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## Forecast Summary (averages)

	Actual	Forecasts					2018		2019			
	2018 Mar	2018 Apr	May	Jun	Jul	Q3	Q4	Q1	Q2	Q3	Q4	
BoC overnight	1.25	1.25	1.25	1.25	1.50	1.50	1.75	2.00	2.25	2.50	2.50	
10-yr Canadas	2.19	2.20	2.20	2.25	2.25	2.30	2.45	2.60	2.75	2.90	3.00	
Fed funds	1.63	1.63	1.63	1.88	1.88	2.13	2.38	2.63	2.88	2.88	2.88	
10-yr Treasuries	2.84	2.80	2.85	2.85	2.90	2.90	3.05	3.15	3.25	3.35	3.45	
C\$ per US\$	1.293	1.288	1.284	1.279	1.274	1.269	1.255	1.245	1.238	1.230	1.223	
US\$/€	1.23	1.23	1.23	1.24	1.24	1.24	1.25	1.26	1.26	1.27	1.28	
US\$/£	1.40	1.40	1.40	1.41	1.41	1.42	1.43	1.44	1.45	1.46	1.47	
¥/US\$	106	106	106	106	106	105	105	105	104	104	103	

## Since the last issue of Rates Scenario:

- The **Bank of Canada** and **Federal Reserve** made policy announcements in March. The BoC (on the 7th) kept policy rates unchanged (as expected), with its eye on trade uncertainties and households' reactions to past rate hikes. Deputy Governor Lane indicated the next day in the Bank's inaugural Economic Progress Report (for meetings not followed by pressers) that the housing watch was also on as recent macroprudential manoeuvres worked their way through the system. In a speech the next week, Governor Poloz talked about "*nurturing*" an increase in labour supply, which would "*permanently raise the country's capacity to grow without leading to higher inflation*". On balance, these are not the words of a central bank itching to hike rates anytime soon.
- The Fed (on the 21st) raised policy rates by 25 bps, with the target range for fed funds now 1.50%-to-1.75%. The Statement and Chairman Powell's inaugural presser were balanced, which helped a bond market that was betting on a slight hawkish hue. In a fresh Summary of Economic Projections, the market also made hay out of the fact that: (1) the FOMC's median projection for three rate hikes this year remained unchanged, despite a slightly higher path for the out years; and, (2) despite projecting significantly stronger real GDP growth and lower jobless rates, the core PCE inflation forecast was nudged up only a tenth to 2.1% in 2019-20. However, the median policy rate call is just one dot away from shifting to four moves this year. And, what central bank worth its salt would forecast meaningfully missing its inflation target two years out? On balance, it seems that the net risks lie with the Bank of Canada doing less than the market expects this year, and the Fed doing more.
- We still forecast Bank of Canada policy will remain on pause until the second half of this year, with moves in July and October, and a quarterly rate-hike cadence continuing into 2019 until the bottom of the Bank's 2.50%-to-3.50% estimated neutral range is hit. As March's policy announcement reiterated, while "*the economic outlook is expected to warrant higher interest rates over time, some continued monetary policy accommodation will likely be needed*", which means they are in no hurry to get back to neutral.
- We still look for the FOMC to raise policy rates another three times this year, at the June, September and December meetings, and to also continue hiking at a quarterly clip until its current longer-run median projection of 2.875% (the 2.75%-to-3.00% range) is reached in June 2019—just in time to herald the longest business

expansion in U.S. economic history. And, how long this soon-to-be-record cycle lasts will depend heavily on whether the Fed feels compelled to lift rates higher in the second half of next year to counter inflation pressures. At this point, we judge there are net upside risks to our 2019 Fed call. However, these net upside risks are more modest than they otherwise would be owing to the policy-tightening influence of the Fed's steadily shrinking balance sheet.

