

# Rates Scenario

## Forecast Update

An outlook on key interest and foreign exchange rates

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### Forecast Summary (averages)

|                  | Actual | Forecasts |       |       |       |       |       | 2018  |       |       |       |
|------------------|--------|-----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                  | 2017   | 2017      |       |       |       |       |       | 2018  |       |       |       |
|                  | Jul    | Aug       | Sep   | Oct   | Nov   | Dec   | Jan   | Q1    | Q2    | Q3    | Q4    |
| BoC overnight    | 0.75   | 0.75      | 0.75  | 1.00  | 1.00  | 1.00  | 1.00  | 1.00  | 1.25  | 1.25  | 1.50  |
| 10-yr Canadas    | 1.91   | 2.00      | 2.05  | 2.05  | 2.10  | 2.15  | 2.15  | 2.15  | 2.25  | 2.35  | 2.50  |
| Fed funds        | 1.13   | 1.13      | 1.13  | 1.13  | 1.13  | 1.38  | 1.38  | 1.38  | 1.63  | 1.88  | 2.13  |
| 10-yr Treasuries | 2.32   | 2.30      | 2.30  | 2.35  | 2.35  | 2.40  | 2.40  | 2.40  | 2.50  | 2.65  | 2.75  |
| C\$ per US\$     | 1.270  | 1.260     | 1.270 | 1.280 | 1.290 | 1.300 | 1.298 | 1.296 | 1.290 | 1.283 | 1.277 |
| US\$/€           | 1.15   | 1.17      | 1.18  | 1.17  | 1.17  | 1.16  | 1.15  | 1.14  | 1.13  | 1.14  | 1.17  |
| US\$/£           | 1.30   | 1.31      | 1.32  | 1.31  | 1.30  | 1.30  | 1.29  | 1.28  | 1.26  | 1.25  | 1.27  |
| ¥/US\$           | 112    | 113       | 114   | 115   | 116   | 117   | 117   | 117   | 116   | 116   | 115   |

### Since the last issue of Rates Scenario (on July 5<sup>th</sup>):

- The Bank of Canada raised rates on July 12<sup>th</sup>, as expected, but the tone of the policy pronouncement was more upbeat than anticipated, prompting us to pull forward our January 2018 rate hike call to October. The output gap is now projected to close “around the end of 2017” (it was the “first half of 2018” before). As a result, the bond market not only had to contemplate the reversal of the 50 bps of easing in 2015; but also potentially, a more expeditious policy normalization path. This triggered a much steeper-than-expected sell-off in bond yields, alongside a constant parade of stronger-than-expected Canadian economic data. However, at this point, we doubt an October rate hike will mark the start of a quarterly rate-hike pattern, given the risk of strengthening an already-strong Canadian dollar or slow core inflation proving to be more persistent, and “keeping in mind continued uncertainty and financial system vulnerabilities.” As before, we see subsequent rate hikes in April and October 2018, and more frequent ones afterwards.
- We still expect the Fed to announce the start of tapering reinvestments in September. This appears to be on track with the July 26<sup>th</sup> FOMC policy statement shifting the forward guidance from “this year” to “relatively soon”. As the Fed focusses on commencing balance sheet normalization, we continue to judge it will become a bit more cautious, essentially moving from an apparent quarterly rate-hike cadence to a semi-annual one. As before, we see the next hikes in December, then in June 2018, and more frequent rate hikes afterwards.
- This now paints a picture of tit-for-tat, BoC-Fed rate increases going forward, which should throttle back some of the pressure for Canadas to continue underperforming Treasuries.
- The ECB continues to keep markets guessing as to when it will remove some of the accommodation from its current policies. President Draghi played down expectations at the July 20<sup>th</sup> meeting but he revealed that a more in-depth discussion will be held in the “fall or the autumn”. So, we look to the September 7<sup>th</sup> policy meeting for changes to be announced (example: trimming monthly asset purchases starting in 2018). We may get a hint before that, when Mr. Draghi speaks at the KC Fed’s annual symposium in Jackson Hole, WY during the last weekend in August. Markets will pick up on any key comments he could make, such as the telling one from the same event in 2014, when he said “we stand ready to adjust our policy stance further.”

