	109	109	108

¹ actual value for August 2018

Since the previous issue of Rates Scenario (on July 4th):

- The **Bank of Canada** raised its policy rate 25 bps to 1.50% on July 11, which was widely expected. While uncertainty continues to cloud the outlook for the Canadian economy, a near-month-long run of solid data has another hike priced in by October (consistent with our call), with some even calling for a September hike. The BoC's July statement reinforced expectations of gradual tightening, highlighting trade uncertainty, and reinserting concerns that wage growth remains sluggish. We're not entirely ruling out a September hike at this point, but it would take a very strong run of data over the next month. Keys to watch are the July jobs report, Governor Poloz's speech on August 25, and Q2 GDP on August 30. As before, we expect two rate hikes next year and for the Bank to only hit the bottom of its 2.50%-to-3.50% estimated neutral range in 2020.
- We **still look for the Fed to raise rates again in September**, lifting the Fed funds target range by 25 bps to 2.00%-to-2.25%, with the midpoint (2.125%) unequivocally rising above core PCE inflation (1.9% y/y) for the first time since March 2008. Our base case remains that the Fed continues tightening at a quarterly cadence. But, starting in Q4, we judge the FOMC will become more cautious, raising the risk of a pause or, more generally, a shift out of a quarterly rate-hike gear. We suspect that this was the rationale behind the "for now" language being very visibly inserted into Chairman Powell's forward guidance on gradualism proffered in his recent congressional testimony (this should make it into September's FOMC statement despite not making it into August's). The extra caution is elicited by the following two factors.
- First, while the Fed seems completely comfortable with non-negative real policy rates, there is still much uncertainty surrounding the current level of the short-run, neutral real policy rate, let alone its evolution over time and, ultimately, its longer-run level. Second, with the FOMC just about to reach the fully-phased-in QE reinvestments threshold (a year in the making), the inherent risk of an adverse reaction in financial markets from balance sheet reduction will presumably be at its highest level. If we don't get a pause in the interim, we still expect we'll get one once the Fed hits its current longer-run median projection of 2.875% (the 2.75%-to-3.00% range) in June 2019. At this time, the potential first policy steps into net restrictive territory will cast their own

pull of caution. How long any pause lasts for will depend on domestic/global economic and financial developments. Our base case is for the Fed to take a couple of tightening steps in 2020.

- In the Treasury market, we judge a slow, ratcheting uptrend in longer-term yields continues to unfold. 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, not to mention buying by yield-starved investors. Even with 10-year yields starting closer to 3.00%, it's still going to be a grinding, ratcheting rise even to revisit this year's 3.11% high (which we expect by year-end). While the risk of inversion (2s, 10s) is also increasing, we judge it will persist only if the Fed feels compelled to push policy rates above neutral in 2019H2 or sooner (and matters as a recession signal only if the full curve inverts). Longer-term Canadas should underperform as the Bank of Canada also tightens, with 10-year yields averaging around 2.55% by year-end.
- The **CAD** has remained largely range-bound as trade/NAFTA uncertainties have largely overwhelmed the move in oil prices. Some of the recent loonie strength has been driven by rising Bank of Canada rate hike expectations, pushing rate spreads in the loonie's favour.
- We've chopped our forecasts for the **GBP** and the **EUR** significantly since the last issue of Rates Scenario as **the Brexit issue will likely dominate for the remainder of the year**. Indeed, the possibility of a cliff-edge Brexit is growing, although no one, including the negotiators themselves, knows what the final outcome will be, or what the final deal will look like (we still assume there will be a deal). And there is a new twist now that PM May's negotiating team has seen some turnover (David Davis resigned), and the British leader made herself the key negotiator with the EU. Even the unexpected unanimous backing to the **BoE's expected 25 bp rate hike** on August 2 failed to give the GBP a lift. Piling on, it was not particularly helpful that BoE Governor Carney weighed in with his view that the risk of a no-deal Brexit was "*uncomfortably high*", followed by a complaint by U.K. International Trade Secretary Liam Fox (and Brexiteer) that the EU's Michel Barnier had dismissed the British proposals, which "*makes the chance of no deal greater*", and that "*the intransigence of the commission is pushing us towards a no deal*". Although the **ECB** continues to aim towards wrapping up its bond purchases by the end of 2018, and for rates to stay at current levels "*through the summer of 2019*" (we continue to have a September 2019 rate hike pencilled in), the EUR will reflect more Brexit uncertainty in the near term than an ECB rate hike next summer.
- The outlook for the **BoJ** remains unchanged: continued monetary accommodation until inflation hits target, which "*will take more time than expected*". At the July 31 meeting, though, policymakers signalled greater flexibility for longer-term rates, and would tolerate yields deviating as much as 0.2% on either side of the zero target, compared to 0.1% now. The **Banco de Mexico** stayed on the sidelines at the August 2 meeting, leaving rates at a near-decade high of 7.75%. The **MXN** has strengthened in the aftermath of Mexico's elections, as NAFTA talks between the U.S. and Mexico seem to have taken a more constructive tone. The central bank is wary of keeping its currency from weakening too much, for fear of sparking inflation pressures as the economy softens.

Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual 2018 Jul	Forecasts 2018						2019 Jan	2019			
		Aug	Sep	Oct	Nov	Dec		Q1	Q2	Q3	Q4	
Canadian Dollar												
C\$ per US\$	1.313	1.306	1.298	1.290	1.283	1.275	1.273	1.271	1.265	1.258	1.252	
US\$ per C\$	0.761	0.766	0.770	0.775	0.780	0.784	0.786	0.787	0.791	0.795	0.799	
Trade-weighted	95.6	96.2	96.8	97.4	98.0	98.6	98.7	98.8	99.0	99.2	99.3	
U.S. Dollar												
Trade-weighted ¹	124.1	124.2	124.5	124.7	124.9	125.1	124.9	124.6	123.4	122.2	120.9	
European Currencies												
Euro ²	1.17	1.16	1.17	1.17	1.18	1.18	1.18	1.18	1.20	1.22	1.24	
Danish Krone	6.38	6.40	6.40	6.35	6.35	6.30	6.30	6.25	6.15	6.10	6.00	
Norwegian Krone	8.13	8.20	8.15	8.15	8.10	8.05	8.00	8.00	7.85	7.75	7.65	
Swedish Krone	8.82	8.85	8.80	8.80	8.75	8.75	8.70	8.65	8.55	8.45	8.35	
Swiss Franc	0.995	0.999	1.004	1.008	1.013	1.017	1.016	1.014	1.010	1.006	1.001	
U.K. Pound ²	1.32	1.30	1.30	1.29	1.29	1.28	1.27	1.26	1.30	1.34	1.39	
Asian Currencies												
Chinese Yuan	6.71	6.80	6.83	6.85	6.88	6.90	6.88	6.87	6.82	6.77	6.72	
Japanese Yen	111	111	111	111	110	110	110	110	109	109	108	
Korean Won	1,122	1,125	1,130	1,130	1,135	1,140	1,135	1,135	1,130	1,120	1,115	
Indian Rupee	68.7	68.7	68.8	68.9	68.9	69.0	68.7	68.3	67.3	66.3	65.3	
Singapore Dollar	1.36	1.37	1.37	1.37	1.38	1.38	1.38	1.37	1.36	1.35	1.34	
Malaysian Ringgit	4.05	4.05	4.05	4.10	4.10	4.10	4.10	4.10	4.05	4.00	3.95	
Thai Baht	33.3	33.3	33.3	33.4	33.4	33.5	33.4	33.4	33.2	33.0	32.9	
Philippine Peso	53.4	53.4	53.4	53.4	53.5	53.5	53.2	52.9	52.1	51.3	50.5	
Taiwan Dollar	30.5	30.6	30.7	30.8	30.9	31.1	31.0	31.0	30.8	30.7	30.5	
Indonesian Rupiah	14,405	14,445	14,480	14,520	14,555	14,595	14,550	14,505	14,375	14,245	14,115	
Other Currencies												
Australian Dollar ²	0.740	0.740	0.743	0.745	0.748	0.750	0.753	0.755	0.763	0.770	0.778	
New Zealand Dollar ²	0.679	0.675	0.686	0.698	0.709	0.720	0.722	0.724	0.730	0.737	0.743	
Mexican Peso	19.01	18.60	18.85	19.05	19.30	19.50	19.40	19.35	19.10	18.85	18.60	
Brazilian Real	3.83	3.75	3.80	3.90	3.95	4.00	4.00	4.00	4.00	3.95	3.95	
Russian Ruble	62.8	63.3	62.9	62.6	62.2	61.9	61.4	60.9	59.4	58.0	56.5	
South African Rand	13.4	13.3	13.2	13.1	13.1	13.0	13.0	13.0	13.1	13.2	13.2	
Cross Rates												
Versus Canadian Dollar												
Euro (C\$/€)	1.53	1.51	1.51	1.51	1.51	1.50	1.50	1.50	1.52	1.54	1.56	
U.K. Pound (C\$/£)	1.73	1.70	1.68	1.66	1.65	1.63	1.61	1.60	1.64	1.69	1.73	
Japanese Yen (¥/C\$)	85	85	85	86	86	86	86	86	86	86	86	
Australian Dollar (C\$/A\$)	0.97	0.97	0.96	0.96	0.96	0.96	0.96	0.96	0.96	0.97	0.97	
Versus Euro												
U.K. Pound (£/€)	0.89	0.89	0.90	0.91	0.91	0.92	0.93	0.94	0.93	0.91	0.90	
Japanese Yen (¥/€)	130	129	129	129	130	130	130	130	131	133	134	

