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Forecast Summary (averages)

	Actual	Forecasts				2018			2019			
	2018	2018										
	Jan	Feb	Mar	Apr	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
BoC overnight	1.25	1.25	1.25	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.50	
10-yr Canadas	2.20	2.30	2.35	2.35	2.40	2.55	2.60	2.80	3.00	3.10	3.15	
Fed funds	1.38	1.38	1.63	1.63	1.88	1.88	2.13	2.38	2.63	2.63	2.63	
10-yr Treasuries	2.58	2.70	2.75	2.75	2.80	2.90	3.00	3.10	3.30	3.35	3.40	
C\$ per US\$	1.243	1.230	1.227	1.224	1.221	1.212	1.203	1.196	1.190	1.183	1.177	
US\$/€	1.22	1.25	1.24	1.24	1.24	1.26	1.27	1.28	1.29	1.29	1.30	
US\$/£	1.38	1.42	1.44	1.44	1.44	1.45	1.46	1.47	1.48	1.49	1.50	
¥/US\$	111	109	109	108	108	107	106	106	105	104	103	

Since the last issue of Rates Scenario:

- The Bank of Canada raised policy rates by 25 bps on January 17th, with the overnight target now at 1.25% or a nine-year high, but sounded a bit more cautious about subsequent actions. The Bank reiterated that it would “remain cautious in considering future policy adjustments”, waiting to see what the incoming data tell about “the economy’s sensitivity to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation.” However, it also said “while the economic outlook is expected to warrant higher interest rates over time, some continued monetary policy accommodation will likely be needed to keep the economy operating close to potential and inflation on target”. The requirement for “continued stimulus” reflected escalating concerns over NAFTA negotiations and the housing market’s response to new mortgage lending rules, along with whether the latest rate hike could be the proverbial straw that breaks households’ debt-burdened backs. We still look for two more Bank of Canada rate hikes in 2018, but only in the second half of the year (July and October) in recognition of these concerns.
- The FOMC left policy rates unchanged on January 31st, as anticipated. This was Janet Yellen’s final meeting as Fed Chair with Jay Powell taking the helm February 3rd. But, the Committee tweaked its statement to point more to a March move. First, the economic assessment was more upbeat, and even the increase in inflation compensation was cited. Second, the Fed’s inflation expectations brightened; inflation was expected to “move up this year” compared to “remain somewhat below 2 percent” before. Third, in mentioning again the prospective “gradual adjustments in the stance of monetary policy” and “gradual increases in the federal funds rate”, the FOMC inserted the word “further” in front of gradual. These are all likely hints of the next normalization step occurring on March 21st.
- We still look for three Fed rate hikes this year (in line with the FOMC’s median projection), following 2017’s pattern (March, June, December). However, unlike last year, we judge there are net risks of more moves (September), reflecting the inflation risks posed by an economy growing at a faster-than-potential pace (owing to tax cuts) while sporting a positive output gap and essentially at full employment. Although some of these

risks should be mitigated by capacity-expanding investment (incented by the positive gap itself and tax cuts) and secular disinflationary trends (e.g., automation and digitalization), the voting members in the FOMC have a more hawkish bias this year under the new Fed Chair. This means the Committee is likely to react more ardently to rising inflation risks, let alone actual readings of rising inflation.

- On both sides of the border, given the prospects for more policy rate hikes, continued above-potential growth, further tightening of already-tight labour markets and rising inflation risks, we look for bond yields to continue trending higher this year. For example, 10-year Treasury yields should average around 3.00% by the end of the year, with comparable Canadas around 2.65% (these are about 15 bps above our previous Rates Scenario). Importantly, **we do not anticipate that the yield curve will invert.**
- The **ECB** has begun buying fewer bonds each month, but still refuses to call it tapering. Our view that the central bank could very well close the books on the asset purchase program this year is supported by the Euro Area's strongest growth pace in a decade at 2.5% in 2017 (not far from the ECB's forecast). And, recent data suggest that the trend continued at the start of the current year. Still, don't expect changes to the guidance on rates or asset purchases until March, at the earliest. Sluggish inflation and the euro's recent rally to 3-year highs may be reason for ECB officials to proceed cautiously, although a few hawks will be squawking a lot louder.
- There has been little change on the **BoE** front. After lifting rates in November, the Bank still expects to make "*further modest increases*" over the next few years. Meantime, it will keep an eye on well-above-target inflation (though it did fall in December), wage growth (still sluggish), and credit demand. But the sharp sell-off in the greenback has returned the GBP close to levels that prevailed before the referendum, and that will help keep a lid on any further inflation pressures. The tone of the Brexit negotiations still carries a lot of weight, although Governor Carney now sees a "*disorderly Brexit*" as "*not a likely scenario at all, less likely than at the time we did the assessment in the fall.*"
- Markets fully expected the **BoJ** to remain on hold in January but there was some expectation of a more hawkish bent, particularly after the central bank trimmed its long-term JGB holdings in early January. However, Governor Kuroda quickly put those thoughts to rest, as "*the size of the purchases at any given time or the timing of the purchases is no indication of the direction of future monetary policy*" and it was "*important for the BoJ to patiently continue with powerful monetary easing*". Indeed, the central bank raised its purchases of 3-to-5 year JGBs late in the month. Still, with the economy clearly improving and the labour market tight, the market continues to look for some tweaking to policy. Ten-year JGB yields hit a 6-month high recently of 0.095%. We expect the BoJ to lift the target of its long-term maturities to about 0.1% (or more) from 0% over the course of the next 12 months.
- Mexico is facing many strong headwinds, including the uncertainty surrounding the fate of NAFTA and inflation that is near 16-year highs. Earthquakes weighed on the economy in 2017, contributing to a decline in Q3, but growth bounced back in the final quarter of the year. **Banco de Mexico** will continue to focus on fighting inflation by extending the rate-hike spree this year after raising rates five times in 2017. Of course, if NAFTA is terminated, look for the currency to touch record lows and for the central bank to pause the tightening campaign.
- Australia is adding jobs at the fastest pace in nearly a decade, and labour market conditions are tight. However, underwhelming wage growth, below-target inflation and elevated household debt concerns continue to support the **RBA's** cautious stance.

