

2026 YEAR AHEAD OUTLOOK: EXIT THROUGH THE GIFT SHOP

FICC Strategy | Economics | Portfolio Strategy

November 2025

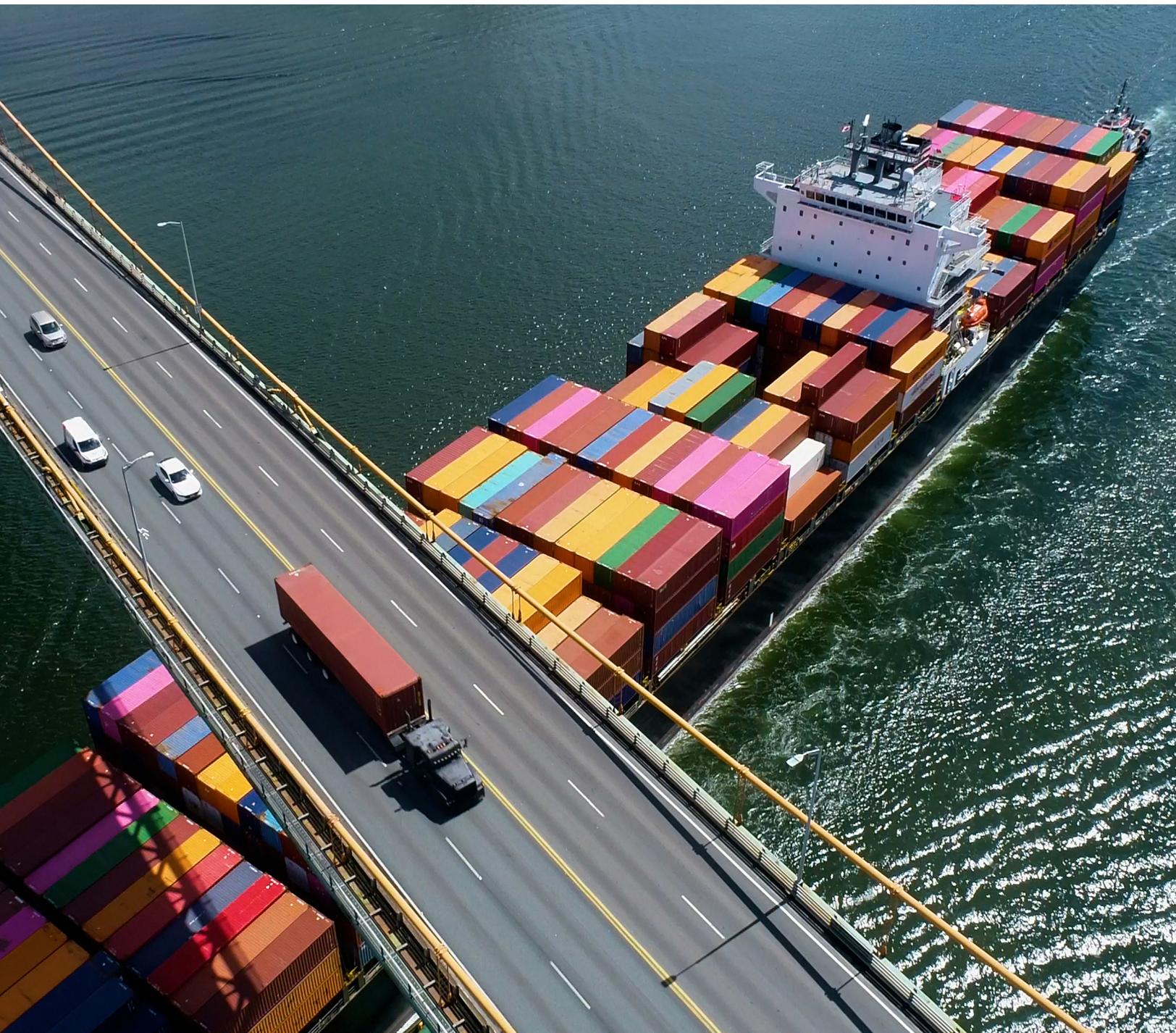


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Introduction: Terms & conditions may apply

Central bankers will be hard pressed to justify taking policy interest rates below neutral in 2026, and our policy forecasts are calibrated to see most regions stop the easing cycle at the lower-bound of neutral rate ranges. Preventing the move to provide more stimulus reflects a delicate balancing act between two forces.

The first force is pro-growth, and is the tailwind from prior rate cuts and the start of broad based fiscal expansions. Fiscal efficiency matters here, because turning the fiscal spend into nominal GDP gains isn't uniform across regions. Germany, Japan and Canada appear the most able to turn fiscal dividends into real output gains, restricting a rise in longer term interest rates. In contrast, highly productive economies operating closer to full employment, like the United States, will see less bang for the buck from additional fiscal support and could be penalized by investors' worries of fiscal imprudence, keeping the yield curve steeper for longer.

The second force is inflation is likely to remain higher for longer. While tariff driven inflation should begin to soften, in part because of base-effects unwinding and a gradual pass-through into final prices, financial conditions are now just as easy as they were prior to the 2022 rate hiking cycle. The wealth created from financial assets is the key to this easiness, and it supports consumption patterns and the ability for tariff pass-through to persist. Energy prices should counterbalance this to a degree, as we remain cautious in the near-term with a WTI price target of USD\$65.0/bbl in 2026.

Demand remains resilient in oil markets, but the growth of supply coming online faster should prove to be a headwind. In contrast, natural gas prices should stay elevated next year as US demand remains strong, supported by the expansion of LNG projects more broadly and ongoing data center development.

Although slack will remain evident in trade-exposed economies, it won't be enough to put substantial downward pressure on prices and the result will be a limited set of disinflationary forces amongst advanced economies. Absent a material shock to equity & credit markets or labor market stress induced by AI adoption—neither of which we expect – there remains a very large burden of proof for policy settings to dip further below what is currently priced in most economies.

The United States stands out in this regard, as a new Fed Chair risks an interim period of potential monetary impropriety. The risk we foresee is a Fed willing to provide more policy largesse in order to expedite the stabilization in the US labour market, but also, reinforcing easier financial conditions that ultimately extend the current AI capex cycle and keep inflation well above target for more than half a decade. Inflation expectations, for markets and forecasters, could gradually reset and all of this has an obvious impact on R^* pricing.

In Canada, downside risks to growth should recede after H1-26, as information on the fate of CUSMA should be available around this time. Tweaks to the trade agreement are likely, but more certainty should be the ultimate outcome and we expect the agreement to broadly remain intact, living uncomfortably alongside sectoral tariffs. But the key will be that the risk of tariff escalation will be off the table, allowing a lagged capex pipeline to be unlocked, which should coincide with fiscal cash hitting the economy later in the year. This should help the economy gradually return to balance, allowing the labor market to heal somewhat from the scars of the trade war. The Bank of Canada won't lean against this uptick in growth next year, keeping policy unchanged to allow slack to be absorbed and the economy to transition to a post-tariff world. However, expectations for a couple of hikes in 2027 will likely build next year as this progress materializes.

For interest rates in 2026, we expect ranges to be limited in longer-term rates with shorter-term rates rising the most. That reflects both the end of easing cycles, and looking ahead to hikes in 2027 and beyond, but also the impact that fiscal expansion has on the pricing of medium-term policy expectations. Longer-term rates will rise, but not enough to offset the move in the front-end & belly, resulting in flatter curves. The easy steepening is now behind us. Supply considerations still matter, but our forecasts don't see much growth in net bond supply until 2028. The small upward pressure we expect should occur through a rebuilding of real term premia in regions with limited savings relative to investment, like Canada, and higher breakeven term premia in economies that aren't fiscally efficient (United States, United Kingdom). Whereas fiscal dominance drove global long-end yields in 2025, more activist policies by debt managers are expected in the year ahead, reducing the influence of bond vigilantism.

As for how this impacts the currency market, the maturity of global central bank cycles means that a return-to-neutral or remain-at-neutral is already priced. This should translate into more decay for overall FX volatility, and we expect tight ranges in the G10 with a high degree of mean reversion. This translates into rapid, but monetizable, windows to hedge. Our outlook for the USD, given our growth and rate forecasts, is U-shaped in 2026. Ongoing portfolio flow concerns will persist, but a still strong capex cycle predicated on AI should limit de-dollarization concerns.

In Emerging Markets (EM), a corollary of aged easing cycles and vol decay is a reach for yield. Investors should favor diversified carry baskets early next year, concentrated around EM currencies. Idiosyncratic risks in H2 may drive investors to pull back and refocus on core G10 crosses. And as an insurance hedge to US trade-policy and AI uncertainty, we like selling CNH/JPY.

Together, the combination of rangebound yields in the long-end and declining FX volatility should produce a favorable macro backdrop for risk assets. The reduction of macro catalysts, however, doesn't obviate the need to be defensive. For example, if we are right on our view that Canada receives more visibility around the CUSMA, the associated unlocking of capital expenditures may produce too much corporate supply for the market to absorb. Resultantly, widening spreads in the second-half of 2026 should be expected, and sectoral alpha becomes more important.

In equities, our preference is for a portfolio that can allow for upside participation but meaningful downside outperformance. US earnings growth will benefit from solid economic fundamentals and a stabilization in the jobs market, with positive lagged impacts of prior rate cuts and deregulation. Solvency issues in the AI 'hyperscalers' isn't obvious, making parallels to the early 2000s tech-wreck more misplaced than misguided. Canadian equities should benefit in this environment, particularly as a macro bull case for the Canadian economy becomes more intuitive later in 2026. For Canadian equity positioning, we prefer owning cyclical/capex beta that exploits more trade certainty.

