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Forecast Summary (averages)

	Actual	Forecasts							2019		2020
	2019	2019							Q3	Q4	Q1
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug			
BoC overnight	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.00
10-yr Canadas	1.95	1.95	1.95	1.95	2.00	2.00	2.00	2.05	2.05	2.10	2.05
Fed funds	2.38	2.38	2.38	2.38	2.38	2.38	2.38	2.38	2.38	2.63	2.63
10-yr Treasuries	2.71	2.70	2.70	2.75	2.75	2.75	2.80	2.80	2.80	2.85	2.80
C\$ per US\$	1.330	1.330	1.329	1.329	1.328	1.328	1.327	1.327	1.327	1.325	1.321
US\$/€	1.14	1.14	1.15	1.15	1.15	1.15	1.15	1.16	1.16	1.17	1.17
US\$/£	1.29	1.30	1.31	1.31	1.32	1.33	1.33	1.32	1.32	1.31	1.31
MXN/US\$	19.16	19.45	19.75	19.60	19.45	19.35	19.20	19.05	19.05	18.65	18.45
¥/US\$	109	109	109	109	109	109	110	110	110	110	110

Policy rates are end of period

Since the previous issue of Rates Scenario (on January 10th):

- One and done... We reduced the number of rate hikes on both sides of the Canada/U.S. border from two to just one this year. The January 30th FOMC policy statement and Fed Chair Powell's inaugural every-meeting presser turned out to be more dovish than expected, and the key catalyst for the forecast change.
- The FOMC dropped its previous forward guidance and net risk assessment completely. These policy guideposts were replaced by: *"The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes"*. Importantly, there was no indication if any *"future adjustments"* would be increases, and the language was ambiguous enough not to exclude decreases. As such, the change from signalling continued, but less regular, rate hikes just six weeks ago to signalling that the current rate-tightening cycle could be over and the possibility that the next move could be a rate cut was a radical change. Powell mentioned that, despite sturdy economic performance and a positive outlook, *"over the past few months we have seen some cross-currents and conflicting signals about the outlook"*.
- While improvements on the *"cross-currents and conflicting signals"* front would make the Fed feel more comfortable about raising rates again, we judge that it's going to be inflation performance that dictates whether we get more rate hikes. And, we do expect inflation to creep up a bit this year, reflecting a mounting positive output gap in the wake of continued at- or above-potential growth (apart from Q1 owing to the government shutdown) and a falling unemployment rate (to 3.5% by year-end), with wages already mildly accelerating. Also, importantly, still sturdy consumer demand will allow businesses to pass on some of their higher costs (wages, tariffs). We look for core PCE inflation to run in a 2.0%-to-2.3% range as the year unfolds, up from the current 1.8%-to-2.0%. Previously, we judged that this would be sufficient to get the Fed to raise rates a couple more times (in June and December), with the net risk that there would be fewer actions. However, the FOMC's dovish pronouncements have led us to factor this into our call; we now look for only one rate hike in December.

- The Fed was not alone in preaching patience. On January 9th, the Bank of Canada signalled that the timing of potential rate hikes was becoming more ambiguous. The policy statement said: *“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 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”*. The phrase *“over time”* was purposely inserted for this reason. Now, with one less Fed action, the recent Canadian GDP report (-0.1% m/m for November) emphasizing weakness in the interest-sensitive sectors (retail and construction), and our expectation that the Bank could lower its estimate of the neutral range (2.5%-to-3.5% currently), we pared our Bank of Canada rate hike call to one as well (now only Dec. vs July/Dec. previously).
- The lower fed funds profile also pulls down our projection for 10-year Treasury yields; it remains persistently below 3%; but, we still expect a net (mild) up-drift from current levels (averaging around 2.85% by year-end). Apart from another Fed rate hike, net upward pressure should come from an anticipated modest re-acceleration of inflation expectations (owing to coming-soon cycle-high core PCE inflation readings and firmer oil prices), continued Fed balance sheet reduction (although there’s a chance this could start being tapered before year-end), and a surging supply of Treasuries (with budget deficits looking to top \$1 trillion).
- With the Bank keeping pace with Fed rate hikes, we judge Canada-US longer-term yield spreads will likely stick to their current ranges (e.g., 10-year spreads around -75 bps). This reflects the net near-term risk that the BoC still tightens less (so not at all) and, more fundamentally, America’s much worse fiscal dynamics as well as Canada’s poorer economic competitiveness (that should result in a perennial more-cautious-than-Fed monetary policy stance).
- The **Canadian dollar** was given a needed lift in recent weeks, but that was due to the more dovish comments coming from Fed Chair Powell than domestic events. Lower growth projections and a more cautious BoC will leave the CAD hovering around \$1.33 this year.
- The *“fog of Brexit”* remains, by far, the highest source of uncertainty in the U.K. The **BoE** stayed on hold in early February, as the uncertainty about Britain’s withdrawal from the EU has *“intensified”*. Although the Committee still believes *“ongoing tightening over the forecast period”* is still *“appropriate”*, a hard Brexit could clearly change the Bank’s monetary policy response very quickly. Meantime, the BoE’s cut to the growth forecast, and the risk of hard Brexit, caused us to push out our expectation for the next rate hike to early 2020.
- Expectations that the **ECB** will delay its next move continue to grow. After ending QE last year, the risks to the outlook for economic growth have changed; in fact, they’ve now moved to the downside (were previously *“balanced”*). Although the rates guidance hasn’t been tweaked (rates will stay where they are *“at least through the summer of 2019”*), it is only a matter of time before *“summer”* is replaced with another season. Given the raft of worrying figures of late, and with concerns over a possible recession in Germany and the technical recession in Italy, we now look for the ECB to delay a rate hike until early 2020, or about half a year after the next ECB president takes over.
- There has been no change to our **BoJ** call. Policymakers are aware of the costs of prolonged easing, but they are reluctant to change the target for short-term rates (at a record low -0.1%) or stop buying JGBs as inflation is still far from target. In fact, Governor Kuroda highlighted the risks to the outlook, particularly with respect to the U.S./China tensions and, if the trade talks are drawn out, they would pose a *“serious risk to the global economy”*.

Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual	Forecasts							2019 Q3	2019 Q4	2020 Q1
	2019 Jan	2019 Feb	Mar	Apr	May	Jun	Jul	Aug			
Canadian Dollar											
C\$ per US\$	1.330	1.330	1.329	1.329	1.328	1.328	1.327	1.327	1.327	1.325	1.321
US\$ per C\$	0.752	0.752	0.752	0.753	0.753	0.753	0.753	0.754	0.754	0.754	0.757
Trade-weighted	94.6	94.7	94.7	94.7	94.7	94.7	94.6	94.6	94.6	94.6	94.8
U.S. Dollar											
Trade-weighted ¹	126.7	128.0	128.1	127.9	127.7	127.5	127.2	126.9	126.9	126.0	125.5
European Currencies											
Euro ²	1.14	1.14	1.15	1.15	1.15	1.15	1.15	1.16	1.16	1.17	1.17
Danish Krone	6.54	6.50	6.50	6.50	6.50	6.45	6.45	6.45	6.45	6.40	6.35
Norwegian Krone	8.55	8.55	8.50	8.50	8.45	8.45	8.45	8.40	8.40	8.35	8.30
Swedish Krone	8.99	9.15	9.10	9.05	9.05	9.00	8.95	8.90	8.90	8.80	8.75
Swiss Franc	0.990	0.991	0.992	0.993	0.993	0.994	0.995	0.996	0.996	0.999	1.010
U.K. Pound ²	1.29	1.30	1.31	1.31	1.32	1.33	1.33	1.32	1.32	1.31	1.31
Asian Currencies											
Chinese Yuan	6.79	6.78	6.77	6.76	6.76	6.75	6.73	6.70	6.70	6.63	6.59
Japanese Yen	109	109	109	109	109	109	110	110	110	110	110
Korean Won	1,121	1,115	1,115	1,110	1,110	1,105	1,105	1,100	1,100	1,090	1,090
Indian Rupee	70.7	71.6	71.1	70.7	70.3	69.9	69.4	69.0	69.0	67.7	67.3
Singapore Dollar	1.36	1.35	1.35	1.35	1.34	1.34	1.34	1.33	1.33	1.32	1.32
Malaysian Ringgit	4.12	4.10	4.10	4.10	4.05	4.05	4.05	4.05	4.05	4.00	3.95
Thai Baht	31.8	31.4	31.5	31.6	31.7	31.8	31.9	32.0	32.0	32.2	32.4
Philippine Peso	52.4	52.3	52.1	51.9	51.7	51.6	51.4	51.2	51.2	50.7	50.6
Taiwan Dollar	30.8	30.7	30.7	30.6	30.5	30.5	30.4	30.3	30.3	30.1	30.0
Indonesian Rupiah	14,151	13,950	13,920	13,890	13,865	13,835	13,805	13,775	13,775	13,690	13,680
Other Currencies											
Australian Dollar ²	0.715	0.717	0.720	0.722	0.724	0.726	0.729	0.731	0.731	0.738	0.743
New Zealand Dollar ²	0.678	0.680	0.682	0.684	0.686	0.688	0.690	0.692	0.692	0.698	0.703
Mexican Peso	19.16	19.45	19.75	19.60	19.45	19.35	19.20	19.05	19.05	18.65	18.45
Brazilian Real	3.73	3.75	3.75	3.75	3.80	3.80	3.80	3.80	3.80	3.85	3.85
Russian Ruble	66.6	66.4	66.2	66.0	65.8	65.6	65.4	65.1	65.1	64.7	64.7
South African Rand	13.8	13.5	13.6	13.7	13.8	13.9	14.0	14.1	14.1	14.4	14.6
Cross Rates											
Versus Canadian Dollar											
Euro (C\$/€)	1.52	1.52	1.52	1.52	1.53	1.53	1.53	1.53	1.53	1.55	1.55
U.K. Pound (C\$/£)	1.72	1.73	1.73	1.74	1.76	1.77	1.76	1.75	1.75	1.73	1.73
Japanese Yen (¥/C\$)	82	82	82	82	82	82	83	83	83	83	83
Australian Dollar (C\$/A\$)	0.95	0.95	0.96	0.96	0.96	0.96	0.97	0.97	0.97	0.98	0.98
Versus Euro											
U.K. Pound (£/€)	0.89	0.88	0.88	0.87	0.87	0.86	0.87	0.88	0.88	0.89	0.90
Japanese Yen (¥/€)	124	125	125	125	126	126	126	127	127	128	129