- It is not often that central banks change their tune quickly but the **BoE** did just that. Under a handful of policymakers started voicing their view that rates should be higher, including Governor Carney's, surprising the market and pushing the GBP sharply higher. But, the spate of negative economic news since then, including a cooler report on consumer price inflation, will likely keep the majority on the MPC to vote to keep rates on hold at the August 3<sup>rd</sup> meeting.
- The **BoJ** is a central bank that has not changed its tune and remains firmly on hold. This view became more entrenched at the July 20<sup>th</sup> meeting. The expected timeline to reach the 2% CPI target was extended by one year, from 2018 to "*around fiscal 2019*".

## Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

|                                 | Actual      | Forecasts   |        |        |        |        |        | 2018   |        |        |        |
|---------------------------------|-------------|-------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|                                 | 2017<br>Jul | 2017<br>Aug | Sep    | Oct    | Nov    | Dec    | Jan    | Q1     | Q2     | Q3     | Q4     |
| <b>Canadian Dollar</b>          |             |             |        |        |        |        |        |        |        |        |        |
| C\$ per US\$                    | 1.270       | 1.260       | 1.270  | 1.280  | 1.290  | 1.300  | 1.298  | 1.296  | 1.290  | 1.283  | 1.277  |
| US\$ per C\$                    | 0.787       | 0.794       | 0.787  | 0.781  | 0.775  | 0.769  | 0.770  | 0.772  | 0.775  | 0.779  | 0.783  |
| Trade-weighted                  | 98.9        | 99.5        | 98.6   | 98.0   | 97.3   | 96.7   | 96.9   | 97.2   | 97.9   | 98.2   | 98.5   |
| <b>U.S. Dollar</b>              |             |             |        |        |        |        |        |        |        |        |        |
| Trade-weighted <sup>1</sup>     | 120.7       | 120.4       | 120.5  | 120.9  | 121.4  | 121.8  | 122.0  | 122.2  | 122.7  | 122.5  | 122.1  |
| <b>European Currencies</b>      |             |             |        |        |        |        |        |        |        |        |        |
| Euro <sup>2</sup>               | 1.15        | 1.17        | 1.18   | 1.17   | 1.17   | 1.16   | 1.15   | 1.14   | 1.13   | 1.14   | 1.17   |
| Danish Krone                    | 6.45        | 6.45        | 6.45   | 6.45   | 6.45   | 6.45   | 6.45   | 6.40   | 6.40   | 6.35   | 6.35   |
| Norwegian Krone                 | 8.16        | 8.15        | 8.15   | 8.20   | 8.20   | 8.20   | 8.20   | 8.15   | 8.10   | 8.05   | 8.00   |
| Swedish Krone                   | 8.32        | 8.30        | 8.35   | 8.35   | 8.35   | 8.35   | 8.35   | 8.35   | 8.25   | 8.20   | 8.10   |
| Swiss Franc                     | 0.96        | 0.95        | 0.95   | 0.95   | 0.95   | 1.00   | 1.00   | 1.00   | 1.00   | 1.00   | 1.00   |
| U.K. Pound <sup>2</sup>         | 1.30        | 1.31        | 1.32   | 1.31   | 1.30   | 1.30   | 1.29   | 1.28   | 1.26   | 1.25   | 1.27   |
| <b>Asian Currencies</b>         |             |             |        |        |        |        |        |        |        |        |        |
| Chinese Yuan                    | 6.77        | 6.75        | 6.75   | 6.74   | 6.74   | 6.73   | 6.73   | 6.73   | 6.73   | 6.73   | 6.73   |
| Japanese Yen                    | 112         | 113         | 114    | 115    | 116    | 117    | 117    | 117    | 116    | 116    | 115    |