So where can our base-case go wrong? In a few places. First, a more contentious renegotiation of the CUSMA and/or a cessation signaled by the United States would require a fresh easing cycle from the BoC and the Fed. This would lower rates, steepen the curve and see a rally in USD/CAD. For the Fed, such an outcome would be a bit hit to US confidence, making easy Fed policy less imprudent. Second, idiosyncratic challenges in private credit markets remains a low probability/high impact event, and one that not only widens IG but also limits the ongoing AI infrastructure spend. Such an outcome would put downward pressure on medium-term policy expectations, as the capital intensity of current non-residential investment would need lower rates to persist. Third, the post-Powell period could be more inappropriate than expected, raising serious doubts about the

Fed independence more dramatically and inflation expectations could de-anchor. That would ultimately steepen the curve, with more bond premia added in the long-end, which would in turn short circuit the AI capex boom. Finally, fiscal expansion could generate more productivity enhancement than expected, sooner, forcing a faster repricing of future policy paths. This would be a key risk to US equity valuations.

In the balance of this publication we discuss each of the themes presented in this introduction in more detail.

As in prior years, we would like to thank you for the opportunity to take part in your investment decision making process. We remain committed to providing best-in-class, actionable, research and look forward to speaking in the year ahead.

Across our research franchise, we wish all of our readers a very happy holiday season ahead and a very profitable 2026.

All the best,

IP

Ian Pollick

Managing Director & Head, Fixed Income, Currency & Commodity (FICC) Strategy

Economic Outlook: Middling, and muddling through

Avery Shenfeld

The year ahead won't be the best of times or the worst of times, with the US seeing middling growth results and Canada muddling through its more notable challenges. Stateside, a moderate growth backdrop could leave the success or disappointments over AI as a more important driver of equity market performance than economic news. The Treasuries markets might not see quite as much Fed easing as its counting on. The bond market rally in Canada is now long in the tooth, but those asking about a 2026 monetary tightening in Canada are also jumping the gun in an economy that will need extended support.

In both countries, softer population growth will mean that what would have been a less than satisfactory GDP pace prior to 2025 won't translate into a wider output gap. Indeed, we expect Canada to see some gradual progress towards narrowing economic slack over the course of the year.

Fed keeps one eye on the inflation risks

The government shutdown has meant that economists and central bankers are more in the dark on the US economic picture than usual. As of late summer, the data were presenting a contradictory picture, with healthy readings for Q2 and Q3 GDP, but signs of a decelerating job market. ADP and other survey data, and corporate earnings reports, suggest that this pattern may have continued through October.

With only limited data at hand, we're sticking with our prior view, with the US on a slightly-below-2% growth trend (Table 1). That's not far from the economy's non-inflationary speed limit these days, given the sharp reduction in population growth. As a result, we don't see much further upside in the unemployment rate from here, even with sluggish job growth.

Table 1: US economic outlook

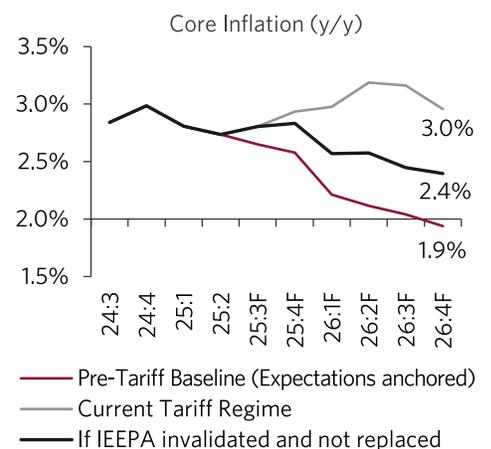
	2024A	2025F	2026F	2027F
GDP (y/y% change)	2.8	2.0	1.9	1.7
CPI (y/y% change)	2.9	2.9	3.3	2.5
Unemployment rate (%)	4.0	4.2	4.4	4.2

Source: BEA, BLS and CIBC.

The inflation picture still has some upside, albeit with some shifts in what's is likely to drive it. Tariffs are looking somewhat less threatening, as healthy margins may be allowing retailers to spread out tariff-related price hikes over a longer timeframe. The Trump Administration has shown some willingness to trim tariffs where they are seen as a risk to consumer prices. An upcoming Supreme Court ruling could strike down the reciprocal and fentanyl tariffs on constitutional grounds. If they were not replaced with other levies, and that's a big if, it would take a big chunk out of the inflation upside (Chart 1)

More likely, the President will replace most of any tariffs the court strikes down with alternatives, including additional sectoral levies on national security grounds. Another legislative route would permit a broad 15% tariff, matching most of the current reciprocal tariffs, after declaring a balance of payments emergency, although that would have to be extended by Congress after 150 days. A recent Senate vote opposing reciprocal tariffs suggests that such an approval might not be forthcoming, so there might be more of an easing in tariffs later in 2026.

Chart 1: US core PCE inflation scenarios



Source: BLS, CIBC.

Offsetting a bit of relief from tariff driven inflation, health care premiums are on the rise, pushed by rising costs for care and less widely available government subsidies. As a result, we're still likely to see core PCE inflation edge above 3% in upcoming quarters.

The Fed seems willing to look past these price pressures to some extent, and after a quarter point cut in December, could return with a further 25 basis point easing in the first quarter if the labour market still looks a bit shaky. In addition to weak hiring, the central bankers may fear that too much of the recent growth has been tied to AI-related capital spending and consumer spending pushed by related wealth gains in equities. That AI capital spending boom will continue into 2026, but at some point, the growth rate in those capital outlays will inevitably begin to crest. Lower rates will help rebalance growth somewhat, reducing the drag on interest sensitive demand.

That could include some business-related construction tied to sectors in which tariffs are encouraging reshoring. But sharply slower population growth that implies fewer new workers, and higher prices that are unlikely to be matched by an acceleration in wages, will impose a drag on consumer spending power, by combining to generate a slowing in total real labour income growth (Chart 2A and 2B). That said, the first half of the year could see an offsetting lift from a larger dose of tax refunds tied to elements of the fiscal package that payroll deductions would not have accounted for during 2025.

Our call for two more quarter point cuts, taking the funds rate to roughly neutral territory, is less than the market is pricing-in at this point. While a new Chair is likely to bring a more dovish voice at the top of the central bank, even Trump's Fed appointees won't be willing to get aggressive with inflation above target, since that would risk a steeper rise in long rates. Note that of the three Trump appointees currently on the Fed, only Mirin, who plans to return to a White House job, has called for a materially faster pace of cuts.

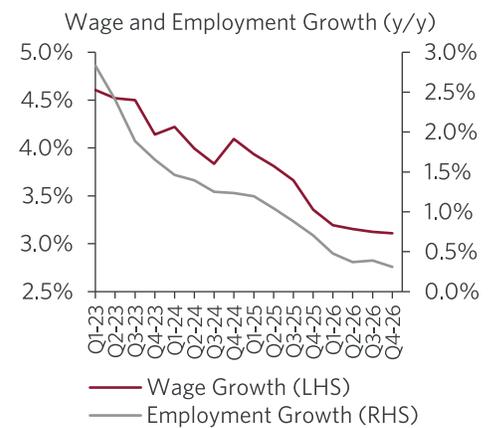
We could end up needing more interest rate relief later in the cycle, beyond 2026, if an equities correction further dents consumption. But given the huge build up in wealth we've seen in the last few years, it might take a major pullback in asset values to have a material impact on spending by upper-income Americans.

Canada: Deal or no deal?

Canada's economy saw the steepest hit from tariffs in Q2, and appears to be back on a choppy growth trend in the latter half of 2025. To state the obvious, Canada's fate will still be shaped by the outcome of trade talks with the US. After a pause, we expect negotiations or unilateral moves by the White House to reduce aluminum tariffs, and perhaps those on steel, with political support from American metal-consuming industries. Progress on lumber and autos seems unlikely, and sliding output in those sectors will weigh on activity.

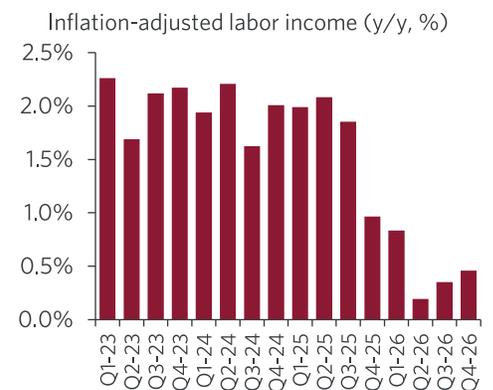
Our forecast assumes that agreement is reached to extend the USMCA pact in 2026 to preserve tariff-free access for most Canadian exports to the US. The fact that Trump acknowledged that treaty in exempting Canada and Mexico from broader tariffs suggests that the administration sees some value in preserving it. Alternatively, if the USMCA expires, Canada could achieve a similar result if the Supreme Court strikes down the emergency powers the President cited for his broad "fentanyl" and "reciprocal" tariffs. If the White House doesn't reach for other tariffs to replace them, or Congress refuses to extend those tariffs, a move to very low most-favoured-nations tariffs would come close to preserving the free trade access for those companies not facing US sectoral tariffs.

Chart 2A: US sees cooler job and wage gains....



Source: BLS and CIBC.

Chart 2B: ... slowing real labour income growth



Source: BEA, CIBC.

Fiscal policy should provide an offset to trade headwinds, but we see more of the lift from the Federal budget coming after 2026 (Chart 3) The lags in that stimulus are inherent in its emphasis on large scale capital projects. Other than projects that were already slated to commence prior to the budget, those just on the drawing board will take time to roll out and bring their associated construction and equipment jobs. The even greater lift would come later in the decade, as these projects come on stream and raise potential growth in key sectors. In the near term, we'll also feel some headwinds from a tightening in federal budgets for day to day operations and staffing.

Still, helped by the lagged impacts of prior rate cuts, and a rebound in exports in sectors that got an all clear on US tariffs, Canada's economy could manage to muddle through in 2026 (Table 2). With slowing population and labour force growth, even our 1.4% forecast pace, entailing a 2% pace on a Q4 over Q4 basis, could make meaningful progress in narrowing economic slack.

