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## Forecast Summary (averages)

	Actual	Forecasts							2019		
	2018 Sep	2018 Oct	Nov	Dec	2019 Jan	Feb	Mar	Apr	2019 Q2	Q3	Q4
BoC overnight	1.50	1.75	1.75	1.75	2.00	2.00	2.00	2.25	2.25	2.50	2.50
10-yr Canadas	2.35	2.40	2.45	2.50	2.55	2.55	2.60	2.65	2.65	2.80	2.90
Fed funds	2.13	2.13	2.13	2.38	2.38	2.38	2.63	2.63	2.88	2.88	3.13
10-yr Treasuries	3.00	3.05	3.05	3.10	3.10	3.15	3.15	3.20	3.20	3.25	3.35
C\$ per US\$	1.304	1.294	1.284	1.275	1.273	1.271	1.269	1.267	1.265	1.258	1.252
US\$/€	1.17	1.17	1.18	1.18	1.17	1.17	1.16	1.17	1.19	1.22	1.24
US\$/£	1.31	1.29	1.28	1.26	1.25	1.23	1.22	1.25	1.27	1.33	1.38
MXN/US\$	19.01	19.00	19.00	19.00	19.00	18.95	18.95	18.90	18.90	18.85	18.75
¥/US\$	112	112	112	112	112	112	112	111	111	111	110

## Since the previous issue of Rates Scenario (on September 6<sup>th</sup>):

- We look for the **Bank of Canada** to raise its policy rate by 25 bps on October 24<sup>th</sup>, with average core inflation running a tenth above the 2% target, real GDP growth out of the Q3 gate seemingly doing better than expected (the BoC's current call is 1.5% annualized), the economy “operating near capacity for some time”, and policy rates still accommodative (negative in real terms). With the advent of the **United States-Mexico-Canada Agreement (USMCA)**, a major source of uncertainty surrounding Canada's economic outlook has been assuaged, removing a key reason why the Bank would take a pass on rate hikes. Back on September 5<sup>th</sup>, the Bank said it was “monitoring closely the course of NAFTA negotiations and other trade policy developments”, and trade uncertainty was a regular reason the Bank downgraded its economic outlook over the past year. With a new deal reached, we suspect that the Bank will sound (cautiously) upbeat, emphasizing the upside risks to, or upgrading, its economic outlook. Indeed, reflecting the reduced downside risks, we now expect the Bank to continue with a quarterly (a.k.a. “gradual”) rate-hike pattern until the bottom of the estimated neutral range (2.5% to 3.5%) is hit, at which time we look for at least a six-month pause before potentially pushing rates up in this range. **We now have three rate hikes in 2019 versus our previous call for two moves.**
- For the eighth time since December 2015, and the fourth consecutive quarter, the **Fed** hiked its key policy rate by a quarter-point on September 26<sup>th</sup>. The action was completely expected, and occurred amid another “strong” assessment of the U.S. economy by Chairman Powell et al. Indeed, the economic assessment from August 1<sup>st</sup> was repeated verbatim, hinting that, if the economy does as well during the next three months, another rate increase is coming. The Summary of Economic Projection's “dot plot” showed that 12 of 16 participants are projecting another move this year; so, for the fourth December in a row, the Fed will hike rates.
- In lifting the fed funds target range by 25 bps to 2.00%-to-2.25%, the Fed shed negative real policy rates for the first time since March 2008; the range midpoint now sits above current core PCE inflation (2.0% y/y). We judge this marks a critical policy juncture because more nimbleness might be necessary moving forward. First, the road from zero real to neutral real policy rates is paved with uncertainty over timing and terminus. Second, this

month, the Fed's balance sheet reduction will have reached its maximum permissible pace of \$50 billion per month, likely casting the inherent risk of an adverse reaction in financial markets to its highest level.