| Korean Won                      | 1,133       | 1,135       | 1,140  | 1,145  | 1,145  | 1,150  | 1,150  | 1,150  | 1,150  | 1,145  | 1,145  |
| Indian Rupee                    | 64.4        | 64.4        | 64.3   | 64.3   | 64.2   | 64.1   | 64.0   | 63.9   | 63.5   | 63.1   | 62.7   |
| Singapore Dollar                | 1.37        | 1.37        | 1.37   | 1.36   | 1.36   | 1.36   | 1.36   | 1.37   | 1.38   | 1.39   | 1.40   |
| Malaysian Ringgit               | 4.29        | 4.30        | 4.30   | 4.30   | 4.30   | 4.30   | 4.30   | 4.30   | 4.30   | 4.30   | 4.30   |
| Thai Baht                       | 33.7        | 33.7        | 33.8   | 33.8   | 33.8   | 33.9   | 33.8   | 33.8   | 33.8   | 33.7   | 33.7   |
| Philippine Peso                 | 50.6        | 50.5        | 50.4   | 50.3   | 50.1   | 50.0   | 50.0   | 50.1   | 50.2   | 50.3   | 50.4   |
| Taiwan Dollar                   | 30.4        | 30.5        | 30.5   | 30.6   | 30.7   | 30.8   | 30.8   | 30.9   | 31.2   | 31.5   | 31.7   |
| Indonesian Rupiah               | 13,342      | 13,345      | 13,350 | 13,355 | 13,355 | 13,360 | 13,360 | 13,365 | 13,370 | 13,375 | 13,380 |
| <b>Other Currencies</b>         |             |             |        |        |        |        |        |        |        |        |        |
| Australian Dollar <sup>2</sup>  | 0.780       | 0.775       | 0.768  | 0.762  | 0.756  | 0.750  | 0.754  | 0.758  | 0.771  | 0.783  | 0.796  |
| New Zealand Dollar <sup>2</sup> | 0.736       | 0.733       | 0.729  | 0.726  | 0.723  | 0.720  | 0.723  | 0.725  | 0.733  | 0.740  | 0.748  |
| Mexican Peso                    | 17.82       | 17.85       | 17.90  | 17.90  | 17.95  | 18.00  | 18.10  | 18.15  | 18.40  | 18.65  | 18.90  |
| Brazilian Real                  | 3.20        | 3.25        | 3.25   | 3.30   | 3.30   | 3.35   | 3.35   | 3.35   | 3.35   | 3.40   | 3.40   |
| Russian Ruble                   | 59.7        | 59.8        | 60.0   | 60.2   | 60.3   | 60.5   | 60.3   | 60.2   | 59.7   | 59.3   | 58.9   |
| South African Rand              | 13.2        | 13.2        | 13.3   | 13.4   | 13.5   | 13.6   | 13.5   | 13.5   | 13.3   | 13.2   | 13.0   |
| <b>Cross Rates</b>              |             |             |        |        |        |        |        |        |        |        |        |
| <b>Versus Canadian Dollar</b>   |             |             |        |        |        |        |        |        |        |        |        |
| Euro (C\$/€)                    | 1.46        | 1.47        | 1.50   | 1.50   | 1.50   | 1.50   | 1.49   | 1.48   | 1.45   | 1.47   | 1.49   |
| U.K. Pound (C\$/£)              | 1.65        | 1.65        | 1.68   | 1.68   | 1.68   | 1.69   | 1.67   | 1.66   | 1.62   | 1.61   | 1.62   |
| Japanese Yen (¥/C\$)            | 89          | 90          | 90     | 90     | 90     | 90     | 90     | 90     | 90     | 90     | 90     |
| Australian Dollar (C\$/A\$)     | 0.99        | 0.98        | 0.98   | 0.98   | 0.98   | 0.98   | 0.98   | 0.98   | 0.99   | 1.01   | 1.02   |
| <b>Versus Euro</b>              |             |             |        |        |        |        |        |        |        |        |        |
| U.K. Pound (£/€)                | 0.89        | 0.89        | 0.89   | 0.89   | 0.89   | 0.89   | 0.89   | 0.89   | 0.89   | 0.91   | 0.92   |
| Japanese Yen (¥/€)              | 130         | 133         | 135    | 135    | 135    | 135    | 134    | 133    | 131    | 132    | 134    |