Table 2: Canadian economic outlook

	2024A	2025F	2026F	2027F
GDP (y/y% change)	2.0	1.7	1.4	2.0
CPI (y/y% change)	2.4	2.1	1.9	2.0
Unemployment rate (%)	6.4	6.9	6.7	6.1

Source: Statistics Canada and CIBC.

BoC won't have an itchy rate hike trigger finger

That could see the Bank of Canada opt to stay on hold over that forecast horizon, rather than step in with additional rate cuts. We've seen an upturn in multifamily housing activity outside Ontario and BC, sufficient to turn that sector from a major drag to a modest positive in the coming year if single family home building also starts to pick up.

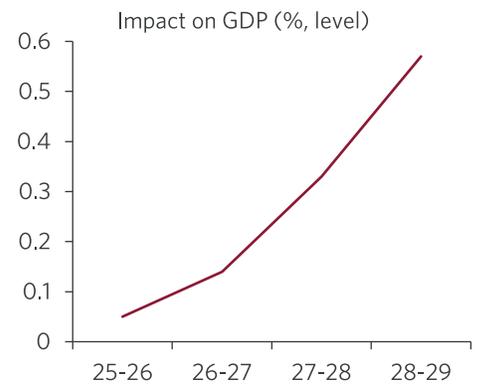
That said, given that rates are only barely in stimulative territory, we see little reason for the Bank of Canada to even think about a rate hike until 2027 at the earliest. If we do see a move on rates in the coming year, it's much more likely to be a cut or two in response to any disappointments in the pace of the recovery. That's contrary to a recent BoC survey of market participants that projected a hike as early as next summer.

Domestically, a sizeable output gap should moderate both wage gains and consumer spending power. The jobless rate has dipped to 6.9%, but that's still nearly a percentage point above what we would see as full employment, leaving employers much less willing to open their wallets with higher pay scales. Rent inflation remains more heated in the CPI than what we're observing in leading indicators for its direction ahead, including a softer picture for asking rents on newly available units.

We don't share the Bank of Canada's concerns that cost increases tied to a rejigging of global supply chains will generate a meaningful upside risk to inflation from abroad in the coming year. Canada has slashed the tariffs it initially imposed on US goods. Global growth has been dulled by US tariffs, part of why we've seen softness in world crude oil prices. Increasing excess capacity in overseas consumer goods industries that are facing US tariffs should produce downward pressure on wholesale prices for what Canada imports from Europe and Asia.

That's an environment in which Canada's central bank needn't have an itchy finger on its rate hike trigger. If anything, it will continue to be watch for signs that current interest rates aren't delivering the needed lift to domestic demand.

Chart 3: Fiscal boost has a long lag



Source: Finance Canada, CIBC.

Provincial Economic Outlook: Did you have to let it linger?

Andrew Grantham and Tom Bognar

Provincial governments have benefitted from a mostly risk-on tone in markets this year which, combined with generally positive surprises to the final tallies of 2024/25 public finances, has led to tighter spreads relative to Government of Canada benchmarks. However, in the year ahead some of those factors are likely to unwind, with lingering trade uncertainties keeping GDP, and by extension revenue, slower for longer than we previously anticipated. That could see borrowing programs touch pandemic highs, pressuring domestic spreads even after accounting for a continued elevated level of foreign issuance.

A little bit of history revised

New revenue figures and revised economic data have shown that provincial finances were, generally, on a more solid footing than it first appeared as we entered into the current period of trade uncertainty and the associated economic slowdown. Public finances for fiscal 2024/25 revealed an aggregate deficit that was only a third of what was expected in the spring budgets, largely driven by smaller shortfalls in Ontario and Quebec, and a larger surplus in Alberta.

However, so far that better fiscal starting point has not yet spilled over into expectations for the current fiscal year. While Ontario lowered its deficit forecast, due in part to adjusted revenue projections, that has so far been offset by some slippage in other provinces (Chart 1).

Of course, it is possible that some provinces are being a little conservative in their revenue projections, and are not yet fully incorporating upward revisions to GDP (which have partly resulted from newly available tax data). If that is the case then the provinces that have seen the largest upward revisions to recent economic growth figures could still see some improvement in their fiscal projections. Saskatchewan, Nova Scotia and Manitoba are at the top of the pack with regards to the extra economic growth that was unearthed with the release of the latest provincial GDP figures (Chart 2), although for Saskatchewan any revenue improvement has so far been more than offset by other factors.

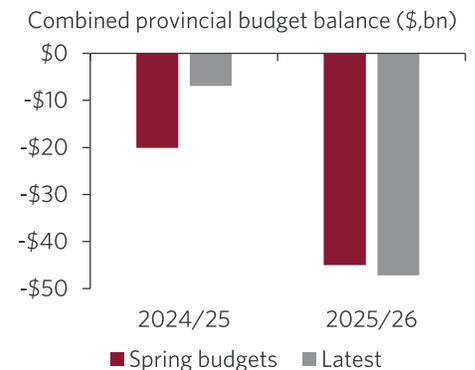
Ontario, where revenue forecasts have already been revised higher thanks to prior year adjustment, sat closer to the middle of the pack. Alberta and Newfoundland growth went largely unrevised in the most recently released provincial economic accounts, suggesting less scope for upward revisions to corporate and personal tax revenue. Both will also likely be revising down oil price assumptions and, by extension, resource revenue.

The lingering cloud of uncertainty

Unfortunately, the better starting point for provincial finances is being overshadowed by the lingering cloud of uncertainty that is US trade policy. While many provinces have avoided the worst of the economic impacts thanks to CUSMA exemptions, that hasn't proven to be the case for those with a heavier concentration of trade in sectors subjected to specific tariffs. These include Ontario (autos and steel), and Quebec (aluminum), with British Columbia and New Brunswick recently making an unwelcome rise up the leaderboard of most exposed provinces thanks to the ratcheting up of lumber tariffs (Chart 3).

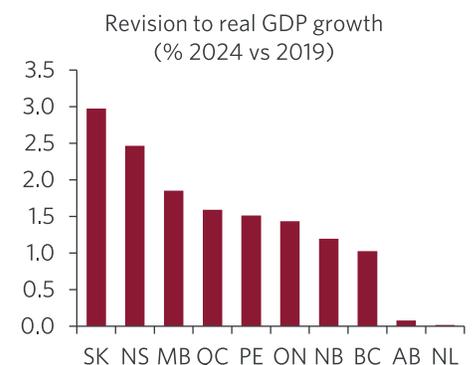
Looking forward, we see a path for reducing steel and aluminum tariffs from their current lofty levels, but progress on long standing areas of dispute such as lumber is less likely. Moreover, the continued uncertainty will restrain GDP growth to a pace below what we otherwise would have forecast, even in parts of the country with little direct exposure to tariffs.

Chart 1: Smaller prior year deficit hasn't dramatically changed view of current year



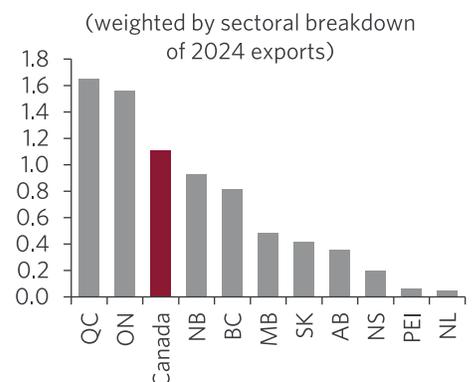
Source: Provincial budgets, CIBC.

Chart 2: Recent GDP revisions not uniform



Source: Statistics Canada, CIBC.

Chart 3: Quebec, Ontario paying highest tariff rates as a percentage of GDP



Source: US Customs, Statistics Canada, CIBC.

The continued slowdown in population growth could also start impacting GDP in some parts of the country. While restrictions on non-permanent resident numbers, in particular students, has brought population growth in Ontario and BC to a near standstill, and negatively impacted the education sector, wider economic impacts are expected to be limited (Chart 4). Both provinces have unemployment rates that are well above both year-ago and pre-pandemic levels, suggesting plenty of workers available to grow the economy should demand for labour improve.

That is not the case in some other provinces. Nova Scotia has also seen a marked easing in population growth, but the jobless rate there is little changed from a year ago and still below pre-pandemic norms. A lack of labour availability isn't constraining growth just yet, although the job vacancy rate has started to edge up, and labour constraints could see growth in that province slip back below the national average by 2027 (Table 1). Quebec could also find itself in a similar position, although there some easing of trade pressures should still bring stronger GDP growth by 2027. Overall, most provinces will continue to see only modest economic growth next year, but should see an acceleration in thereafter.

Table 1: Real GDP forecasts (% y/y)

	2024A	2025F	2026F	2027F
BC	1.1	1.5	1.4	2.0
Alta	3.0	2.5	1.8	2.4
Sask	3.0	2.1	1.5	1.8
Man	1.7	1.7	1.4	1.7
Ont	1.6	1.3	1.3	2.1
Qué	1.7	1.5	1.5	1.9
NB	2.7	1.8	1.4	1.7
NS	3.1	2.2	1.5	1.8
PEI	3.8	2.4	1.7	2.2
N&L	2.7	2.9	1.9	1.7

Source: Statistics Canada, CIBC

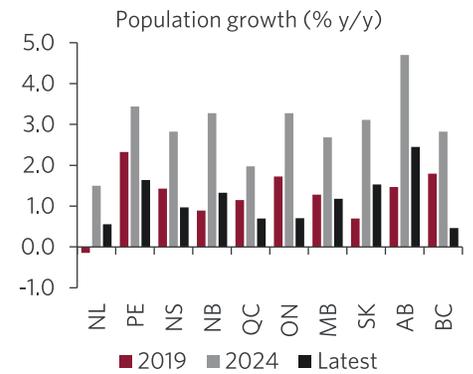
Provincial borrowing to remain elevated

For the current fiscal year, provincial aggregate borrowing is ahead of plan at 80% completed, while 60% of the fiscal year has elapsed. Despite being ahead by 20%, the pace is behind last year's 25% at this point. Overall though, funding levels have almost been identical with C\$114bn completed this year vs C\$116bn last year. The main difference being the larger expected borrowing programs this time around.

