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## Forecast Summary (averages)

	Actual	Forecasts							2019		2020
	2018 Dec	2019 Jan	Feb	Mar	Apr	May	Jun	Jul	Q3	Q4	Q1
BoC overnight	1.75	1.75 <sup>1</sup>	1.75	1.75	1.75	1.75	1.75	2.00	2.00	2.25	2.25
10-yr Canadas	2.06	1.95	2.00	2.00	2.00	2.05	2.10	2.15	2.15	2.20	2.25
Fed funds	2.38	2.38	2.38	2.38	2.38	2.38	2.63	2.63	2.63	2.88	2.88
10-yr Treasuries	2.83	2.70	2.75	2.75	2.75	2.80	2.85	2.85	2.90	2.95	3.00
C\$ per US\$	1.344	1.333	1.332	1.332	1.331	1.330	1.329	1.329	1.328	1.326	1.321
US\$/€	1.14	1.14	1.14	1.14	1.15	1.15	1.15	1.15	1.16	1.17	1.17
US\$/£	1.27	1.25	1.24	1.23	1.23	1.23	1.24	1.25	1.26	1.29	1.31
MXN/US\$	20.11	20.00	20.50	21.00	20.75	20.50	20.25	20.00	19.75	19.00	18.70
¥/US\$	112	109	109	109	109	109	109	110	110	110	110

<sup>1</sup> actual value for January 2019

## Since the previous issue of Rates Scenario (on December 17<sup>th</sup>):

- We have scaled back our forecasts for Bank of Canada and Federal Reserve policy. We still look for two rate hikes from each this year, but with a bit more delay. And, we no longer expect a follow-up rate hike next year.
- On December 19, the **FOMC** lifted the fed funds target range by 25 bps to 2.25%-to-2.50%, marking the fifth consecutive quarterly move, but also indicated that it was shifting into a slower and more hesitant rate-hike gear ahead. In the Statement, the forward-looking language was modified; the word “*some*” was inserted in front of “*further gradual increases*”. And, the risk assessment included “global economic and financial developments” for the first time in more than 1½ years. Indeed, the phrase that it will “*monitor global economic and financial developments and assess their implications for the economic outlook*” was eerily similar to what was newly inserted back in January 2016, which presaged a year-long policy pause.
- In the presser, Chair Powell acknowledged that, since mid-September, “*some crosscurrents have emerged*” and that the FOMC was “*incorporating those crosscurrents into our judgments about the outlook and the appropriate course of policy*”. Later, on January 4, Powell said that the Fed was “*listening carefully*” to financial markets (markets that seem to have rising recession risks on their minds). Powell summed it up succinctly (on January 10): “*We’re in a place where we can be patient and flexible and wait and see what does evolve, and I think for the meantime we’re waiting and watching*”.
- This year, we still expect above-potential U.S. economic growth to continue (2.4%, on average), helping achieve new cycle-lows in the unemployment rate (under 3.7%) and new cycle-highs in core PCE inflation (above 2.1% y/y). Presuming Fed concerns about “*global economic and financial developments*” don’t escalate and U.S. markets’ recession fears subside, **we still expect a couple of Fed rate hikes** (although now June-December instead of May-September). **However, as economic growth slips below potential next year, the Fed’s new caution will likely keep policy on hold indefinitely.**
- On January 9, the **Bank of Canada** also modified its forward-looking language: “*Governing Council continues to judge that the policy interest rate will need to rise over time into a neutral range to achieve the inflation*”.

*target*". The "over time" part was new and purposely inserted to convey more ambiguity about coming rate hikes. Governor Poloz mentioned in the presser that, although there is much uncertainty over the neutral policy rate (a range of 2.5% to 3.5% with the bounds sporting their own confidence intervals), the neutral rate was definitely above inflation (which is still a rate hike away). The Statement said: "*The appropriate pace of rate increases will depend on how the outlook evolves, with a particular focus on developments in oil markets, the Canadian housing market, and global trade policy*". As Douglas Porter noted, if oil stabilizes or even recovers further, the housing market stays on its soft-landing path, and there is some sort of semi-positive resolution to the U.S./China trade talks, the Bank looks plenty comfortable restarting the rate-hike process. But for now, like the Fed, the BoC is waiting and watching.

