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Forecast Summary (averages)

| | Actual | Forecasts | | | | | | | 2019 | | |
|------------------|-------------|-------------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|------------|
| | 2018 Oct | 2018 Nov | 2018 Dec | 2019 Jan | 2019 Feb | 2019 Mar | 2019 Apr | 2019 May | 2019 Q2 | 2019 Q3 | 2019 Q4 |
| BoC overnight | 1.75 | 1.75 | 1.75 | 2.00 | 2.00 | 2.00 | 2.25 | 2.25 | 2.25 | 2.50 | 2.50 |
| 10-yr Canadas | 2.49 | 2.50 | 2.45 | 2.50 | 2.50 | 2.55 | 2.60 | 2.60 | 2.60 | 2.70 | 2.80 |
| Fed funds | 2.13 | 2.13 ¹ | 2.38 | 2.38 | 2.38 | 2.63 | 2.63 | 2.63 | 2.88 | 2.88 | 3.13 |
| 10-yr Treasuries | 3.15 | 3.15 | 3.10 | 3.10 | 3.15 | 3.15 | 3.20 | 3.20 | 3.20 | 3.25 | 3.35 |
| C\$ per US\$ | 1.300 | 1.310 | 1.320 | 1.317 | 1.313 | 1.310 | 1.307 | 1.303 | 1.303 | 1.293 | 1.283 |
| US\$/€ | 1.15 | 1.14 | 1.14 | 1.13 | 1.13 | 1.12 | 1.11 | 1.10 | 1.11 | 1.15 | 1.20 |
| US\$/£ | 1.30 | 1.28 | 1.26 | 1.25 | 1.24 | 1.23 | 1.25 | 1.28 | 1.28 | 1.33 | 1.38 |
| MXN/US\$ | 19.18 | 19.60 | 20.00 | 20.35 | 20.65 | 21.00 | 20.75 | 20.50 | 20.50 | 19.75 | 19.00 |
| ¥/US\$ | 113 | 112 | 112 | 112 | 112 | 112 | 111 | 111 | 111 | 111 | 110 |

¹ actual value for November 2018

Since the previous issue of Rates Scenario (on October 3rd):

- The Bank of Canada raised its policy rate by 25 bps on October 24th, as expected, and gave a stronger signal of its intention to return rates to neutral, which wasn't expected. The Bank dropped its reference to rate hikes being "gradual" (to avoid the perception of moving at a predetermined pace) and, bluntly, said rates "will need to rise to a neutral stance to achieve the inflation target". With the economy operating at full capacity and sporting at-target core inflation readings (on average), the hawkish tilt's catalyst was likely the USMCA (as the negative risk of no deal was replaced by the positive risk of a capex pickup). In determining the coming rate-hike cadence, the Bank said it "will continue to take into account how the economy is adjusting to higher interest rates, given the elevated level of household debt... [and] pay close attention to global trade policy developments and their implications for the inflation outlook." Our base case continues to be for the Bank to raise rates three times next year (January, April and July) to achieve the bottom of the estimated neutral range (2.50%-to-3.50%), but the intervals between the moves could easily be shortened or lengthened depending on the data, and, potentially, oil prices. Also data-dependent will be how much, if at all, the Bank potentially ventures into this range during late 2019 and 2020 (for the latter, we've pencilled in one move in the spring).
- The FOMC left its policy rates unchanged on November 8, still saying that "further gradual increases... will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term". The FOMC's latest median call for the longer-run fed funds rate is 3.00%, or a 1.00% neutral real rate, and we look for the current quarterly rate-hike cadence to continue, including a rate hike next month, 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. But with above-potential growth continuing while the economy is already at full capacity, core PCE inflation drifting up and the jobless rate drifting down, we're expecting a fifth consecutive December rate hike next year (setting up at least another action in early 2020). 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. Indeed, we

wouldn't be surprised if, next month, the FOMC tears a page out of the BoC's playbook and drops the "gradual" reference because it has become synonymous with moving quarterly.