- In the Treasury market, reduced Fed demand is going to coincide with a surge in supply to fund ballooning budget deficits caused by tax cuts and spending hikes. Fiscal stimulus looks to add well above a percentage point to cumulative economic growth this year and next, which, with the economy essentially at full employment and already sporting a positive output gap, should augment wage growth and inflation (the latter to slightly above the 2% target for the headline and core PCE readings). Against this background and with the Fed likely to raise rates more than the market currently expects, Treasury yields should continue ratcheting on an ascending trend (allowing for occasional downswings triggered by things such as equity market volatility). We're sticking with our 2018-end call for 10-year yields around 3.10%, and for the curve (2s10s) to not invert (unless, of course, the Fed does indeed feel compelled to push policy rates well above neutral in 2019H2). Longer-term Canadas should hold their own, with Canada-US yield spreads staying around current levels, until the Bank of Canada begins raising rates again. This should then trigger some underperformance relative to Treasuries. By the 2018-end, we look for 10-year Canadas to be averaging around 2.55%.
- Elsewhere, perhaps the biggest development over the past month from a monetary policy standpoint has come from the **ECB**. As we expected, the Governing Council dropped its easing bias at the March 8<sup>th</sup> monetary policy meeting, omitting the line that it "*stands ready to increase the APP in terms of size and/or duration*". President Draghi managed to cap a euro rally by downplaying the significance of the move, and repeated that "*an ample degree*" of stimulus was still required. Call it what you want: they're taking baby steps toward the exits. Expect the APP to be pared in September, and conclude by year-end.
- The **BoE** should walk its talk and raise rates at the May 10<sup>th</sup> meeting, as hinted strongly at the February meeting. This expectation became more entrenched after two hawks voted at the March 22<sup>nd</sup> meeting to raise rates immediately. While some of the manufacturing and construction surveys have been considerably weak of late, this was mostly due to the heavy snowstorms dubbed the "*Beast from the East*". And, the Brexit negotiations took a big step forward, with both sides arriving at a broad agreement for a transition deal. Let the next stage of talks begin.
- The **BoJ** is still the laggard in the G7. The economy has improved and inflation is creeping toward the official target but the pace is achingly slow. And, there is not one but two doves on the Policy Board, which could sway the decision-making process. Nonetheless, Governor Kuroda recently acknowledged that there have been "*internal discussions*" about an eventual exit strategy, but maintained that it would be "*misleading*" to talk about it now. Indeed, the first step is admitting that an exit is coming. Although we do not look for rate hikes in the near term, we continue to expect the Bank to tweak its program over the next year, likely by adjusting its 10-year JGB purchases to hold yields at a level higher than the current "*around 0%*" (0.15% is possible).
- The **RBA** has been on hold for nearly two years and has given no indication of when it may move rates higher. The central bank remains very concerned about high levels of household debt and sluggish wage growth.

## Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual	Forecasts					2018		2019			
	2018 Mar	2018 Apr	May	Jun	Jul	Q3	Q4	Q1	Q2	Q3	Q4	
<b>Canadian Dollar</b>												
C\$ per US\$	1.293	1.288	1.284	1.279	1.274	1.269	1.255	1.245	1.238	1.230	1.223	
US\$ per C\$	0.773	0.776	0.779	0.782	0.785	0.788	0.797	0.803	0.808	0.813	0.818	
Trade-weighted	95.9	96.4	96.7	97.1	97.5	97.8	98.7	99.3	99.8	100.3	100.7	
<b>U.S. Dollar</b>												
Trade-weighted <sup>1</sup>	118.1	118.5	118.6	118.7	118.4	118.2	117.2	116.5	115.9	115.4	114.9	
<b>European Currencies</b>												
Euro <sup>2</sup>	1.23	1.23	1.23	1.24	1.24	1.24	1.25	1.26	1.26	1.27	1.28	
Danish Krone	6.04	6.05	6.00	6.00	6.00	6.00	5.95	5.95	5.90	5.85	5.85	
Norwegian Krone	7.77	7.75	7.75	7.70	7.70	7.70	7.60	7.55	7.55	7.50	7.45	
Swedish Krone	8.24	8.35	8.35	8.30	8.30	8.30	8.25	8.20	8.15	8.10	8.05	
Swiss Franc	0.948	0.949	0.951	0.952	0.953	0.955	0.959	0.963	0.967	0.971	0.975	
U.K. Pound <sup>2</sup>	1.40	1.40	1.40	1.41	1.41	1.42	1.43	1.44	1.45	1.46	1.47	
<b>Asian Currencies</b>												
Chinese Yuan	6.32	6.30	6.29	6.28	6.27	6.25	6.21	6.18	6.16	6.13	6.11	
Japanese Yen	106	106	106	106	106	105	105	105	104	104	103	
Korean Won	1,070	1,065	1,065	1,060	1,055	1,055	1,045	1,040	1,035	1,030	1,025	
Indian Rupee	65.0	64.9	64.8	64.7	64.5	64.4	64.0	63.7	63.4	63.2	62.9	
Singapore Dollar	1.31	1.31	1.31	1.31	1.30	1.30	1.29	1.29	1.28	1.28	1.27	
Malaysian Ringgit	3.90	3.90	3.90	3.85	3.85	3.85	3.80	3.80	3.75	3.75	3.70	
Thai Baht	31.3	31.2	31.1	31.1	31.0	30.9	30.8	30.6	30.5	30.4	30.2	
Philippine Peso	52.1	52.0	51.9	51.8	51.7	51.6	51.3	51.0	50.8	50.6	50.4	
Taiwan Dollar	29.2	29.2	29.1	29.1	29.0	29.0	28.9	28.8	28.6	28.5	28.4	
Indonesian Rupiah	13,759	13,735	13,710	13,690	13,665	13,640	13,570	13,425	13,240	13,055	12,870	
<b>Other Currencies</b>												
Australian Dollar <sup>2</sup>	0.776	0.777	0.778	0.779	0.780	0.781	0.784	0.788	0.791	0.795	0.799	
New Zealand Dollar <sup>2</sup>	0.726	0.726	0.727	0.727	0.728	0.728	0.730	0.733	0.738	0.743	0.748	
Mexican Peso	18.59	19.00	19.40	19.80	19.75	19.65	19.20	18.90	18.80	18.65	18.55	
Brazilian Real	3.28	3.30	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.30	3.30	
Russian Ruble	57.1	57.0	56.9	56.8	56.6	56.5	56.1	55.8	55.5	55.1	54.8	
South African Rand	11.8	11.9	11.9	11.9	11.9	11.9	12.0	11.9	11.8	11.7	11.5	
<b>Cross Rates</b>												
<b>Versus Canadian Dollar</b>												
Euro (C\$/€)	1.60	1.58	1.58	1.58	1.58	1.57	1.57	1.56	1.56	1.56	1.56	
U.K. Pound (C\$/£)	1.81	1.81	1.80	1.80	1.80	1.80	1.79	1.79	1.79	1.79	1.79	
Japanese Yen (¥/C\$)	82	82	82	83	83	83	84	84	84	84	84	
Australian Dollar (C\$/A\$)	1.00	1.00	1.00	1.00	0.99	0.99	0.98	0.98	0.98	0.98	0.98	
<b>Versus Euro</b>												
U.K. Pound (£/€)	0.88	0.88	0.88	0.88	0.88	0.88	0.87	0.87	0.87	0.87	0.87	
Japanese Yen (¥/€)	131	130	130	131	131	131	131	131	132	132	132	

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

## Interest Rate Forecasts

Percent (averages)