- As above-potential Canadian economic growth resumes after a dismal 2019Q1 (the latter partly owing to mandatory oil output cuts in Alberta) and the core inflation readings start drifting above 2.0% y/y, **we still expect a couple of BoC rate hikes** (although now July-December instead of April-October), **but slower growth next year causes the Bank to join the Fed on the policy sidelines.**
- As the Fed raises rates (which means markets' recession fears have sufficiently receded along with concerns over "global economic and financial developments"), we expect longer-term Treasury yields to retrace some of their recent rally. Several pressures are poised to help prod yields higher, including, an anticipated modest re-acceleration of inflation expectations (coming-soon cycle-high core PCE inflation readings and firmer oil prices), continued 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 \$1 trillion). However, we suspect 10-year yields, for example, will be hard pressed to move much above 3.0%. Meanwhile, we look for the yield curve (2s10s) to continue flattening to low single-digits and skirt persistent inversion, and for the more complete curve (from 3 months out to 10 years) to skirt this as well. However, the **net risk lies on the side of inversion**. With the Bank of Canada keeping pace with Fed rate hikes, we expect that longer-term Canada-US yield spreads will stick to their current ranges, keeping to a more negative territory than overnight spreads.
- A less-hawkish Federal Reserve will weigh on the greenback in the coming year and give the beleaguered **Canadian dollar** a needed lift, although it won't be much. Higher energy prices should support the loonie as well, while relatively steady Canada/US spreads will provide little headwind. We see the CAD range-bound in the low \$1.30s this year.
- The **BoE** remains on the sidelines, studying how the economy handles the Brexit uncertainty. Even though the latest manufacturing PMI survey hit a 6-month high, it was due to stockpiling ahead of the departure from the EU. One survey showed business confidence at an 18-month low last month. And consumers, who held up fairly well over the past year, pulled back on their holiday spending. The BoE held to the view in December that "*ongoing tightening*" was still "*appropriate*"; but, whatever happens with Brexit, the monetary policy response "*could be in either direction*". Although we would normally cringe at such a vague comment, in this case of high uncertainty, it is justified. We continue to pencil in one rate hike toward the latter half of 2019.
- Now that the **ECB's** QE is over, it has become public knowledge that policymakers are indeed worried. The Governing Council was concerned even during the December meeting, despite declaring an end to bond purchases. Recall we had expected some waffling on the rates guidance, but the ECB stuck to its view that rates will "*remain at their present levels at least through the summer of 2019*". The Minutes from the December meeting, however, showed that there was debate over the balance of risks. Although the view that the risks are "*fairly balanced*" ultimately won out, policymakers agreed to insert the warning that the risks were moving to

the downside. We continue to look for the ECB to tweak the timing on the rates guidance soon and push out expectations for rate hikes to later this year, or possibly next.

- The **BoJ** remains dovish and is not expected to rein in any of its monetary stimulus. Although we've felt for quite some time that the central bank should at least reconsider its 0% ceiling for 10-year JGB yields, given the recent bout of weaker signals on the economy, that is no longer in the cards for now. The less-hawkish Fed will also put pressure on the JPY, which would hurt exporters. Governor Kuroda dropped a strong hint in late December on which way he is leaning: "*If necessary, we have the means available to ease policy further.*"

## Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual 2018 Dec	Forecasts 2019							2019 Q3	2020 Q4	2020 Q1
		Jan	Feb	Mar	Apr	May	Jun	Jul			
<b>Canadian Dollar</b>											
C\$ per US\$	1.344	1.333	1.332	1.332	1.331	1.330	1.329	1.329	1.328	1.326	1.321
US\$ per C\$	0.744	0.750	0.751	0.751	0.751	0.752	0.752	0.753	0.753	0.754	0.757
Trade-weighted	94.1	94.6	94.8	94.9	94.9	94.9	94.9	94.9	94.8	94.7	94.9
<b>U.S. Dollar</b>											
Trade-weighted <sup>1</sup>	128.5	127.8	128.2	128.6	128.4	128.2	127.9	127.5	127.0	125.5	124.9
<b>European Currencies</b>											
Euro <sup>2</sup>	1.14	1.14	1.14	1.14	1.15	1.15	1.15	1.15	1.16	1.17	1.17
Danish Krone	6.56	6.55	6.55	6.50	6.50	6.50	6.45	6.45	6.45	6.40	6.35
Norwegian Krone	8.63	8.60	8.60	8.55	8.55	8.50	8.50	8.45	8.45	8.35	8.30
Swedish Krone	9.03	8.95	8.95	8.90	8.90	8.90	8.85	8.85	8.85	8.80	8.75
Swiss Franc	0.992	0.980	0.982	0.984	0.985	0.987	0.989	0.991	0.993	0.998	1.010
U.K. Pound <sup>2</sup>	1.27	1.25	1.24	1.23	1.23	1.23	1.24	1.25	1.26	1.29	1.31
<b>Asian Currencies</b>											
Chinese Yuan	6.88	6.85	6.86	6.87	6.88	6.89	6.90	6.86	6.82	6.69	6.65
Japanese Yen	112	109	109	109	109	109	109	110	110	110	110
Korean Won	1,122	1,120	1,120	1,115	1,115	1,110	1,110	1,110	1,105	1,100	1,100
Indian Rupee	70.8	70.0	69.8	69.6	69.4	69.2	69.0	68.8	68.6	68.0	67.9
Singapore Dollar	1.37	1.37	1.36	1.36	1.36	1.35	1.35	1.35	1.34	1.33	1.33
Malaysian Ringgit	4.17	4.15	4.15	4.15	4.10	4.10	4.10	4.10	4.10	4.05	4.00
Thai Baht	32.7	32.7	32.7	32.7	32.7	32.7	32.6	32.6	32.6	32.6	32.6
Philippine Peso	52.8	52.2	52.1	52.0	51.8	51.7	51.6	51.5	51.4	51.0	51.0
Taiwan Dollar	30.8	30.7	30.7	30.7	30.6	30.6	30.5	30.5	30.4	30.3	30.3
Indonesian Rupiah	14,506	14,200	14,160	14,120	14,080	14,040	14,000	13,965	13,925	13,805	13,800
<b>Other Currencies</b>											
Australian Dollar <sup>2</sup>	0.717	0.719	0.721	0.723	0.725	0.727	0.728	0.730	0.732	0.738	0.743
New Zealand Dollar <sup>2</sup>	0.682	0.683	0.685	0.686	0.688	0.689	0.691	0.692	0.694	0.698	0.703
Mexican Peso	20.11	20.00	20.50	21.00	20.75	20.50	20.25	20.00	19.75	19.00	18.70
Brazilian Real	3.88	3.75	3.75	3.75	3.80	3.80	3.80	3.80	3.80	3.85	3.85
Russian Ruble	67.5	67.3	67.1	66.9	66.7	66.5	66.2	66.0	65.8	65.2	64.7
South African Rand	14.3	14.0	14.0	14.1	14.1	14.2	14.2	14.3	14.3	14.5	14.6
<b>Cross Rates</b>											
<b>Versus Canadian Dollar</b>											
Euro (C\$/€)	1.53	1.52	1.52	1.52	1.53	1.53	1.53	1.53	1.54	1.55	1.55
U.K. Pound (C\$/£)	1.70	1.67	1.65	1.64	1.64	1.64	1.65	1.66	1.67	1.71	1.73
Japanese Yen (¥/C\$)	83	82	82	82	82	82	82	82	83	83	83
Australian Dollar (C\$/A\$)	0.96	0.96	0.96	0.96	0.96	0.97	0.97	0.97	0.97	0.98	0.98
<b>Versus Euro</b>											
U.K. Pound (£/€)	0.90	0.91	0.92	0.93	0.93	0.93	0.93	0.92	0.92	0.90	0.90
Japanese Yen (¥/€)	128	124	125	125	125	126	126	126	127	128	129

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

## Interest Rate Forecasts

Percent (averages)