- As the Fed raises rates, we judge that the slow, ratcheting uptrend in longer-term Treasury yields will continue. Adding to the upward pressure, there's Fed balance sheet reduction (alleviating some of the compression pressure on term premiums) and a surging supply of Treasuries (with budget deficits looking to top a trillion dollars). However, offsetting Fed policy normalization and supply, there's buying by yield-starved investors (particularly as yields hit new multi-year highs), what seems to be regular bouts of flight-to-liquidity, and the fact that longer-run nominal GDP growth is destined to stay tucked under 4%. On balance, we expect 10-year yields to be trading only about 25 bps higher, on average, a year from now. 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, and longer-term spreads take their cue from persistently narrower shorter-term spreads.
- The **Canadian dollar** found no lasting lift from the announcement of the USMCA, as lingering trade competitiveness concerns and weak domestic oil prices weighed. The latter was pulled down by falling WTI prices and the WCS discount remained hefty after hitting record highs in early October. Even a more hawkish sounding Bank of Canada didn't help (for now). However, we look for the loonie to trade more sideways through the remainder of the year (closing around \$1.32), garnering support from (anticipated) pro-competitiveness federal fiscal measures and OPEC's (expected) efforts to stabilize global crude prices. Amid a start-of-the-year BoC rate hike, these two forces should help strengthen the loonie a little (\$1.28 by 2019-end), but it will still be vulnerable to congressional shenanigans with respect to the USMCA's ratification.
- **Europe is gripped by uncertainty.** The European Commission is viewing **Italy's budget plans** with great scepticism and warns that fines/sanctions will be introduced if the government does not make revisions. The timing of this is very unfortunate, as the ECB is still planning to make its final round of bond purchases in December. We believe QE will end this year; but, depending on the outcome and the bond market's reaction, the ECB's rate-hike plans (currently anticipated to commence in September 2019), may be delayed. Meantime, the **Brexit negotiations** are reaching a high stress point, as some departures from PM May's Cabinet will make it difficult for her to pass any deal that she and Brussels may reach. But the BoE is still expected to average one rate hike per year. Governor Carney surprised markets during the Q&A portion of the November 1st policy meeting when he warned that he could still see a situation—with or without a deal—where the Bank would need to raise rates. This will be resolved (to some extent) by Brexit Day (March 2019); but, before that, we see the EUR and the GBP hitting their lows. The EUR will continue to trend lower into the spring, as the **European Parliamentary elections** kick off and as Chancellor Merkel fights to stay relevant, at least until her final term officially ends in 2022. The **BoJ** remains in its highly accommodative stance, holding the JPY over ¥110. Uncertainty around the USMCA and Mexico's new Administration will keep the **MXN** weak into the early part of 2019 before regaining its footing. Finally, the **PBoC** will allow the RMB to trade through 7.00 as the trade war between China and the U.S. shows little sign of letting up.

Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

| | Actual 2018 Oct | Forecasts | | | | | | | 2019 | | |
|---------------------------------|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|------------|
| | | 2018 Nov | 2018 Dec | 2019 Jan | 2019 Feb | 2019 Mar | 2019 Apr | 2019 May | 2019 Q2 | 2019 Q3 | 2019 Q4 |
| Canadian Dollar | | | | | | | | | | | |
| C\$ per US\$ | 1.300 | 1.310 | 1.320 | 1.317 | 1.313 | 1.310 | 1.307 | 1.303 | 1.303 | 1.293 | 1.283 |
| US\$ per C\$ | 0.769 | 0.763 | 0.758 | 0.759 | 0.761 | 0.763 | 0.765 | 0.767 | 0.767 | 0.773 | 0.779 |
| Trade-weighted | 96.9 | 96.3 | 95.8 | 96.1 | 96.5 | 96.9 | 97.1 | 97.4 | 97.3 | 97.4 | 97.5 |
| U.S. Dollar | | | | | | | | | | | |
| Trade-weighted ¹ | 126.9 | 127.8 | 128.8 | 129.3 | 129.7 | 130.2 | 130.1 | 130.0 | 129.8 | 127.8 | 125.5 |
| European Currencies | | | | | | | | | | | |
| Euro ² | 1.15 | 1.14 | 1.14 | 1.13 | 1.13 | 1.12 | 1.11 | 1.10 | 1.11 | 1.15 | 1.20 |
| Danish Krone | 6.49 | 6.50 | 6.55 | 6.50 | 6.45 | 6.45 | 6.40 | 6.35 | 6.35 | 6.25 | 6.15 |
| Norwegian Krone | 8.26 | 8.30 | 8.35 | 8.30 | 8.30 | 8.30 | 8.30 | 8.30 | 8.30 | 8.25 | 8.20 |
| Swedish Krone | 9.04 | 9.05 | 9.10 | 9.05 | 9.00 | 8.95 | 8.90 | 8.90 | 8.90 | 8.75 | 8.65 |
| Swiss Franc | 0.994 | 1.006 | 1.018 | 1.014 | 1.010 | 1.006 | 1.002 | 0.998 | 0.998 | 0.986 | 0.974 |
| U.K. Pound ² | 1.30 | 1.28 | 1.26 | 1.25 | 1.24 | 1.23 | 1.25 | 1.28 | 1.28 | 1.33 | 1.38 |
| Asian Currencies | | | | | | | | | | | |
| Chinese Yuan | 6.92 | 6.96 | 7.00 | 7.02 | 7.03 | 7.05 | 7.07 | 7.08 | 7.08 | 7.03 | 6.93 |
| Japanese Yen | 113 | 112 | 112 | 112 | 112 | 112 | 111 | 111 | 111 | 111 | 110 |
| Korean Won | 1,132 | 1,145 | 1,155 | 1,155 | 1,150 | 1,150 | 1,150 | 1,150 | 1,150 | 1,145 | 1,140 |
| Indian Rupee | 73.6 | 73.5 | 73.5 | 73.4 | 73.3 | 73.2 | 73.2 | 73.1 | 73.1 | 72.8 | 72.5 |
| Singapore Dollar | 1.38 | 1.39 | 1.40 | 1.40 | 1.40 | 1.40 | 1.39 | 1.39 | 1.39 | 1.39 | 1.38 |