	Actual 2018 Mar	Forecasts 2018					2018 Q3	2018 Q4	2019			
		Apr	May	Jun	Jul			Q1	Q2	Q3	Q4	
<b>Cdn. Yield Curve</b>												
Overnight	1.25	1.25	1.25	1.25	1.50	1.50	1.75	2.00	2.25	2.50	2.50	
3 month	1.10	1.10	1.10	1.10	1.30	1.30	1.55	1.80	2.05	2.30	2.30	
6 month	1.28	1.35	1.35	1.45	1.55	1.60	1.80	2.00	2.20	2.40	2.40	
1 year	1.59	1.65	1.65	1.75	1.80	1.85	2.05	2.25	2.40	2.55	2.60	
2 year	1.80	1.80	1.85	1.90	1.95	2.05	2.20	2.35	2.50	2.65	2.65	
3 year	1.91	1.95	2.00	2.05	2.10	2.15	2.30	2.45	2.60	2.70	2.80	
5 year	2.03	2.05	2.05	2.10	2.15	2.20	2.35	2.50	2.65	2.80	2.85	
7 year	2.09	2.10	2.15	2.15	2.20	2.25	2.40	2.55	2.70	2.85	2.95	
10 year	2.19	2.20	2.20	2.25	2.25	2.30	2.45	2.60	2.75	2.90	3.00	
30 year	2.34	2.35	2.35	2.40	2.40	2.45	2.65	2.80	2.90	3.05	3.20	
1m BA	1.60	1.65	1.65	1.75	1.85	1.85	2.05	2.25	2.45	2.65	2.65	
3m BA	1.70	1.75	1.75	1.85	1.95	2.00	2.20	2.40	2.60	2.75	2.75	
6m BA	1.86	1.90	1.90	2.10	2.05	2.15	2.30	2.50	2.65	2.75	2.75	
12m BA	2.06	2.10	2.15	2.30	2.25	2.35	2.50	2.65	2.75	2.85	2.85	
Prime Rate	3.45	3.45	3.45	3.45	3.70	3.70	3.95	4.20	4.45	4.70	4.70	
<b>U.S. Yield Curve</b>												
Fed funds	1.63	1.63	1.63	1.88	1.88	2.13	2.38	2.63	2.88	2.88	2.88	
3 month	1.73	1.70	1.80	1.90	1.90	2.00	2.15	2.35	2.55	2.65	2.65	
6 month	1.92	1.90	2.00	2.10	2.10	2.15	2.35	2.50	2.70	2.80	2.80	
1 year	2.06	2.10	2.15	2.20	2.25	2.30	2.50	2.65	2.85	2.90	2.90	
2 year	2.28	2.30	2.35	2.40	2.45	2.50	2.65	2.85	3.00	3.05	3.05	
3 year	2.42	2.45	2.45	2.50	2.55	2.60	2.80	2.95	3.10	3.15	3.15	
5 year	2.63	2.60	2.65	2.70	2.75	2.75	2.90	3.05	3.15	3.25	3.30	
7 year	2.77	2.75	2.75	2.80	2.85	2.85	3.00	3.15	3.25	3.35	3.40	
10 year	2.84	2.80	2.85	2.85	2.90	2.90	3.05	3.15	3.25	3.35	3.45	
30 year	3.09	3.05	3.05	3.10	3.15	3.15	3.30	3.40	3.50	3.60	3.70	
1m LIBOR	1.80	1.90	1.95	2.05	2.05	2.10	2.25	2.40	2.55	2.65	2.65	
3m LIBOR	2.17	2.30	2.40	2.45	2.45	2.55	2.70	2.85	3.00	3.10	3.10	
6m LIBOR	2.35	2.45	2.55	2.60	2.60	2.70	2.85	3.00	3.15	3.25	3.25	
12m LIBOR	2.60	2.70	2.75	2.80	2.85	2.90	3.05	3.20	3.35	3.40	3.40	
Prime Rate	4.58	4.60	4.60	4.85	4.85	4.90	5.15	5.40	5.65	5.85	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	0.25	0.25	0.25	
10yr Bund	0.59	0.65	0.70	0.70	0.75	0.80	0.95	1.10	1.20	1.35	1.45	
BoE Repo	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	
10yr Gilt	1.45	1.50	1.55	1.60	1.65	1.65	1.80	1.95	2.10	2.30	2.45	
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	0.04	0.05	0.05	0.05	0.06	0.06	0.08	0.10	0.11	0.12	0.12	

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