Foreign Exchange Forecasts

Local Currency per U.S. Dollar (averages)

	Actual	Forecasts				2018			2019			
	2018 Jan	2018 Feb	Mar	Apr	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Canadian Dollar												
C\$ per US\$	1.243	1.230	1.227	1.224	1.221	1.212	1.203	1.196	1.190	1.183	1.177	
US\$ per C\$	0.804	0.813	0.815	0.817	0.819	0.825	0.831	0.836	0.841	0.845	0.850	
Trade-weighted	100.1	100.8	101.2	101.5	101.8	102.4	102.8	103.2	103.6	104.0	104.4	
U.S. Dollar												
Trade-weighted ¹	117.5	115.6	116.0	116.2	116.4	115.5	114.0	113.1	112.6	112.0	111.5	
European Currencies												
Euro ²	1.22	1.25	1.24	1.24	1.24	1.26	1.27	1.28	1.29	1.29	1.30	
Danish Krone	6.10	6.10	6.05	6.05	6.00	5.95	5.85	5.80	5.80	5.75	5.75	
Norwegian Krone	7.90	7.90	7.85	7.80	7.80	7.70	7.55	7.50	7.45	7.45	7.40	
Swedish Krone	8.05	8.05	8.00	8.00	7.95	7.85	7.75	7.70	7.65	7.65	7.60	
Swiss Franc	0.96	0.95	0.95	0.95	0.95	0.90	0.90	0.90	0.90	0.90	0.90	
U.K. Pound ²	1.38	1.42	1.44	1.44	1.44	1.45	1.46	1.47	1.48	1.49	1.50	
Asian Currencies												
Chinese Yuan	6.42	6.35	6.34	6.32	6.31	6.26	6.22	6.18	6.16	6.13	6.11	
Japanese Yen	111	109	109	108	108	107	106	106	105	104	103	
Korean Won	1,066	1,060	1,060	1,055	1,055	1,045	1,040	1,030	1,025	1,015	1,010	
Indian Rupee	63.7	63.5	63.4	63.2	63.1	62.6	62.2	61.8	61.6	61.3	61.0	
Singapore Dollar	1.32	1.32	1.31	1.30	1.30	1.28	1.26	1.26	1.26	1.25	1.25	
Malaysian Ringgit	3.95	3.95	3.95	3.90	3.90	3.85	3.85	3.80	3.80	3.80	3.75	
Thai Baht	31.9	31.8	31.7	31.5	31.4	31.0	30.5	30.3	30.3	30.3	30.2	
Philippine Peso	50.6	50.5	50.4	50.3	50.2	49.8	49.5	49.2	49.0	48.8	48.6	
Taiwan Dollar	29.4	29.3	29.1	29.0	28.9	28.4	28.1	28.1	28.0	27.9	27.8	
Indonesian Rupiah	13,372	13,335	13,295	13,255	13,215	13,100	12,985	12,910	12,860	12,805	12,755	
Other Currencies												
Australian Dollar ²	0.796	0.796	0.798	0.801	0.803	0.810	0.818	0.825	0.833	0.840	0.848	
New Zealand Dollar ²	0.726	0.729	0.732	0.736	0.740	0.750	0.761	0.766	0.767	0.768	0.770	
Mexican Peso	18.91	18.50	19.15	19.75	20.40	20.35	19.35	18.90	18.80	18.65	18.55	
Brazilian Real	3.21	3.20	3.20	3.20	3.15	3.15	3.10	3.10	3.10	3.10	3.05	
Russian Ruble	56.6	56.4	56.3	56.1	55.9	55.4	54.8	54.4	54.1	53.8	53.5	
South African Rand	12.2	12.2	12.1	12.1	12.1	11.9	11.8	11.6	11.4	11.3	11.1	
Cross Rates												
Versus Canadian Dollar												
Euro (C\$/€)	1.52	1.54	1.52	1.52	1.52	1.52	1.53	1.53	1.53	1.53	1.53	
U.K. Pound (C\$/£)	1.72	1.75	1.77	1.77	1.76	1.76	1.75	1.75	1.76	1.76	1.76	
Japanese Yen (¥/C\$)	89	89	89	89	89	88	88	88	88	88	88	
Australian Dollar (C\$/A\$)	0.99	0.98	0.98	0.98	0.98	0.98	0.98	0.99	0.99	0.99	1.00	
Versus Euro												
U.K. Pound (£/€)	0.88	0.88	0.86	0.86	0.86	0.87	0.87	0.87	0.87	0.87	0.87	
Japanese Yen (¥/€)	135	136	135	134	135	135	135	135	135	134	134	