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

## Interest Rate Forecasts

Percent (averages)

|                         | Actual<br>2017<br>Jul | Forecasts<br>2017 |       |       |       |       |       | 2018<br>Jan | 2018  |       |       |  |
|-------------------------|-----------------------|-------------------|-------|-------|-------|-------|-------|-------------|-------|-------|-------|--|
|                         |                       | Aug               | Sep   | Oct   | Nov   | Dec   |       | Q1          | Q2    | Q3    | Q4    |  |
| <b>Cdn. Yield Curve</b> |                       |                   |       |       |       |       |       |             |       |       |       |  |
| Overnight               | 0.75                  | 0.75              | 0.75  | 1.00  | 1.00  | 1.00  | 1.00  | 1.00        | 1.25  | 1.25  | 1.50  |  |
| 3 month                 | 0.73                  | 0.75              | 0.75  | 0.95  | 0.95  | 0.95  | 0.95  | 0.95        | 1.20  | 1.20  | 1.45  |  |
| 6 month                 | 0.89                  | 0.90              | 0.90  | 1.15  | 1.15  | 1.15  | 1.15  | 1.15        | 1.35  | 1.35  | 1.55  |  |
| 1 year                  | 1.07                  | 1.15              | 1.15  | 1.30  | 1.35  | 1.35  | 1.40  | 1.40        | 1.60  | 1.65  | 1.85  |  |
| 2 year                  | 1.22                  | 1.30              | 1.35  | 1.40  | 1.45  | 1.50  | 1.55  | 1.60        | 1.75  | 1.90  | 2.05  |  |
| 3 year                  | 1.29                  | 1.35              | 1.40  | 1.45  | 1.50  | 1.55  | 1.60  | 1.65        | 1.80  | 1.95  | 2.10  |  |
| 5 year                  | 1.52                  | 1.60              | 1.65  | 1.70  | 1.75  | 1.80  | 1.80  | 1.85        | 1.95  | 2.10  | 2.25  |  |
| 7 year                  | 1.71                  | 1.80              | 1.85  | 1.85  | 1.90  | 1.95  | 2.00  | 2.00        | 2.10  | 2.25  | 2.35  |  |
| 10 year                 | 1.91                  | 2.00              | 2.05  | 2.05  | 2.10  | 2.15  | 2.15  | 2.15        | 2.25  | 2.35  | 2.50  |  |
| 30 year                 | 2.28                  | 2.45              | 2.45  | 2.50  | 2.50  | 2.55  | 2.55  | 2.55        | 2.65  | 2.75  | 2.85  |  |
| 1m BA                   | 1.13                  | 1.15              | 1.15  | 1.35  | 1.35  | 1.35  | 1.35  | 1.35        | 1.60  | 1.60  | 1.80  |  |
| 3m BA                   | 1.21                  | 1.20              | 1.20  | 1.45  | 1.45  | 1.45  | 1.45  | 1.45        | 1.65  | 1.65  | 1.90  |  |
| 6m BA                   | 1.34                  | 1.35              | 1.35  | 1.55  | 1.55  | 1.55  | 1.55  | 1.55        | 1.80  | 1.80  | 2.00  |  |
| 12m BA                  | 1.53                  | 1.60              | 1.60  | 1.75  | 1.75  | 1.80  | 1.80  | 1.85        | 2.00  | 2.10  | 2.30  |  |
| Prime Rate              | 2.85                  | 2.95              | 2.95  | 3.20  | 3.20  | 3.20  | 3.20  | 3.20        | 3.45  | 3.45  | 3.70  |  |
| <b>U.S. Yield Curve</b> |                       |                   |       |       |       |       |       |             |       |       |       |  |