That only leaves an estimated \$30bn of provincial issuance between now and the fiscal year-end in March. However, we anticipate select provinces will engage in pre-funding as has been the case historically, taking expected overall issuance to around C\$155-160bn. Meanwhile, that estimate is tilted to the upside as we have only received two of the 10 provincial mid-year updates at time of writing. In those updates, for the most part, we suspect further deterioration on the back of lingering tariff uncertainty.

One of the contributing factors to issuance volumes being near pandemic highs this year, perhaps even surpassing, is just under C\$80bn of maturities that need to be refinanced. Recall, during the initial stages of the pandemic, predominately shorter-dated deals were being executed which are now coming due. For the upcoming 2026/27 fiscal year, maturities are a smaller portion of overall funding requirements with just under C\$60bn.

Chart 4: Population growth slowing sharply in most provinces



Source: Statistics Canada, CIBC.

With most provinces forecasting deficits for next year as well, those will have to be funded through additional borrowing. And as highlighted in the Federal budget, infrastructure spending is a major component of future growth. Indeed, most provinces have been increasing their capital spending allocations with record amounts year-after-year. Those two factors combined more than offset the lower refinancing needs, placing projected borrowing around C\$160bn again next year (Chart 5). That overall amount will likely change for both this year and next, primarily relating to how much pre-funding will be completed over the remainder of this fiscal year.

Spreads unlikely to grind much tighter

With the prospects of record high borrowing, trade protectionism causing fiscal deterioration, and spreads already at tight levels, a further grind tighter in spreads seemed unlikely. But, despite all that coming to fruition, provincial spreads over the past year have compressed 9bps in 5s, 15bps in 10s, and 12bps in 30s. And for most parts of the curve, spreads are now at tights prior to the Global Financial Crisis of 2008 (Chart 6). That spread tightening however, was not related to fiscal outperformance. Every single province's financials have deteriorated from this point last year, as well as having an overall larger aggregate borrowing program. The move in spreads was more related to the general market backdrop where demand for all credit products across multiple jurisdictions outweighed the available supply. At the same time, investors were searching for credit products that exhibited superior carry and roll properties, which provincials offered.

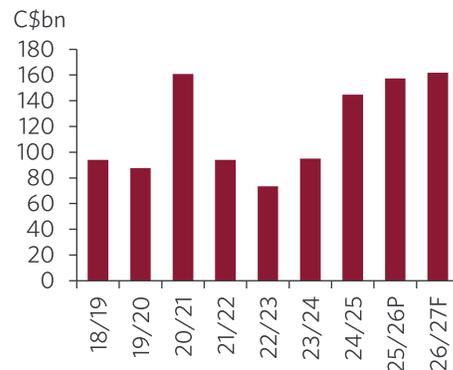
Looking ahead to this upcoming year, provincial markets once again face a number of headwinds. As of the latest updates, borrowing is forecasted to remain at elevated levels on the back of funding larger deficits and increasingly higher capital allocations. At the same time, lingering trade uncertainties arising from the renegotiation of CUSMA on the horizon will restrict economic growth, and specific tariffs continue to hurt select provinces fiscally. Meanwhile, banks (treasuries) who have been the peripheral buyers of provincial credit over the past couple years, have begun to pare back their marginal purchases according to the latest data available. Therefore, from a fundamental standpoint, we believe spreads should be pressured this upcoming year with a slight pull back from these extreme tight levels. However, spreads will predominately depend on a few factors, the overall market sentiment towards credit products, carry and roll characteristics, as well as foreign market's appetite for provincial credit.

Foreign deals expected to continue, as long as savings can be found

One of the dominate themes playing out again this year is the abundance of international provincial issuance. Historically, as funding levels rise, so too does the percentage of foreign deals (Chart 7). At time of writing, roughly 40% off all issuance has been in non-domestic currencies, which is very elevated compared to the norms. Overall, that has helped support domestic spreads, which has also contributed to the tightening move. Provinces have also shown some modifications in issuance patterns, with some longer dated transactions stemming from investor's appetite (i.e. 20yr EURO), whereas previously foreign deals were typically 10yrs and under.

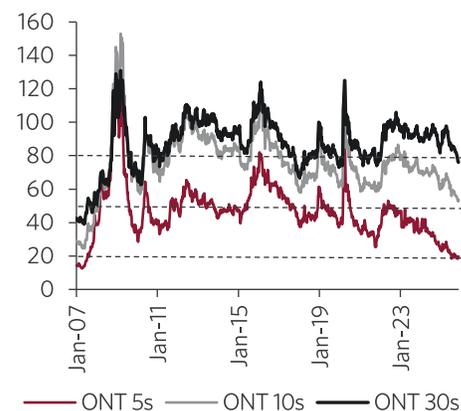
With projected funding needs for the upcoming fiscal year forecasted to remain at heightened levels, and with CAD rates being rich compared to other jurisdictions, international investors could continue to prefer the safety of Canadian provinces in non-Canadian denominated currencies. At the same time, favourable international arbitrages have afforded provinces some savings compared to similar domestic transactions. Overall, we expect foreign issuance to continue this upcoming year, provided arbitrage opportunities for savings are prevalent, which should prevent provincial spreads from seeing a larger pull-back.

Chart 5: Aggregate provincial borrowing programs



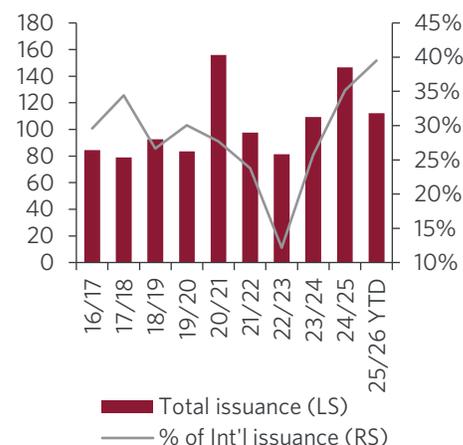
Source: Provincial budgets and updates, CIBC Capital Markets.

Chart 6: Benchmark (Ontario) spreads are at tights (CMT, bps)



Source: CIBC Capital Markets.

Chart 7: Overall Provincial issuance (C\$bn) and international issuance (%)



Source: CIBC Capital Market.

Canadian Housing Outlook: Where are we heading?

Benjamin Tal and Katherine Judge

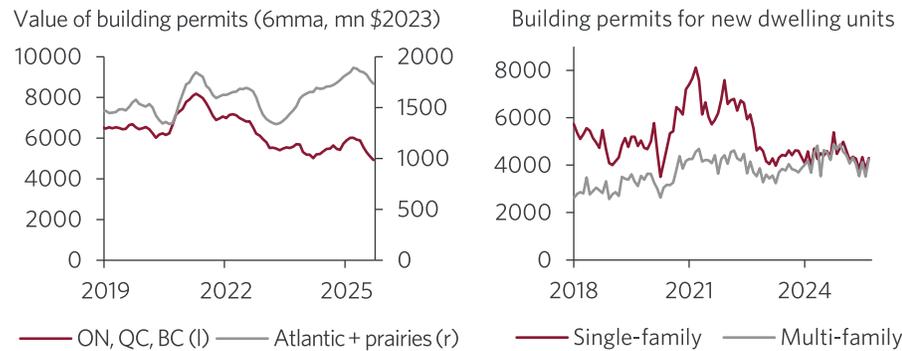
We are often asked to comment on the health of the Canadian housing market. A simple question, but not a simple answer. The housing market has many faces that often dance to different tunes. The most obvious is location, with the headline housing market masking stark regional divergences. That's true for the resale market, where Ontario and BC only recently moved out of buyers' markets, while the rest of the country is sitting comfortably in balanced market territory. Ditto for housing starts, with the entire upward trajectory in national homebuilding attributable to the Atlantic and prairie provinces, while the most populous provinces have seen an easing in building since Covid (Chart 1). Starts on a per-capita basis were at a decade high in the Atlantic/prairie provinces as of mid-year, while Ontario and Quebec are well below their recent peaks, with BC seeing an improvement lately.

What's in the pipeline?

However, housing starts are a lagging indicator that reflect past decisions. Looking at leading indicators suggests that the regional gap is closing. Building permit issuance has waned recently for the Atlantic and prairie provinces, and is down for both the single and multi-family segments of the market at the national level (Chart 2). What's more, the multi-family permit data is likely being exaggerated by builders pulling forward permit issuance in anticipation of higher development charges in some provinces as well as a significant reduction in the cost of holding applications in Ontario. This means that many of those permits will not translate into new building in the near term, as builders will wait until market conditions are more favorable.

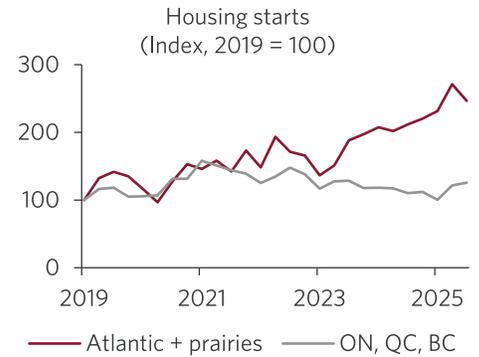
Another telling indicator is growth in new home sales. And as illustrated in Chart 3, the picture here is not promising. New home sales are down by over 50% year-to-date versus last year in Toronto and Vancouver, with other major areas (including Alberta) also showing double digit declines. And things look even worse in comparison to average sales volumes seen since 2016 (Chart 4). While resale sales aren't performing as poorly as new home sales, the latter is a leading indicator of where things could be headed in the resale market. Unit sales in that market are already averaging roughly flat in year-over-year terms this year, with the level of sales 39% below Covid-era peaks, and slightly below 2019 levels.