| Malaysian Ringgit | 4.16 | 4.20 | 4.25 | 4.25 | 4.25 | 4.25 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 |
| Thai Baht | 32.8 | 33.0 | 33.3 | 33.3 | 33.3 | 33.4 | 33.4 | 33.5 | 33.5 | 33.6 | 33.8 |
| Philippine Peso | 54.0 | 53.8 | 53.6 | 53.6 | 53.7 | 53.7 | 53.8 | 53.8 | 53.8 | 54.0 | 54.1 |
| Taiwan Dollar | 30.9 | 31.2 | 31.5 | 31.5 | 31.5 | 31.5 | 31.5 | 31.5 | 31.5 | 31.4 | 31.4 |
| Indonesian Rupiah | 15,175 | 15,255 | 15,330 | 15,305 | 15,280 | 15,260 | 15,235 | 15,210 | 15,210 | 15,140 | 15,065 |
| Other Currencies | | | | | | | | | | | |
| Australian Dollar ² | 0.711 | 0.721 | 0.730 | 0.732 | 0.733 | 0.735 | 0.737 | 0.738 | 0.738 | 0.743 | 0.748 |
| New Zealand Dollar ² | 0.653 | 0.662 | 0.670 | 0.669 | 0.668 | 0.668 | 0.667 | 0.666 | 0.666 | 0.663 | 0.661 |
| Mexican Peso | 19.18 | 19.60 | 20.00 | 20.35 | 20.65 | 21.00 | 20.75 | 20.50 | 20.50 | 19.75 | 19.00 |
| Brazilian Real | 3.76 | 3.80 | 3.80 | 3.80 | 3.85 | 3.85 | 3.85 | 3.90 | 3.90 | 3.95 | 4.00 |
| Russian Ruble | 65.8 | 67.1 | 68.4 | 68.5 | 68.6 | 68.7 | 68.8 | 68.9 | 68.9 | 69.3 | 69.6 |
| South African Rand | 14.5 | 14.6 | 14.8 | 14.8 | 14.8 | 14.8 | 14.8 | 14.9 | 14.9 | 14.9 | 15.0 |
| Cross Rates | | | | | | | | | | | |
| Versus Canadian Dollar | | | | | | | | | | | |
| Euro (C\$/€) | 1.49 | 1.50 | 1.50 | 1.49 | 1.48 | 1.47 | 1.45 | 1.43 | 1.45 | 1.49 | 1.54 |
| U.K. Pound (C\$/£) | 1.69 | 1.68 | 1.66 | 1.65 | 1.63 | 1.61 | 1.64 | 1.66 | 1.66 | 1.72 | 1.78 |
| Japanese Yen (¥/C\$) | 87 | 86 | 85 | 85 | 85 | 85 | 85 | 85 | 85 | 86 | 86 |
| Australian Dollar (C\$/A\$) | 0.92 | 0.94 | 0.96 | 0.96 | 0.96 | 0.96 | 0.96 | 0.96 | 0.96 | 0.96 | 0.96 |
| Versus Euro | | | | | | | | | | | |
| U.K. Pound (£/€) | 0.88 | 0.89 | 0.90 | 0.91 | 0.91 | 0.91 | 0.89 | 0.86 | 0.87 | 0.86 | 0.87 |
| Japanese Yen (¥/€) | 130 | 129 | 128 | 127 | 126 | 125 | 124 | 122 | 123 | 127 | 133 |

