

MARKET CALL

- We released an updated interest and exchange rate outlook in our January 14th issue of *Forecast*, and have maintained that outlook here. We didn't see any hints in the Bank of Canada's latest report that it intends to extend the pledge to keep interest rates on hold, and strong first half growth could see overnight rates nudged higher as early as Q3—prematurely in our view, given our less enthusiastic growth projection for the latter half of the year. That slowdown could have the Bank of Canada surprising markets by delaying any follow-up move on rates until well into 2011.
- The bond market's recent rally looks vulnerable, not only due to pressure on two-year yields as we approach the first BoC rate hikes, but also from the impact on global bond yields from heavy deficit financing worldwide. Such pressures should be more evident in the US and some eurozone countries than in Canada, where the fiscal position is less troublesome.
- As we expected, the US dollar managed to find a better footing early in 2010, and that, alongside a dip in oil prices, helped take dollar-Canada towards our 1.07 March-end target. If we're right about the Bank jumping ahead of the Fed on the first rate hikes, Q1 will represent a good opportunity to buy the loonie ahead of its bullish response to a wider short-rate differential.

INTEREST & FOREIGN EXCHANGE RATES

END OF PERIOD:	2010					2011	
	27-Jan	Mar	Jun	Sep	Dec	Mar	Jun
CDA Overnight target rate	0.25	0.25	0.25	1.00	1.00	1.00	1.50
98-Day Treasury Bills	0.16	0.20	0.60	1.15	1.05	1.15	1.75
2-Year Gov't Bond	1.23	1.45	1.90	2.35	2.00	2.40	2.70
10-Year Gov't Bond	3.37	3.65	3.85	3.95	3.75	4.00	4.05
30-Year Gov't Bond	3.97	4.15	4.30	4.45	4.30	4.35	4.40
U.S. Federal Funds Rate	0.15	0.15	0.15	0.15	0.25	0.75	1.50
91-Day Treasury Bills	0.08	0.10	0.10	0.10	0.20	1.00	1.50
2-Year Gov't Note	0.92	1.05	1.10	1.20	1.35	2.20	2.45
10-Year Gov't Note	3.65	3.85	4.00	4.15	4.10	4.45	4.45
30-Year Gov't Bond	4.56	4.70	4.75	4.95	4.85	5.05	5.05
Canada - US T-Bill Spread	0.08	0.10	0.50	1.05	0.85	0.15	0.25
Canada - US 10-Year Bond Spread	-0.28	-0.20	-0.15	-0.20	-0.35	-0.45	-0.40
Canada Yield Curve (30-Year — 2-Year)	2.74	2.70	2.40	2.10	2.30	1.95	1.70
US Yield Curve (30-Year — 2-Year)	3.64	3.65	3.65	3.75	3.50	2.85	2.60
EXCHANGE RATES							
CADUSD	0.94	0.93	0.97	1.02	0.97	0.96	1.00
USDCAD	1.06	1.07	1.03	0.98	1.03	1.04	1.00
USDJPY	90	94	93	90	87	86	86
EURUSD	1.40	1.37	1.38	1.44	1.47	1.48	1.50
GBPUSD	1.62	1.59	1.61	1.67	1.71	1.72	1.73
AUDUSD	0.895	0.920	0.940	0.960	1.000	0.990	0.995
USDCHF	1.05	1.06	1.04	1.01	0.99	1.00	1.01
USDBRL	1.86	1.87	1.82	1.77	1.72	1.70	1.69
USDMXN	12.9	13.5	13.0	12.7	12.5	12.3	12.3