Chart 2: Building permits slowing across the country (l), for both single and multi-family (r)



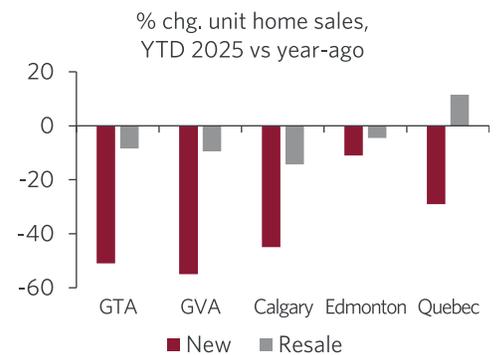
Source: StatCan, CIBC.

Chart 1: Most populous provinces seeing weak housing starts



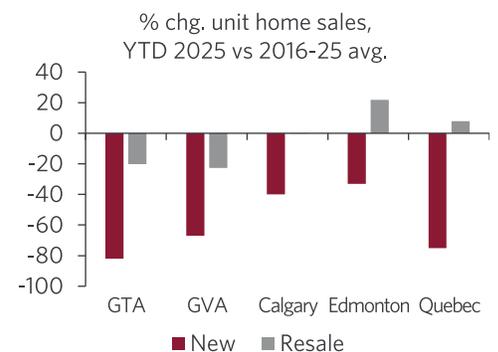
Source: CMHC, CIBC.

Chart 3: New homes sales plummeting relative to year-ago levels



Source: Altus Group, CREA, CIBC.

Chart 4: New home sales look even worse relative to last decade average



Source: Altus Group, CREA, CIBC.

Note that this ongoing softening is not only a condo story. Growth in low-rise new home sales in all major cities is in negative territory as well (Chart 5). That picture does not bode well for housing starts over the next few months, but we still expect building activity in 2026 to show some growth over 2025, with consumers gaining confidence as economic uncertainty fades and borrowers recognizing that mortgage rates are unlikely to fall further. Overall, we expect housing starts to average 264K in 2026, 1.7% above the expected 2025 pace, with greater activity in the single-family segment boosting activity more notably starting in Q2.

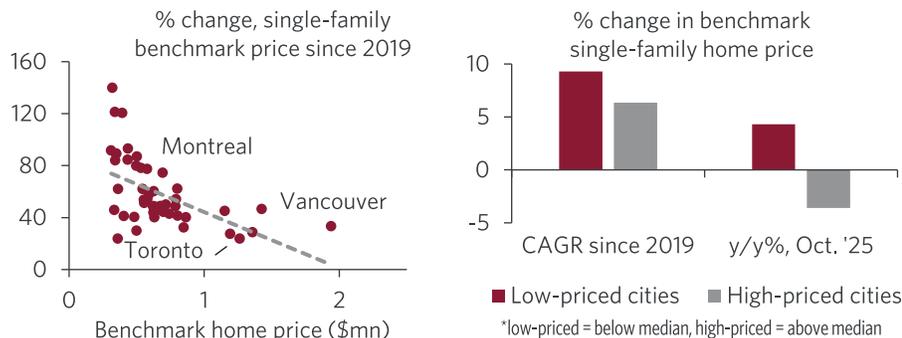
What has prevented an even steeper slowing in starts is the ongoing renaissance in purpose-built rental (PBR) construction activity that is currently rising by 20% y/y, surpassing condo construction for the first time in over thirty years (Chart 6). That strong performance reflects an array of factors such as the removal of HST/GST on new PBRs earlier in the year, some increased flexibility regarding inclusionary zoning, and the fact that many builders' proforma was helped notably by the fact that they already owned the land. While the low-hanging fruit in that space are now less available, the recent move to increase MBS and CMHC's multi-residential lending capacity should help to keep the level of activity elevated, although we doubt that the pace of growth in the coming quarters could accelerate in any meaningful way.

The increase in supply be it via the condo market or PBRs is being met with a notable slowing in demand due to slower population growth. That is compounding downward pressure on rent in most centers, led by Ontario and BC. And while the CPI rent inflation index is showing rents increasing by over 5% y/y, the CMHC survey suggests that asking rents are falling by 3% y/y (Chart 7). In fact, actual rent inflation might be notably lower than the official CMHC numbers since they do not account for landlords' incentives such as offering free rent for a month or two, or free utilities. We believe that official CPI rent inflation data is overstating actual rent inflation in the economy as a whole, with important implications for overall core inflation.

Drive until you qualify

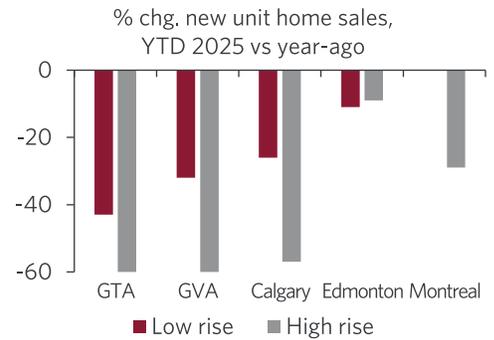
Another dimension to look at is performance based on the affordability of cities. Looking at benchmark home prices, it's clear that higher-priced cities like Toronto and Vancouver have seen the most damage since the Covid boom. And that's not due to the condo segment, as we are only looking at single-family prices here (Chart 8). Affordability dictated migration patterns and has worked to boost prices in more affordable cities since Covid. That's also clear when looking within Ontario, where there is a clear positive correlation between single-family home prices and the distance of cities from Toronto, with the option to work from home solidifying demand in more affordable areas (Chart 9).

Chart 8: Lower-priced cities have seen more sustainable gains in home prices



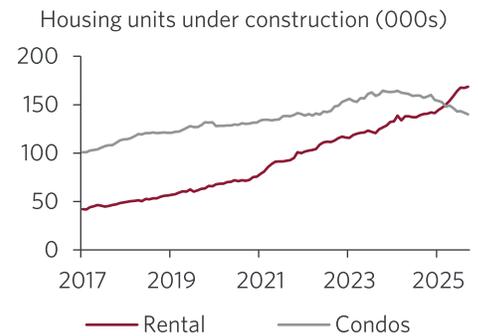
Source: CREA, CIBC.

Chart 5: Weakness being seen in low-rise segment as well



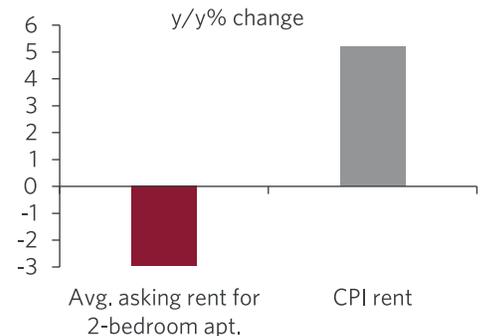
Source: Altus Group, CIBC.

Chart 6: Rental construction now surpassing condos



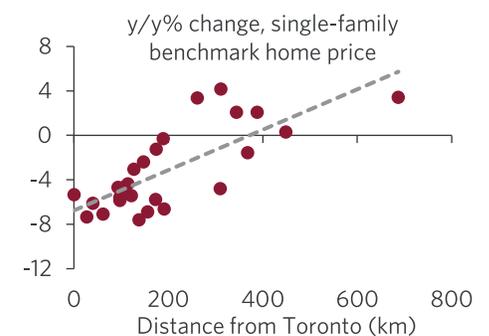
Source: CMHC, CIBC.

Chart 7: Rents likely notably lower than official CPI estimate



Source: StatCan, CMHC, CIBC.

Chart 9: Within Ontario, home prices have risen only in areas far from Toronto



Source: CREA, CIBC.

The discussion on prices to this point has omitted condos from the equation, as they don't play a big role in cities outside of Toronto and Vancouver. But we can see the impact that segment has had when we compare benchmark total prices to the simple national average home price. The benchmark index for home prices controls for the mix of sales so that each month measures a uniform composition of sales across single and multi-family markets. When demand diverges from that benchmark, average prices that do not control for the type of unit purchased move to reflect that. In today's case, the simple average price is sitting above the benchmark index, suggesting that demand has shifted to larger and more expensive units (away from condos and towards low rise) (Chart 10), in line with price drops being the most significant in the condo space.

The fact that low-rise hasn't deteriorated as much as the lower-cost multi-family segment means that mortgage originations are still up by 19% y/y, with levels not far off of Covid-era peaks (Chart 11). The composition of mortgages has changed, however, with mortgages in the 3-year category now accounting for over 40% of originations, and 5-year originations only at 17%.

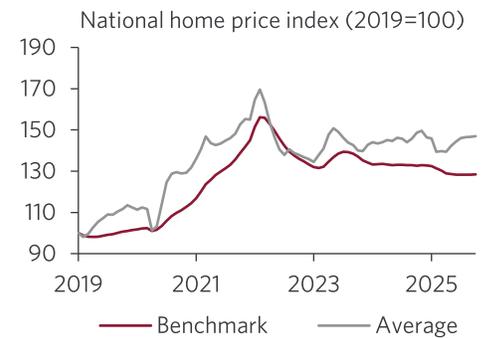
The federal government's budget pledge to expand the GST rebate for first-time homebuyers for new homes priced up to \$1.5mn should see greater originations from that segment of the market ahead, especially when paired with the expansion of insured mortgages to that price level that took effect at the end of 2024. Currently, first time buyers account for 20% of originations, of which just over 20% buy new units (and thus qualified for the GST rebate). In all likelihood, that share will rise in the coming quarters. Overall, look for mortgages outstanding to rise by close to 5% in the coming year, following a similar increase in 2025.