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

Interest Rate Forecasts

Percent (averages)

| | Actual 2018 Oct | Forecasts 2018 | | | 2019 | | | | | 2019 | | |
|-------------------------|-----------------------|-------------------|-------|-------|-------|-------|-------|-------|-------|-------|------|--|
| | | Nov | Dec | Jan | Feb | Mar | Apr | May | Q2 | Q3 | Q4 | |
| Cdn. Yield Curve | | | | | | | | | | | | |
| Overnight | 1.75 | 1.75 | 1.75 | 2.00 | 2.00 | 2.00 | 2.25 | 2.25 | 2.25 | 2.50 | 2.50 | |
| 3 month | 1.63 | 1.65 | 1.75 | 1.85 | 1.85 | 2.00 | 2.10 | 2.10 | 2.15 | 2.35 | 2.35 | |
| 6 month | 1.84 | 1.85 | 1.95 | 2.05 | 2.05 | 2.15 | 2.25 | 2.25 | 2.30 | 2.45 | 2.45 | |
| 1 year | 2.10 | 2.10 | 2.20 | 2.25 | 2.30 | 2.35 | 2.40 | 2.45 | 2.45 | 2.60 | 2.60 | |
| 2 year | 2.29 | 2.35 | 2.35 | 2.40 | 2.45 | 2.50 | 2.50 | 2.55 | 2.55 | 2.65 | 2.70 | |
| 3 year | 2.31 | 2.35 | 2.35 | 2.40 | 2.45 | 2.50 | 2.50 | 2.55 | 2.55 | 2.65 | 2.70 | |
| 5 year | 2.40 | 2.40 | 2.40 | 2.45 | 2.50 | 2.50 | 2.55 | 2.60 | 2.60 | 2.70 | 2.75 | |
| 7 year | 2.43 | 2.45 | 2.45 | 2.45 | 2.50 | 2.55 | 2.55 | 2.60 | 2.60 | 2.70 | 2.75 | |
| 10 year | 2.49 | 2.50 | 2.45 | 2.50 | 2.50 | 2.55 | 2.60 | 2.60 | 2.60 | 2.70 | 2.80 | |
| 30 year | 2.50 | 2.50 | 2.50 | 2.50 | 2.55 | 2.60 | 2.65 | 2.65 | 2.65 | 2.80 | 2.90 | |
| 1m BA | 1.96 | 1.95 | 2.05 | 2.20 | 2.20 | 2.30 | 2.40 | 2.40 | 2.45 | 2.65 | 2.65 | |
| 3m BA | 2.12 | 2.10 | 2.25 | 2.35 | 2.35 | 2.45 | 2.55 | 2.55 | 2.60 | 2.80 | 2.80 | |
| 6m BA | 2.28 | 2.30 | 2.35 | 2.45 | 2.45 | 2.55 | 2.65 | 2.65 | 2.65 | 2.80 | 2.80 | |
| 12m BA | 2.51 | 2.55 | 2.60 | 2.65 | 2.65 | 2.70 | 2.80 | 2.80 | 2.80 | 2.90 | 2.95 | |
| Prime Rate | 3.95 | 3.95 | 3.95 | 4.20 | 4.20 | 4.20 | 4.45 | 4.45 | 4.45 | 4.70 | 4.70 | |
| U.S. Yield Curve | | | | | | | | | | | | |
| Fed funds | 2.13 | 2.13 ¹ | 2.38 | 2.38 | 2.38 | 2.63 | 2.63 | 2.63 | 2.88 | 2.88 | 3.13 | |
| 3 month | 2.29 | 2.35 | 2.40 | 2.40 | 2.50 | 2.60 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | |
| 6 month | 2.46 | 2.50 | 2.55 | 2.55 | 2.60 | 2.70 | 2.70 | 2.80 | 2.80 | 2.90 | 3.00 | |
| 1 year | 2.65 | 2.70 | 2.70 | 2.75 | 2.80 | 2.85 | 2.85 | 2.95 | 2.95 | 3.05 | 3.10 | |
| 2 year | 2.86 | 2.90 | 2.90 | 2.95 | 3.00 | 3.00 | 3.05 | 3.10 | 3.10 | 3.15 | 3.25 | |
| 3 year | 2.94 | 2.95 | 2.95 | 3.00 | 3.05 | 3.05 | 3.10 | 3.10 | 3.10 | 3.20 | 3.30 | |
| 5 year | 3.00 | 3.00 | 3.00 | 3.05 | 3.05 | 3.10 | 3.10 | 3.15 | 3.15 | 3.20 | 3.30 | |
| 7 year | 3.09 | 3.10 | 3.05 | 3.10 | 3.10 | 3.15 | 3.15 | 3.20 | 3.20 | 3.25 | 3.30 | |
| 10 year | 3.15 | 3.15 | 3.10 | 3.10 | 3.15 | 3.15 | 3.20 | 3.20 | 3.20 | 3.25 | 3.35 | |
| 30 year | 3.34 | 3.30 | 3.30 | 3.30 | 3.35 | 3.35 | 3.35 | 3.40 | 3.40 | 3.45 | 3.50 | |
| 1m LIBOR | 2.29 | 2.40 | 2.55 | 2.55 | 2.65 | 2.80 | 2.80 | 2.90 | 2.90 | 3.00 | 3.15 | |
| 3m LIBOR | 2.46 | 2.55 | 2.70 | 2.70 | 2.80 | 2.90 | 2.90 | 3.05 | 3.05 | 3.15 | 3.25 | |
| 6m LIBOR | 2.69 | 2.80 | 2.95 | 2.95 | 3.05 | 3.20 | 3.20 | 3.35 | 3.35 | 3.45 | 3.60 | |
| 12m LIBOR | 2.99 | 3.10 | 3.25 | 3.25 | 3.35 | 3.45 | 3.45 | 3.55 | 3.55 | 3.70 | 3.85 | |
| Prime Rate | 5.25 | 5.25 | 5.50 | 5.50 | 5.50 | 5.75 | 5.75 | 5.75 | 5.85 | 6.00 | 6.10 | |
| Other G7 Yields | | | | | | | | | | | | |
| 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 | 0.46 | 0.50 | 0.50 | 0.55 | 0.60 | 0.60 | 0.65 | 0.70 | 0.70 | 0.80 | 0.90 | |
| BoE Repo | 0.75 | 0.75 ¹ | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | |
| 10yr Gilt | 1.56 | 1.60 | 1.65 | 1.70 | 1.70 | 1.75 | 1.75 | 1.80 | 1.80 | 1.90 | 1.95 | |
| 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 | 0.14 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | |

¹ actual value for November 2018

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