- The FOMC's new median call for the longer-run fed funds rate is 3.00% (a 1.00% neutral real rate), and we look for the current quarterly rate-hike cadence to continue until the target range first envelopes this level (2.75%-to-3.00%). At that time (June 2019), the Fed should pause ahead of taking its first policy steps into net restrictive territory. With core PCE inflation potentially pushing above 2.3% y/y next year (currently 2.0% y/y) and the jobless rate, currently 3.8%, plumbing 3.5% (which will be the second lowest level in 66 years!), we've pencilled in a fifth consecutive December rate hike. Our previous forecast had no such move. Note that starting in 2019, there will be press conferences after each meeting, so the timing of rate hikes and passes could become less predictable.
- In the **Treasury market**, we judge that the slow, ratcheting uptrend in longer-term yields continues. A mounting positive output gap, a super-low jobless rate that's primed to move lower, and inflation rates that are poised to push 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, buying by yield-starved investors (as yields hit new highs) and what seems to be regular bouts of flight-to-liquidity can be powerful offsets. On balance, we expect 10-year yields to trade around 3.10% by year-end and 3.35% by 2019-end (the latter is 10 bps above our prior forecast). Meanwhile, we look for the yield curve (2s, 10s) to continue flattening to low single-digits, as the risk of persistent inversion mounts. Longer-term Canadas should underperform as the Bank of Canada also tightens, with 10-year yields averaging above 2.50% by year-end and above 2.90% by 2019-end.
- On the USMCA news, the **Canadian dollar** rallied to above 78 US cents (under \$1.28), the strongest in around 4½ months, before settling back a bit, as the market priced-out negative NAFTA risk. While the currency could score further gains from reduced trade uncertainty, we expect it to strengthen only mildly by year-end, to 78.5 US cents (\$1.275). BoC-Fed policy rate spreads look to stay stable in the period ahead, with both central banks following a quarterly rate-hike cycle (for the time being). Meanwhile, Canada's chronic competitiveness problem continues, holding back some loonie appreciation. By 2019-end, we look for it to average modestly stronger, at around 80 US cents (\$1.25).
- The past month has seen more turmoil on the political and global trade war front, but our calls for monetary policy outside of North America are little-changed. The **ECB** has entered the final stage of bond purchases, with the monthly buying of €15 bln wrapping up by year-end. We continue to expect the ECB to raise rates in September 2019. However, instead of a 25 bp hike to the refi rate, we now look for a 10 bp hike (to 0.10%), coupled with a 10 bp lift to the deposit rate (to -0.30%). Worries over Italy's fiscal outlook have returned to the front burner; and, if such concerns do not ease, President Draghi may tweak the tone on the rates guidance. The **BoE** is not expected to make any moves until after Brexit Day (March 2019), but political tensions and the growing possibility of "no deal" are having a negative impact on business investment decisions. In fact, capex declined in the first two quarters of the year. We've lowered the near-term outlook for the GBP and are keeping watch on economic activity as slower growth may push the BoE beyond the expected May 2019 hike. The **BoJ** remains as is; no moves until inflation nears the 2% target. However, some policymakers are becoming worried about the potential dangers of ultra-easy policy. That is an early hint that a tiny step toward normalizing monetary policy could finally be in the offing.

## Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual 2018 Sep	Forecasts 2018				2019				2019 Q2	Q3	Q4
		Oct	Nov	Dec	Jan	Feb	Mar	Apr				
<b>Canadian Dollar</b>												
C\$ per US\$	1.304	1.294	1.284	1.275	1.273	1.271	1.269	1.267	1.265	1.258	1.252	
US\$ per C\$	0.767	0.773	0.779	0.784	0.786	0.787	0.788	0.789	0.791	0.795	0.799	
Trade-weighted	96.5	97.2	97.9	98.6	98.8	99.1	99.3	99.3	99.3	99.4	99.5	
<b>U.S. Dollar</b>												
Trade-weighted <sup>1</sup>	126.0	125.8	125.9	126.0	126.1	126.1	126.2	125.8	125.4	124.4	123.5	
<b>European Currencies</b>												
Euro <sup>2</sup>	1.17	1.17	1.18	1.18	1.17	1.17	1.16	1.17	1.19	1.22	1.24	
Danish Krone	6.39	6.35	6.35	6.30	6.30	6.25	6.25	6.20	6.15	6.10	6.00	
Norwegian Krone	8.25	8.20	8.10	8.05	8.00	8.00	7.95	7.90	7.85	7.75	7.65	
Swedish Krone	8.95	8.95	8.95	9.00	8.95	8.85	8.80	8.75	8.70	8.55	8.40	
Swiss Franc	0.968	0.985	1.001	1.017	1.016	1.014	1.013	1.011	1.010	1.006	1.001	
U.K. Pound <sup>2</sup>	1.31	1.29	1.28	1.26	1.25	1.23	1.22	1.25	1.27	1.33	1.38	
<b>Asian Currencies</b>												
Chinese Yuan	6.85	6.87	6.89	6.90	6.90	6.90	6.89	6.89	6.89	6.88	6.86	
Japanese Yen	112	112	112	112	112	112	112	111	111	111	110	
Korean Won	1,119	1,125	1,130	1,140	1,140	1,140	1,140	1,140	1,140	1,140	1,135	
Indian Rupee	72.2	72.3	72.4	72.5	72.4	72.4	72.3	72.3	72.2	72.1	72.0	
Singapore Dollar	1.37	1.37	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.37	1.37	
Malaysian Ringgit	4.14	4.15	4.15	4.20	4.20	4.20	4.15	4.15	4.15	4.15	4.15	
Thai Baht	32.6	32.9	33.2	33.5	33.5	33.5	33.5	33.5	33.5	33.5	33.6	
Philippine Peso	54.0	54.2	54.3	54.5	54.4	54.4	54.3	54.3	54.2	54.0	53.8	
Taiwan Dollar	30.7	30.8	30.9	31.1	31.1	31.1	31.1	31.1	31.1	31.1	31.2	
Indonesian Rupiah	14,864	14,945	15,030	15,110	15,095	15,080	15,065	15,050	15,035	14,990	14,950	
<b>Other Currencies</b>												
Australian Dollar <sup>2</sup>	0.721	0.714	0.707	0.700	0.702	0.704	0.706	0.708	0.710	0.717	0.723	
New Zealand Dollar <sup>2</sup>	0.660	0.657	0.653	0.650	0.651	0.652	0.653	0.653	0.654	0.657	0.659	
Mexican Peso	19.01	19.00	19.00	19.00	19.00	18.95	18.95	18.90	18.90	18.85	18.75	
Brazilian Real	4.11	4.25	4.25	4.20	4.20	4.20	4.20	4.15	4.15	4.15	4.10	
Russian Ruble	67.6	66.3	64.9	63.6	63.4	63.2	63.1	62.9	62.7	62.3	61.8	
South African Rand	14.8	15.3	15.9	16.5	16.5	16.6	16.6	16.7	16.7	16.8	17.0	
<b>Cross Rates</b>												
<b>Versus Canadian Dollar</b>												
Euro (C\$/€)	1.52	1.52	1.51	1.50	1.49	1.48	1.47	1.49	1.50	1.53	1.55	
U.K. Pound (C\$/£)	1.70	1.67	1.64	1.61	1.59	1.57	1.55	1.58	1.61	1.68	1.73	
Japanese Yen (¥/C\$)	86	87	87	88	88	88	88	88	88	88	88	
Australian Dollar (C\$/A\$)	0.94	0.92	0.91	0.89	0.89	0.89	0.90	0.90	0.90	0.90	0.91	
<b>Versus Euro</b>												
U.K. Pound (£/€)	0.89	0.91	0.92	0.94	0.94	0.95	0.95	0.94	0.93	0.91	0.90	
Japanese Yen (¥/€)	131	131	132	132	131	130	129	131	132	135	137	

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

## Interest Rate Forecasts

Percent (averages)