Mortgage rate reset in 2026—the real test

What about the mortgage payment cliff? As we have indicated in previous research, 2026 will see the ultimate test, with a much larger portion of borrowers (5%-6% vs 2% in 2025) seeing more than a 40% increase in monthly mortgage payments. Presenting an even greater challenge in 2026 is the fact that prices in 2025 were still notably higher than they were in 2020, allowing stretched borrowers to refinance and therefore ease the pain. Accordingly, refinancing accounted for a relatively large share of originations in 2025. But that's no longer the case. Even if we assume conservatively that prices in 2026 will stay at current levels, the refinancing windows in Ontario and BC are closed (Chart 12). Accordingly, look for some manageable upward pressure on delinquency rates in 2026.

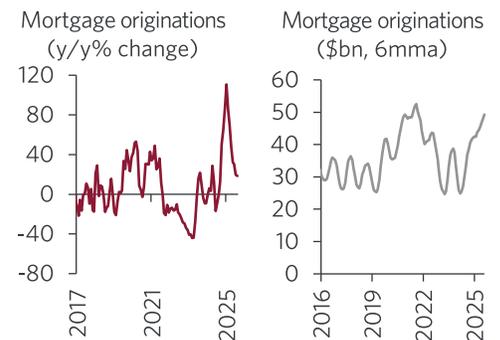
Bottom line: we are not out of the woods yet. The regional performance gap is starting to narrow, with other provinces showing early signs of softening alongside an already weak BC and Ontario. The condo market in Toronto and Vancouver will not clear for a while, with prices continuing to fall in the near future. However, a lack of new supply might suggest renewed upward pressure on condo prices around 2028. Rent inflation is softening due to increased condo inventory, accelerated activity in the PBR space, and slowing population growth. We expect those conditions to persist in 2026. The resale market is likely to see a relatively weak spring market in 2026, followed by a stronger fall market. Overall, we view 2026 as a transition year from a weak market to a much improved market in 2027.

Chart 10: More activity in the low-rise segment is boosting the average price vs benchmark



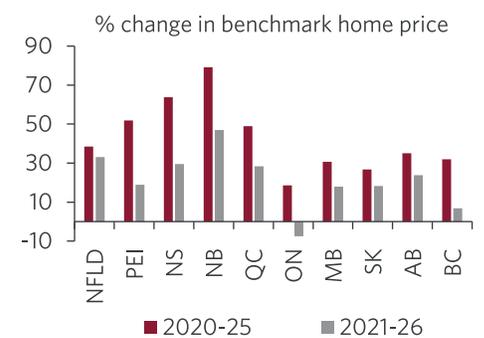
Source: CREA, CIBC.

Chart 11: Mortgage originations still rising



Source: StatCan, CIBC.

Chart 12: Ontario homeowners could be in negative equity position next year, BC not far behind



Source: CREA, CIBC.

Rates Outlook: The easy steepening is over

Ian Pollick, Michael Cloherty, Arjun Ananth

Trade uncertainty was obviously a dominant theme in the rates market in 2025. The changes to US trade policy in of itself had limited impacts to US macro, but material impacts in jurisdictions across the globe. Regional bond markets, rightly, traded the initial impact of trade uncertainty as a net-negative to growth, as a positive impulse for inflation and, as a catalyst for central banks to bridge the loss in output for a bit longer. Critically, the threat of widening economic slack and a desire for more economic autonomy prompted most governments around the world to begin signaling an expansion of fiscal policy. This created a year of two halves, characterized by recession risks rising aggressively in H1-25 and declining meaningfully in H2-25 as fiscal easing dominated the narrative.

And while these channels allowed the yield curve to maintain its steepening bias in virtually every corner of the G7, the same cannot be said for the level of rates. Economies which were already well into their respective easing cycles before 2025 began, such as Canada and Europe, have seen longer-term interest rates selloff compared to start-of-year levels. In contrast, the mid-cycle cutters like the United States and the UK have seen the level of long rates decline since 2025 began, with the US outperforming in this regard.

And with fiscal policy now 'activated' across the globe, there will be material implications to both the flow-of-funds and the trajectory of monetary policy in 2026. Central banks face a material burden-of-proof to take rates below neutral next year, and that likely suggests the 'easy' steepening in the yield curves across the advanced economies is now over. At the same time, the level of yields should be influenced not just by the fundamental economic outlook, which appears to be improving in most regions, but also by the dynamics of fiscal policies and the starting-point composition of term yields.

We see four durable themes for the rates market in 2026, including: i) the efficiency of fiscal policy; ii) changing term premium dynamics; iii) the introduction of hikes being priced, and; iv) bond supply growth. **Ultimately, across all the regions we cover, we see duration being biased slightly higher in 2026, with flatter curves and regional divides getting larger.**

But there are important risks we foresee next year to be sure, which if realized can disrupt our base-case outlook for the bond market. First is the potential that trade certainty, or trade uncertainty fatigue, eats-up non-inflationary growth faster than expected. If realized, this would lead to a tightening of overall financial conditions and jeopardize the recovery prematurely. Second, and specific to Canada, there could be more noise than expected around the USMCA that would force the Bank of Canada to take the policy interest rate below neutral, delaying the start of hikes but raising the risk that an eventual hiking cycle is more rapid. Third, Fed independence and 2026 monetary policy considerations could alter our benign view of US duration, and promote a longer steepening cycle than we expect. Fourth, the potential slowing of the AI boom, the savings imbalance and the implications to calibrating R^* .

In the balance of this outlook we will provide an in-depth look at these themes on an individual basis, discuss the risks to these views and, offer the most effective ways to trade these dynamics.

Fiscal Efficiency – the real risk to more steepening pressures

While fiscal policy dynamics were a material driver of interest rates in 2025, generally speaking, there was a very underwhelming correlation between global duration and fiscal uncertainty in the immediate post-pandemic period. However, with the introduction of US tariffs and signaling from the most impacted economies that fiscal policy would turn easier in the years ahead, longer-term interest rates have become meaningfully more sensitive (see Chart 1). And while the expectation of fiscal policy has increased the level of nominal term premiums in 2025, largely on the view of supply needs rather than faster productivity trends, it is not clear we should expect the same outcome in 2026.

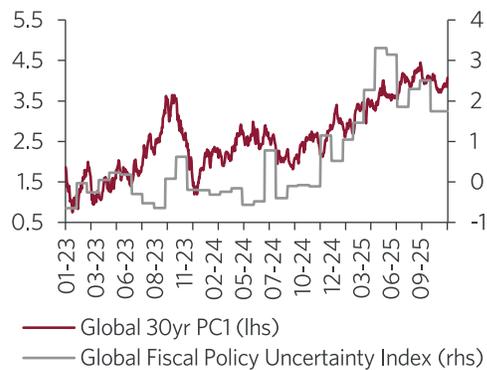
It is one thing to signal the intent to loosen fiscal policy in order to deepen the capital stock, versus actually translating that fiscal spend into nominal growth. For the bond market, understanding which regions have the highest probability of translating spending into growth matters, a lot. Regions which can turn fiscal expansion into tangible growth impulses will not require materially higher nominal yields in longer-term rates. Stagflation concerns would be minimized. Moreover, those same regions should see yield curves enter into sustained flattening cycles as the need for prolonged easier monetary policy is reduced. In contrast, economies which cannot turn fiscal spending into growth risk materially higher longer-term rates than we expect. Moreover, that would ensure maintenance of steepening patterns seen in 2025, specifically because the need to fund fiscal expansion while maintaining easier policy (with higher inflation) will exaggerate dislocations between the front-end and back-end of the curve.

So for our purposes, we need a framework to understand which economies have the highest probability of recycling their fiscal spend into more meaningful output growth. To do this, we create a fiscal efficiency indicator, scored from 1-to-5, with 1 being the worst and 5 being the best. The higher the score, the more likely it is that spending translates into growth. Our indicator is comprised of three underlying components, including: i) the trajectory of the structural balance; ii) the elasticity of growth and the budgetary balance, and; iii) the difference between savings and investment rates within the economy. Together, we can think of these three components as measuring the efficiency of fiscal policy.

As seen in Chart 2, Germany has the highest likelihood of producing topline growth from fiscal expansion, while the United States has the lowest. This makes sense within the context of the available fiscal space, but also given the size of relative output gaps. And, with already very high levels of productivity, an incremental dollar spent in the US just doesn't go as far as in other jurisdictions (in large part because discretionary spending is only 36% of total federal spending today, and the CBO projects that to fall to 29% by 2035). That is an important point for a market like Canada. While productivity trends have historically been exceptionally weak here, a large amount of economic slack means that fiscal policy is scaled faster given how much non-inflationary growth room there is (i.e. monetary policy doesn't create a headwind).

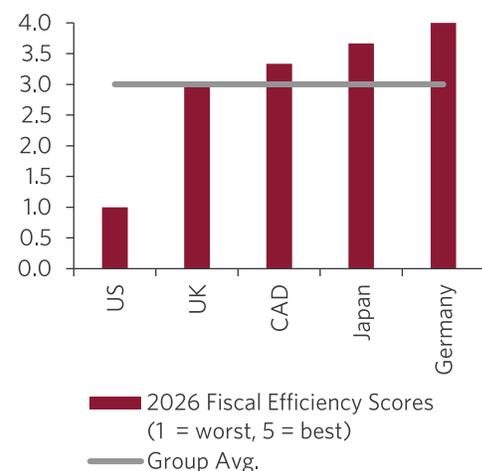
What this fiscal backdrop implies is that the United States and the United Kingdom should both see less curve flattening than other regions, particularly in the first half of 2026. However there will be a lull in the flow of duration to the US market as bill supply rises, putting the UK in the real crosshairs of the greatest steepening risk. In contrast, Canada and Germany should see flatter curves on an absolute and relative basis over the course of next year. By extension, the potential upside risks on longer-dated yields should be similarly greater in the US and UK than in Canada and Europe. However, a more efficient fiscal footprint in Canada and Europe also bring hikes one step closer to being realized, therefore the cross-market story is not as clear.

Chart 1: Fiscal policy and G7 30yrs



Source: Bloomberg, CIBC Capital Markets.

Chart 2: Measuring fiscal efficiencies



Source: IMF, OECD, CIBC Capital Markets.