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

Interest Rate Forecasts

Percent (averages)

	Actual 2019 Jan	Forecasts 2019							2019 Q3	2020 Q4	2020 Q1
		Feb	Mar	Apr	May	Jun	Jul	Aug			
Cdn. Yield Curve											
Overnight	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.00
3 month	1.63	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.85	1.90
6 month	1.74	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.95	2.00
1 year	1.87	1.85	1.85	1.85	1.85	1.90	1.90	1.90	1.90	2.05	2.10
2 year	1.88	1.85	1.85	1.85	1.90	1.90	1.95	1.95	1.95	2.05	2.05
3 year	1.87	1.85	1.85	1.90	1.90	1.95	1.95	1.95	1.95	2.05	2.05
5 year	1.88	1.85	1.85	1.90	1.90	1.95	1.95	2.00	2.00	2.05	2.05
7 year	1.90	1.90	1.90	1.90	1.95	1.95	2.00	2.00	2.00	2.05	2.05
10 year	1.95	1.95	1.95	1.95	2.00	2.00	2.00	2.05	2.05	2.10	2.05
30 year	2.18	2.20	2.20	2.20	2.20	2.25	2.25	2.25	2.25	2.30	2.30
1m BA	2.22	2.10	2.10	2.10	2.10	2.10	2.10	2.10	2.10	2.25	2.35
3m BA	2.25	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.30	2.40
6m BA	2.32	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.45	2.55
12m BA	2.51	2.45	2.45	2.50	2.50	2.50	2.50	2.55	2.55	2.65	2.65
Prime Rate	3.95	3.95	3.95	3.95	3.95	3.95	3.95	3.95	3.95	4.05	4.20
U.S. Yield Curve											
Fed funds	2.38	2.38	2.38	2.38	2.38	2.38	2.38	2.38	2.38	2.63	2.63
3 month	2.42	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.60	2.65
6 month	2.51	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.55	2.75	2.75
1 year	2.58	2.55	2.55	2.60	2.60	2.60	2.60	2.60	2.65	2.75	2.75
2 year	2.54	2.55	2.55	2.55	2.60	2.60	2.65	2.65	2.65	2.70	2.70
3 year	2.52	2.50	2.55	2.60	2.60	2.60	2.65	2.65	2.65	2.70	2.70
5 year	2.54	2.50	2.55	2.60	2.60	2.65	2.65	2.65	2.65	2.75	2.75
7 year	2.61	2.60	2.65	2.65	2.65	2.70	2.70	2.70	2.70	2.80	2.75
10 year	2.71	2.70	2.70	2.75	2.75	2.75	2.80	2.80	2.80	2.85	2.80
30 year	3.04	3.05	3.05	3.05	3.05	3.10	3.10	3.10	3.10	3.15	3.15
1m LIBOR	2.51	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.75	2.85
3m LIBOR	2.77	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.90	3.00
6m LIBOR	2.85	2.80	2.80	2.80	2.80	2.80	2.80	2.80	2.75	2.90	3.00
12m LIBOR	3.02	3.00	3.00	3.00	3.00	3.05	3.05	3.05	3.00	3.05	3.20
Prime Rate	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.60	5.75
Other G7 Yields											
ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10
10yr Bund	0.21	0.20	0.20	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.25
BoE Repo	0.75	0.75 ¹	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00
10yr Gilt	1.28	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
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	0.00	0.01	0.01	0.01	0.02	0.02	0.03	0.03	0.03	0.05	0.05

¹ actual value for February 2019

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