| Fed funds               | 1.13                  | 1.13              | 1.13  | 1.13  | 1.13  | 1.38  | 1.38  | 1.38        | 1.63  | 1.88  | 2.13  |  |
| 3 month                 | 1.09                  | 1.05              | 1.05  | 1.05  | 1.05  | 1.30  | 1.30  | 1.30        | 1.35  | 1.60  | 1.80  |  |
| 6 month                 | 1.13                  | 1.15              | 1.15  | 1.15  | 1.15  | 1.35  | 1.35  | 1.35        | 1.45  | 1.70  | 1.90  |  |
| 1 year                  | 1.22                  | 1.25              | 1.25  | 1.30  | 1.30  | 1.45  | 1.50  | 1.50        | 1.65  | 1.85  | 2.05  |  |
| 2 year                  | 1.37                  | 1.35              | 1.40  | 1.45  | 1.50  | 1.55  | 1.65  | 1.70        | 1.85  | 2.05  | 2.20  |  |
| 3 year                  | 1.54                  | 1.50              | 1.55  | 1.60  | 1.65  | 1.70  | 1.75  | 1.80        | 2.00  | 2.15  | 2.30  |  |
| 5 year                  | 1.87                  | 1.80              | 1.85  | 1.90  | 1.95  | 2.00  | 2.05  | 2.05        | 2.20  | 2.35  | 2.50  |  |
| 7 year                  | 2.13                  | 2.10              | 2.10  | 2.15  | 2.20  | 2.25  | 2.25  | 2.25        | 2.40  | 2.50  | 2.65  |  |
| 10 year                 | 2.32                  | 2.30              | 2.30  | 2.35  | 2.35  | 2.40  | 2.40  | 2.40        | 2.50  | 2.65  | 2.75  |  |
| 30 year                 | 2.88                  | 2.85              | 2.85  | 2.90  | 2.95  | 2.95  | 2.95  | 2.95        | 3.00  | 3.10  | 3.20  |  |
| 1m LIBOR                | 1.23                  | 1.25              | 1.25  | 1.25  | 1.25  | 1.50  | 1.50  | 1.50        | 1.55  | 1.80  | 2.05  |  |
| 3m LIBOR                | 1.31                  | 1.30              | 1.30  | 1.30  | 1.30  | 1.55  | 1.55  | 1.55        | 1.65  | 1.90  | 2.15  |  |
| 6m LIBOR                | 1.46                  | 1.45              | 1.45  | 1.45  | 1.45  | 1.70  | 1.70  | 1.70        | 1.75  | 2.00  | 2.25  |  |
| 12m LIBOR               | 1.74                  | 1.70              | 1.75  | 1.80  | 1.80  | 1.95  | 2.00  | 2.00        | 2.15  | 2.35  | 2.55  |  |
| Prime Rate              | 4.25                  | 4.25              | 4.25  | 4.25  | 4.25  | 4.50  | 4.50  | 4.50        | 4.60  | 4.85  | 5.10  |  |
| <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  | 0.00  | 0.00  |  |
| 10yr Bund               | 0.54                  | 0.60              | 0.65  | 0.70  | 0.80  | 0.80  | 0.80  | 0.85        | 0.90  | 0.95  | 0.95  |  |
| BoE Repo                | 0.25                  | 0.25              | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25        | 0.25  | 0.25  | 0.25  |  |
| 10yr Gilt               | 1.25                  | 1.30              | 1.35  | 1.40  | 1.50  | 1.50  | 1.55  | 1.55        | 1.70  | 1.80  | 1.90  |  |
| Boj O/N                 | -0.06                 | -0.05             | -0.05 | -0.05 | -0.05 | -0.05 | -0.05 | -0.05       | -0.05 | -0.05 | -0.05 |  |
| 10yr JGB                | 0.08                  | 0.08              | 0.09  | 0.10  | 0.10  | 0.08  | 0.08  | 0.08        | 0.09  | 0.09  | 0.10  |  |

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