	Actual 2018 Dec	Forecasts 2019							2019 Q3	2019 Q4	2020 Q1
		Jan	Feb	Mar	Apr	May	Jun	Jul			
<b>Cdn. Yield Curve</b>											
Overnight	1.75	1.75 <sup>1</sup>	1.75	1.75	1.75	1.75	1.75	2.00	2.00	2.25	2.25
3 month	1.65	1.65	1.65	1.65	1.65	1.70	1.80	1.90	1.90	2.05	2.15
6 month	1.81	1.75	1.75	1.75	1.85	1.90	1.95	2.05	2.05	2.25	2.30
1 year	1.95	1.85	1.90	1.90	1.95	2.00	2.00	2.10	2.15	2.25	2.30
2 year	1.98	1.90	1.90	1.95	1.95	2.00	2.00	2.10	2.10	2.20	2.25
3 year	1.99	1.90	1.95	1.95	1.95	2.00	2.00	2.10	2.10	2.20	2.25
5 year	2.00	1.90	1.95	1.95	1.95	2.00	2.05	2.10	2.10	2.20	2.25
7 year	2.01	1.90	1.95	1.95	2.00	2.00	2.05	2.10	2.15	2.20	2.25
10 year	2.06	1.95	2.00	2.00	2.00	2.05	2.10	2.15	2.15	2.20	2.25
30 year	2.22	2.15	2.20	2.20	2.25	2.25	2.30	2.35	2.35	2.45	2.50
1m BA	2.22	2.20	2.20	2.20	2.20	2.30	2.35	2.40	2.40	2.50	2.60
3m BA	2.27	2.25	2.25	2.25	2.25	2.35	2.40	2.45	2.45	2.60	2.65
6m BA	2.34	2.30	2.30	2.30	2.40	2.45	2.45	2.50	2.55	2.65	2.70
12m BA	2.55	2.50	2.50	2.50	2.55	2.55	2.60	2.65	2.65	2.75	2.80
Prime Rate	3.95	3.95	3.95	3.95	3.95	3.95	3.95	4.20	4.20	4.30	4.45
<b>U.S. Yield Curve</b>											
Fed funds	2.38	2.38	2.38	2.38	2.38	2.38	2.63	2.63	2.63	2.88	2.88
3 month	2.41	2.45	2.45	2.45	2.55	2.65	2.70	2.70	2.70	2.90	2.95
6 month	2.54	2.50	2.50	2.65	2.75	2.85	2.85	2.85	2.90	3.10	3.10
1 year	2.66	2.60	2.60	2.65	2.75	2.80	2.85	2.85	2.90	3.05	3.05
2 year	2.68	2.55	2.55	2.60	2.60	2.65	2.75	2.75	2.75	2.85	2.95
3 year	2.67	2.50	2.55	2.60	2.60	2.65	2.75	2.75	2.80	2.85	2.95
5 year	2.68	2.55	2.60	2.60	2.65	2.65	2.75	2.75	2.80	2.90	2.95
7 year	2.75	2.60	2.65	2.65	2.70	2.70	2.80	2.80	2.85	2.90	2.95
10 year	2.83	2.70	2.75	2.75	2.75	2.80	2.85	2.85	2.90	2.95	3.00
30 year	3.10	3.00	3.05	3.05	3.05	3.10	3.15	3.15	3.20	3.25	3.25
1m LIBOR	2.45	2.45	2.45	2.45	2.55	2.65	2.75	2.75	2.75	3.00	3.10
3m LIBOR	2.79	2.80	2.80	2.80	2.85	2.95	3.00	3.00	3.00	3.15	3.25
6m LIBOR	2.89	2.95	2.95	2.85	2.90	2.95	3.10	3.10	3.05	3.20	3.35
12m LIBOR	3.08	3.10	3.10	2.95	2.95	2.95	3.15	3.15	3.15	3.20	3.40
Prime Rate	5.35	5.35	5.35	5.35	5.35	5.35	5.60	5.60	5.60	5.70	5.85
<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	0.25	0.25	0.30	0.30	0.30	0.35	0.35	0.35	0.40	0.45	0.45
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	1.27	1.30	1.30	1.30	1.30	1.35	1.35	1.35	1.35	1.40	1.40
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	0.04	0.01	0.01	0.02	0.02	0.02	0.03	0.03	0.04	0.05	0.05

<sup>1</sup> actual value for January 2019

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