Term Premia Handoff – Internal composition is changing

Now an important parallel to the fiscal view is ‘how’ the fiscal outlook actually impacts the internal composition of yields. From an attribution perspective, we can see in Chart 3 that most of the move in yields in 2025 has come from an increase in the term premium. Complimenting the build in bond market premiums has also been the concern that fiscal expansion would necessitate a material growth in bond supply.

In most measures of the term premium, whether it is the oft-cited ACM or the less known Hordahl & Tristani (HT) version, absolute levels are now at or just slightly above prior cycle averages (see Chart 4). But we can decompose the nominal term premium into a real and breakeven component. The real term premium is just a proxy for supply considerations, policy and overall economic cyclicality. The breakeven term premium can be thought of as a proxy for risk assets, illiquidity and general hedge efficiency of inflation-linked bonds.

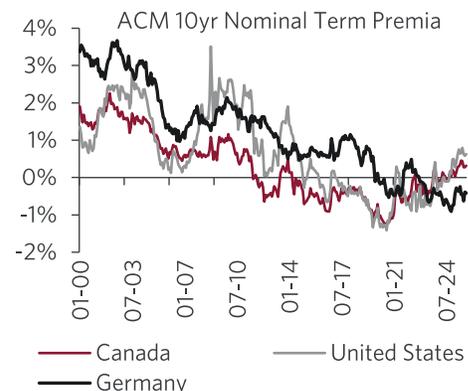
When looked at on a more granular basis, most of the repricing in nominal yields in 2025 has actually come from a rise in real term premiums. For example, we find that 10yr real term premia is in the 54th, 75th and 88th percentile in the US, Canada and Germany, respectively, at time of writing. At the same time, breakeven risk premia sits somewhat high in the United States over recent history, but low outright and compared to history for Canada and Germany (38th, 20th, and 8th percentiles respectively, see Chart 5).

This is entirely consistent with the view from the prior section on fiscal efficiency, where Canada is above average, Germany is the most efficient and the United States is by far the worst. And so in a situation where fiscal efficiency is low, like in the United States, breakeven term premia should be higher while real term premia should be lower, and vice versa. In Canada and Germany, who both have a better opportunity to translate fiscal expansion into nominal growth, breakeven inflation should generally be lower.

But that doesn’t mean Canada should, for example, materially outperform the United States, even if the risks to less fiscal efficiency posit more upside for the level of yields. That’s because the other reason the fiscal efficiency hypothesis matters for term premia is because even with greater relative fiscal efficiency, economies that do not have enough savings to satiate the investment demands of the budgetary expansion must see higher real interest rates. In order to generate the savings required to fund massive infrastructure projects, asset return expectations will need to be elevated and that includes real interest rates. Consider that savings rates in Canada would need to grow nearly 30.0% from current levels in order to balance the demand for investment as it stands today. And with defense spending rising to 5.0% of GDP over the next decade, in addition to AI associated investments within Canada, this profile will only get larger.

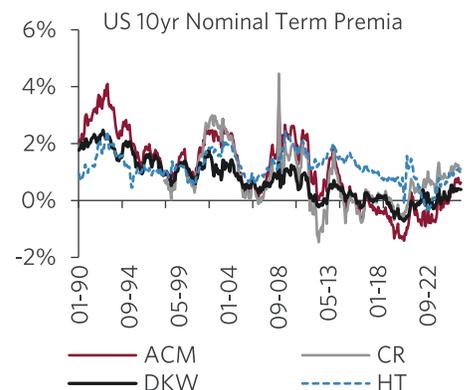
Countries like Japan and Germany are best positioned in this regard, because of the incredibly high amount of savings they already have. One of the unintended consequences of economic autonomy is that global savers no longer transfer their excess savings into economies with low savings rates & high investment needs. And for the US in particular, the center of the AI buildout boom, capital requirements are so enormous as a proportion of savings that it has the ability not only to take rates higher, but to reintroduce concerns that R^* has risen. This flow of funds dynamic matters, and will put pressure on real rates in Canada and the United States. Stateside, real term premia already looks high, but most likely because of supply concerns. Therefore, in 2026 we see CAD real rates rising faster than in the United States in second-half of the year, while breakeven premiums in

Chart 3: Rising yields driven by Term Premiums



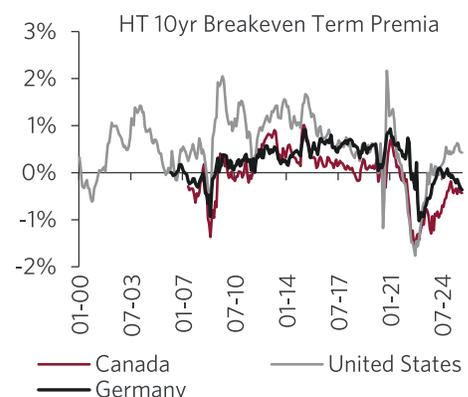
Source: Federal Reserve, Bloomberg, CIBC Capital Markets.

Chart 4: Alternative Term Premia Models are consistent



Source: Federal Reserve, Haver Analytics, CIBC Capital Markets.

Chart 5: Breakeven term premia in focus



Source: Federal Reserve, Bloomberg, CIBC Capital Markets.

the US rise faster than in other markets. That suggests being long intermediate sector TIPS vs nominal yields in Canada is an attractive trade. If we assume that the gap between US CPI and US PCE will be 40bps, if the market expects the Fed to hit its inflation target 10yr BEs should be 2.40%. The means current levels are still a bit cheap, and risks around the new Fed chair and deficits suggest the entry point is attractive.

The big adjustment we foresee in 2026 is that Canada should see a lack of overall movement in breakeven premiums while the US should see an increase. We expect 2.40% to be the floor for front-end and belly breakevens, and real rates should continue to be an important hedge consideration against equities. Concurrently, real interest rates have a higher risk of rising in Canada on a comparable basis, particularly in the belly of the curve, as productivity trends improve and investment needs require more deposit growth.

Forward Pricing out of Easing – When & how do hikes get priced?

Ultimately the improvement we expect in growth trends next year in economies like Canada and Europe mean that hikes should begin to get pulled forward. In the absence of a more material erosion of USMCA talks, the Canadian economy looks to be improving. The UE-rate should finish 2026 at 6.6%, with final domestic demand running above potential growth, resulting in a material absorption (though not full closure) of economic slack.

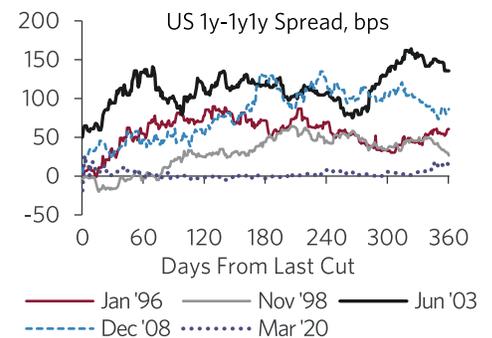
In the United States, core inflation near 3.50% is likely to restrict the Fed’s hand, even during the post-Powell ‘inappropriate’ period. Final domestic demand should look similar to 2025 trends, while the output gap is expected to remain in positive territory. The potential for tariff ‘dividends’ early in 2026, alongside the funds being paid to the economy from the Big Beautiful Bill (BBB) also means that it may be very hard to see additional cuts being delivered early in 2026.

And while the market is unlikely to fully price-out the Fed, that doesn’t mean hikes cannot co-exist with cut pricing, just as cut pricing coexisted with hikes in 2022 and 2023. The question is whether a stylized path exists that we can identify ‘how’ hikes enter market pricing?

Starting with the US, we can see that 1y-1y1y gaps typically start very close to 0.0bps and then steepen as we move further away from the final cut, even if the timing of that steepening isn’t consistent across cycles (see Charts 6 & 7). In the cases where 1y-1y1y steepens quickly, a good portion of that is unwound early, only to be repriced later on. This is very visible if we normalize across cycles, because the length of the pause was different each time. And so, if we look over at time relative to the length of the entire pause, we can see that re-steepening of the 1y-1y1y gap is very consistent around the 70.0% mark. Based on market pricing that means sustained steepening in 1y-1y1y would occur in early 2028, versus Q3-27 using our own forecasts.

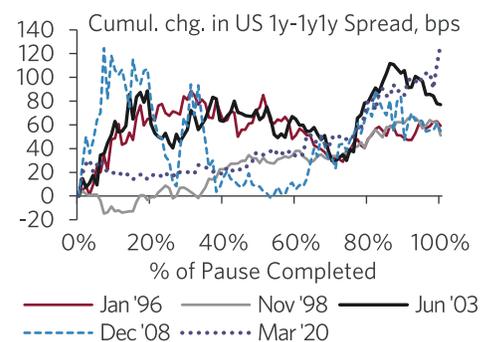
In Canada, the evolution of hikes entering the curve are very different. As seen in Chart 8 and Chart 9, Canada usually comes out of the last BoC cut with a lot of hikes priced-in very quickly. This is intuitive, given that the length of pauses excluding the GFC is much shorter than in the US. Consider that the average US pause (ex-GFC) was 453-days since the 1990s while Canada has been 379-days. That means it is even more important to normalize time as a function of pause completion as described above. And that does indeed show that 1y-1y1y gaps steepen relatively early.

Chart 6: How hikes get ‘priced’ in the United States (Part I)



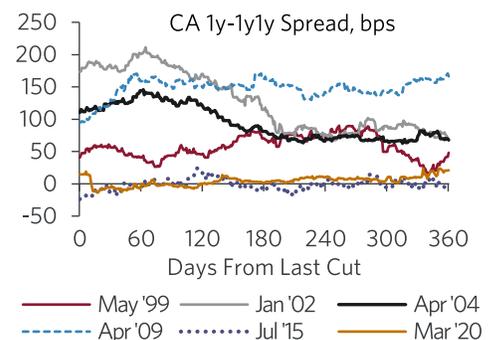
Source: Bloomberg, Haver Analytics, CIBC Capital Markets.