	Actual 2018 Sep	Forecasts 2018				2019				2019		
		Oct	Nov	Dec	Jan	Feb	Mar	Apr	Q2	Q3	Q4	
<b>Cdn. Yield Curve</b>												
Overnight	1.50	1.75	1.75	1.75	2.00	2.00	2.00	2.25	2.25	2.50	2.50	
3 month	1.53	1.75	1.75	1.85	1.95	1.95	2.05	2.15	2.20	2.40	2.40	
6 month	1.72	1.90	1.90	2.00	2.10	2.10	2.20	2.30	2.30	2.45	2.45	
1 year	1.98	2.10	2.10	2.20	2.25	2.30	2.35	2.45	2.45	2.60	2.65	
2 year	2.14	2.20	2.25	2.30	2.35	2.40	2.45	2.50	2.55	2.65	2.75	
3 year	2.17	2.20	2.25	2.30	2.35	2.40	2.45	2.50	2.55	2.65	2.75	
5 year	2.27	2.30	2.35	2.40	2.45	2.50	2.55	2.55	2.60	2.70	2.80	
7 year	2.29	2.35	2.40	2.45	2.45	2.50	2.55	2.60	2.65	2.75	2.85	
10 year	2.35	2.40	2.45	2.50	2.55	2.55	2.60	2.65	2.65	2.80	2.90	
30 year	2.37	2.40	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.85	3.00	
1m BA	1.83	2.05	2.05	2.15	2.25	2.25	2.35	2.45	2.50	2.70	2.70	
3m BA	1.99	2.20	2.20	2.30	2.40	2.40	2.50	2.60	2.65	2.80	2.80	
6m BA	2.15	2.30	2.30	2.40	2.50	2.50	2.60	2.65	2.70	2.85	2.85	
12m BA	2.37	2.50	2.50	2.55	2.65	2.65	2.70	2.80	2.80	2.95	3.00	
Prime Rate	3.70	3.95	3.95	3.95	4.20	4.20	4.20	4.45	4.45	4.70	4.70	
<b>U.S. Yield Curve</b>												
Fed funds	2.13	2.13	2.13	2.38	2.38	2.38	2.63	2.63	2.88	2.88	3.13	
3 month	2.17	2.15	2.25	2.40	2.40	2.50	2.60	2.60	2.70	2.80	2.90	
6 month	2.34	2.35	2.45	2.55	2.55	2.60	2.70	2.70	2.80	2.90	3.00	
1 year	2.56	2.55	2.65	2.70	2.70	2.80	2.85	2.85	2.95	3.05	3.15	
2 year	2.77	2.80	2.85	2.85	2.90	2.95	3.00	3.00	3.05	3.15	3.25	
3 year	2.84	2.85	2.90	2.95	2.95	3.00	3.05	3.05	3.10	3.20	3.30	
5 year	2.89	2.90	2.95	3.00	3.00	3.05	3.10	3.10	3.15	3.20	3.30	
7 year	2.96	3.00	3.00	3.05	3.10	3.10	3.15	3.15	3.20	3.25	3.30	
10 year	3.00	3.05	3.05	3.10	3.10	3.15	3.15	3.20	3.20	3.25	3.35	
30 year	3.15	3.20	3.20	3.25	3.25	3.30	3.30	3.35	3.35	3.40	3.50	
1m LIBOR	2.18	2.20	2.30	2.45	2.45	2.60	2.75	2.75	2.85	3.00	3.15	
3m LIBOR	2.35	2.35	2.50	2.60	2.60	2.75	2.85	2.85	3.00	3.10	3.25	
6m LIBOR	2.57	2.55	2.70	2.85	2.85	3.00	3.15	3.15	3.25	3.40	3.55	
12m LIBOR	2.88	2.90	3.00	3.10	3.15	3.25	3.35	3.40	3.50	3.65	3.80	
Prime Rate	5.03	5.25	5.25	5.50	5.50	5.50	5.75	5.75	5.85	6.00	6.10	
<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	0.10	0.10	
10yr Bund	0.44	0.55	0.60	0.70	0.75	0.75	0.80	0.85	0.85	0.95	1.05	
BoE Repo	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	
10yr Gilt	1.53	1.55	1.60	1.65	1.70	1.70	1.75	1.75	1.80	1.90	1.95	
Boj O/N	-0.06	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	0.00	
10yr JGB	0.11	0.11	0.10	0.10	0.10	0.10	0.11	0.11	0.11	0.12	0.12	

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