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

Interest Rate Forecasts

Percent (averages)

	Actual 2018 Jul	Forecasts 2018						2019 Jan	2019			
		Aug	Sep	Oct	Nov	Dec		Q1	Q2	Q3	Q4	
Cdn. Yield Curve												
Overnight	1.50	1.50	1.50	1.75	1.75	1.75	1.75	1.75	2.00	2.25	2.25	
3 month	1.38	1.45	1.55	1.70	1.70	1.70	1.70	1.70	1.95	2.15	2.15	
6 month	1.55	1.60	1.70	1.80	1.80	1.80	1.80	1.80	2.00	2.20	2.20	
1 year	1.79	1.90	1.95	2.05	2.05	2.05	2.05	2.10	2.25	2.40	2.40	
2 year	1.97	2.10	2.10	2.15	2.15	2.20	2.20	2.25	2.35	2.40	2.50	
3 year	2.01	2.10	2.15	2.20	2.20	2.25	2.25	2.30	2.40	2.45	2.55	
5 year	2.10	2.25	2.30	2.35	2.35	2.40	2.45	2.45	2.55	2.60	2.70	
7 year	2.14	2.30	2.35	2.40	2.40	2.45	2.45	2.50	2.60	2.65	2.75	
10 year	2.19	2.35	2.45	2.45	2.50	2.55	2.55	2.60	2.65	2.75	2.80	
30 year	2.23	2.40	2.45	2.50	2.55	2.55	2.60	2.65	2.75	2.85	2.90	
1m BA	1.80	1.80	1.90	2.00	2.00	2.00	2.00	2.05	2.25	2.45	2.45	
3m BA	1.90	1.95	2.05	2.15	2.15	2.15	2.15	2.20	2.40	2.55	2.55	
6m BA	2.02	2.10	2.15	2.25	2.25	2.25	2.25	2.30	2.50	2.65	2.65	
12m BA	2.22	2.30	2.35	2.40	2.40	2.45	2.45	2.45	2.60	2.70	2.75	
Prime Rate	3.70	3.70	3.70	3.95	3.95	3.95	3.95	3.95	4.20	4.45	4.45	
U.S. Yield Curve												
Fed funds	1.88	1.88 ¹	2.13	2.13	2.13	2.38	2.38	2.63	2.88	2.88	2.88	
3 month	1.99	2.10	2.20	2.20	2.25	2.35	2.35	2.45	2.65	2.75	2.75	
6 month	2.17	2.25	2.30	2.30	2.40	2.45	2.45	2.55	2.70	2.80	2.80	
1 year	2.39	2.45	2.50	2.55	2.60	2.65	2.65	2.70	2.85	2.90	2.90	
2 year	2.61	2.65	2.70	2.75	2.80	2.80	2.85	2.90	3.00	3.05	3.05	
3 year	2.70	2.75	2.80	2.85	2.85	2.90	2.95	2.95	3.05	3.10	3.10	
5 year	2.78	2.85	2.90	2.95	2.95	3.00	3.00	3.05	3.10	3.15	3.15	
7 year	2.85	2.95	3.00	3.00	3.05	3.05	3.10	3.10	3.15	3.20	3.20	
10 year	2.89	3.00	3.05	3.05	3.10	3.10	3.10	3.15	3.20	3.20	3.25	
30 year	3.01	3.10	3.20	3.20	3.20	3.25	3.25	3.25	3.30	3.35	3.40	
1m LIBOR	2.08	2.10	2.30	2.30	2.45	2.55	2.55	2.65	2.90	3.05	3.05	
3m LIBOR	2.34	2.35	2.55	2.55	2.65	2.75	2.75	2.85	3.05	3.15	3.15	
6m LIBOR	2.52	2.55	2.75	2.75	2.85	2.95	2.95	3.10	3.30	3.40	3.40	
12m LIBOR	2.79	2.85	3.00	3.05	3.15	3.25	3.25	3.35	3.55	3.65	3.65	
Prime Rate	5.00	5.00	5.25	5.25	5.25	5.50	5.50	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	0.35	0.50	0.60	0.75	0.85	1.00	1.00	1.05	1.10	1.15	1.25	
BoE Repo	0.50	0.75 ¹	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	
10yr Gilt	1.27	1.40	1.50	1.60	1.75	1.85	1.85	1.90	1.90	1.95	2.00	
Boj O/N	-0.07	-0.05 ¹	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	0.00	
10yr JGB	0.05	0.06	0.07	0.08	0.09	0.10	0.10	0.10	0.11	0.12	0.12	

¹ actual value for August 2018

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