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

Interest Rate Forecasts

Percent (averages)

	Actual	Forecasts				2018			2019			
	2018 Jan	2018 Feb	Mar	Apr	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Cdn. Yield Curve												
Overnight	1.25	1.25	1.25	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.50	
3 month	1.16	1.15	1.15	1.15	1.20	1.45	1.65	1.90	2.15	2.35	2.35	
6 month	1.33	1.30	1.30	1.30	1.35	1.55	1.80	2.00	2.20	2.40	2.40	
1 year	1.59	1.60	1.65	1.65	1.70	1.90	2.05	2.25	2.45	2.60	2.60	
2 year	1.78	1.85	1.90	1.95	2.00	2.15	2.30	2.40	2.55	2.65	2.70	
3 year	1.85	1.95	2.00	2.05	2.10	2.25	2.35	2.50	2.70	2.80	2.80	
5 year	2.00	2.10	2.10	2.15	2.20	2.35	2.45	2.60	2.80	2.90	2.95	
7 year	2.09	2.20	2.25	2.25	2.30	2.45	2.55	2.70	2.90	3.00	3.05	
10 year	2.20	2.30	2.35	2.35	2.40	2.55	2.60	2.80	3.00	3.10	3.15	
30 year	2.35	2.35	2.40	2.45	2.50	2.65	2.75	2.90	3.15	3.25	3.35	
1m BA	1.54	1.55	1.55	1.55	1.55	1.80	2.00	2.25	2.45	2.65	2.65	
3m BA	1.64	1.65	1.65	1.65	1.65	1.90	2.10	2.35	2.55	2.75	2.75	
6m BA	1.82	1.80	1.80	1.80	1.85	2.05	2.25	2.45	2.65	2.80	2.80	
12m BA	2.03	2.05	2.10	2.10	2.15	2.30	2.50	2.65	2.80	2.95	2.95	
Prime Rate	3.45	3.45	3.45	3.45	3.45	3.70	3.95	4.20	4.45	4.70	4.70	
U.S. Yield Curve												
Fed funds	1.38	1.38	1.63	1.63	1.88	1.88	2.13	2.38	2.63	2.63	2.63	
3 month	1.43	1.55	1.60	1.60	1.70	1.80	1.90	2.10	2.30	2.40	2.40	
6 month	1.62	1.70	1.80	1.80	1.90	2.00	2.05	2.25	2.45	2.55	2.55	
1 year	1.80	1.90	1.95	2.00	2.05	2.15	2.30	2.45	2.60	2.65	2.65	
2 year	2.03	2.15	2.20	2.25	2.25	2.40	2.55	2.65	2.80	2.85	2.85	
3 year	2.15	2.30	2.30	2.35	2.40	2.55	2.65	2.80	2.90	3.00	3.00	
5 year	2.38	2.50	2.55	2.60	2.65	2.75	2.80	2.95	3.10	3.20	3.20	
7 year	2.51	2.65	2.70	2.70	2.75	2.85	2.95	3.05	3.25	3.30	3.35	
10 year	2.58	2.70	2.75	2.75	2.80	2.90	3.00	3.10	3.30	3.35	3.40	
30 year	2.88	2.95	3.00	3.00	3.05	3.10	3.20	3.30	3.50	3.55	3.60	
1m LIBOR	1.56	1.65	1.80	1.80	1.90	2.00	2.10	2.35	2.55	2.65	2.65	
3m LIBOR	1.73	1.85	1.95	1.95	2.05	2.15	2.30	2.50	2.70	2.85	2.85	
6m LIBOR	1.91	2.00	2.15	2.15	2.25	2.35	2.50	2.70	2.95	3.05	3.05	
12m LIBOR	2.20	2.35	2.40	2.45	2.55	2.65	2.80	3.00	3.20	3.30	3.30	
Prime Rate	4.50	4.50	4.75	4.75	4.85	5.00	5.10	5.35	5.60	5.75	5.75	
Other G7 Yields												
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	0.55	0.60	0.65	0.65	0.70	0.85	0.95	1.05	1.20	1.30	1.40	
BoE Repo	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	1.00	1.00	
10yr Gilt	1.34	1.40	1.45	1.50	1.60	1.75	1.95	2.05	2.20	2.30	2.40	
Boj O/N	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	0.00	
10yr JGB	0.07	0.07	0.08	0.08	0.08	0.09	0.10	0.10	0.11	0.12	0.12	

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