Chart 7: How hikes get ‘priced’ in the United States (Part II)



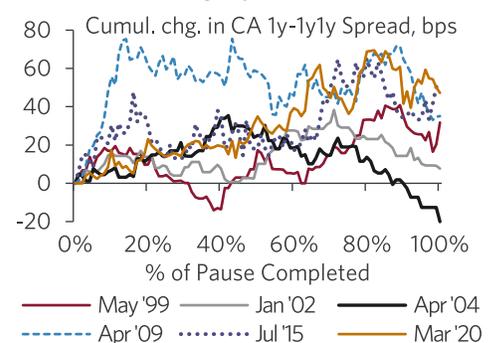
Source: Bloomberg, Haver Analytics, CIBC Capital Markets.

Chart 8: How hikes get ‘priced’ in Canada (Part I)



Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

Chart 9: How hikes get ‘priced’ in Canada (Part II)



Source: Bloomberg, Haver Analytics, CIBC Capital Markets.

Given that the BoC has likely ended its easing cycle, we would expect the aforementioned dynamic to become more pronounced as we get through the really big USMCA risks in January 2026. Interestingly, we note that 1y1y-2y1y gaps almost always flatten coming out of an easing cycle, which is most pronounced around 50.0% completion of the pause (see Chart 10). For Canada, the additional dynamic is that mortgage paying has been heavily concentrated in 3yrs, which restricts how much flattening to expect in this segment of the curve. That said, we have long been of the contention that household preferences will shift to longer-dated mortgages once BoC hikes, rather than a pause, becomes a reality. To that end, we see scope for 1y-1y1y-2y1y to cheapen (belly) versus the United States in 2026.

Supply Trends - Get nervous in 2027, not 2026

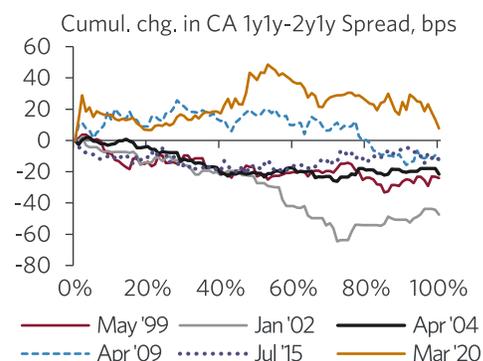
Our final theme of 2026 is that supply fears are still premature, and more likely a story for 2027 and beyond. Consider that in Canada, despite the deficit rising by nearly -C\$200.0bn over the next five fiscal years, issuance will begin decline in 2026, the first time since the pandemic that issuance has fallen on a sequential basis. Similarly, US supply should be flat next year as a looming increase in demand for bills from the Fed and stablecoin opens the door for more bill supply. In 2027 US supply begins to grow again as more maturing debt means the same size coupon auctions raise less cash, but the real jump in the US occurs in 2028 when there is a material jump in maturities and the capacity to issue more bills should start to ebb. For Canada, we are concerned that the fiscal anchor may be overstated, and there remains a decent risk that the Department of Finance (DoF) elects to term out the existing debt as more infrastructure projects begin to get financed. So while the supply story is very much alive and well over a longer horizon, it isn't so much of a story for 2026.

This dynamics reinforces our view that the level of real term premiums in the United States should moderate / trend sideways from current levels. In Canada, the decline in net-supply is important in of itself to maintain the level of real term premiums, though as mentioned earlier, the risk is faster productivity trends that begin to get hikes priced-in earlier.

In terms of the specifics, Canadian gross notional nominal issuance is projected to be C\$298.0bn next year, from C\$316.0bn in the outgoing year (see Chart 11). Proportionally, 10yr+ issuance will remain rise very slightly to 35.0% next year, from 34.0% in 2025. When looking at gross nominal issuance less open-market-operations (OMOs) and private maturities, CAD supply declines are more apparent (see Chart 12), with 2026 supply falling to C\$165.0bn from C\$187.0bn in 2025 (representing a 12.0% reduction year-on-year).

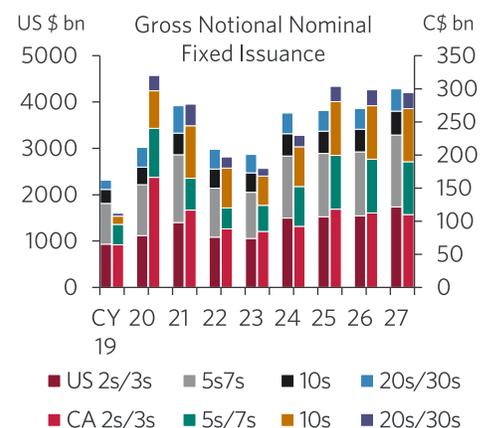
Turning to the United States, The broad narrative around skyrocketing US Treasury issuance in 2025 & 2026 clearly won't materialize, largely due to tariff revenue raised and a still healthy economy broadly speaking. To that end, we do not expect the Treasury to increase coupon auction sizing at all in FY26 (ended September). Communications out of the latest refunding announcement largely confirm that view, with maintenance of the language that "Treasury anticipates maintaining nominal coupon and FRN auction sizes for at least the next several quarters". They did, however, note that they've begun to "preliminarily consider" increases with a "focus on evaluating trends in structural demand and assessing potential costs and risks of various issuance profiles".

Chart 10: CAD 1y/1y1y/2y1y during a pause



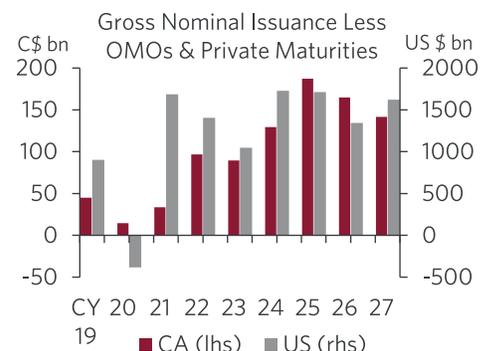
Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

Chart 11: Gross nominal issuance forecast



Source: Department of Finance, Federal Reserve, Haver Analytics, CIBC Capital Markets.

Chart 12: Gross nominal issuance less OMO's & private maturities forecast



Source: Department of Finance, Federal Reserve, Haver Analytics, CIBC Capital Markets.

That reinforces broad signaling that they will continue to rely on bill supply to support funding needs, at least for the next year. And, we can't forget that the Fed stepping in as a buyer in the bill market also adds a layer of demand that the Treasury will certainly be considering in determining how to address rising borrowing costs. More bills will also be purchased to back growth in stablecoin, but we have noted that really aggressive growth in stablecoin is likely to lead to slower currency growth (they are both stores of value/transactions vehicles in economies that are underbanked), and slower currency growth means less Fed demand for T-bills.

Accordingly, we expect modest increase across the curve to begin in FY27, with increases concentrated in 2s, 3s, and 5s. That too is consistent with recent communications from the Treasury, where 'evaluating structural trends in demand' may lead to the conclusion that the long-end cannot support the amount of issuance that will need to come online.

That does, however, contribute to the problem of a maturity pile up in FY28, and onwards, where current short dated issuance need to be refinanced, as will many pandemic-era issues. And that suggests that more meaningful auction sizing increases across the curve will be needed at that point. Ultimately then, concerns over supply should return to the front burner later on in 2027. But in the interim, the net supply profile is not all that worrisome in 2026, which means that we're unlikely to see similar sorts of pressure in the back-end of the curve any time soon.

What is all means – 2026 Rates & Curve forecasts

The totality of themes introduced in this article doesn't lend itself to a huge increase in bond yields in 2026. Front-end yields will continue to be governed by the path of monetary policy, while fiscal efficiency should dictate how well behaved the back-end is. Coupled with almost no fears over supply, the reality is that a benign UST forecast should help restrict further upward pressure in most other, smaller, markets.

In Canada, we see yields rising led by the front-end, which is largely a function of the beginning of a 2027 hiking cycle. For context, from the end of 2025 to end of 2026 we expect GoC 2yrs to rise by 55.0bps and 5yr to rise by 50.0bps. The move higher in belly yields reflects both a repricing of CAD R*, which should settle above the midpoint of the Bank's estimated 2.25%-to-3.25% range, but also a shift in preferences by households to take-out longer-duration mortgages as 2026 progresses. Longer-dated tenors, like GoC 10yrs and GoC 30yrs are projected to rise by 30.0bps and 20.0bps respectively. This reflects the upward pull of real term premiums, in addition to a faster economic speed limit.

In contrast, US duration is expected to be very well contained next year. CIBC Economics expects the Fed to finish the easing cycle at 3.375% by March, meaning the trough in rates is expected by the end of Q1-26. Thereafter, UST 2yrs should rise over the balance of the year, rising by 45.0bps to finish the year at 3.95%. That rise mostly reflects 'some' pricing of a hiking cycle starting in 2028 as we think expectations of R* will creep higher. The belly of the curve should follow commensurately, though ultimately outperform as forward rates are already a bit closer to the long term neutral. Resilience in longer-dated maturities is the dominant theme we see next year, with a modest rise in 10yr yields, and little change in 30yr yields (see Table 1).

Table 1: CIBC Interest Rate Forecasts

Canada	Today	Dec 2025	Mar 2026	Jun 2026	Sep 2026	Dec 2026	Mar 2027	Jun 2027	Sep 2027	Dec 2027
Overnight target rate	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.50	2.75	2.75
98-Day Treasury Bills	2.18	2.20	2.25	2.20	2.20	2.25	2.35	2.55	2.80	2.80
Chartered Bank Prime										
2-Year Gov't Bond	2.45	2.40	2.45	2.55	2.80	2.95	3.05	3.10	3.25	3.35
5-Year Gov't Bond	2.74	2.70	2.80	2.90	3.05	3.20	3.25	3.30	3.35	3.45
10-Year Gov't Bond	3.15	3.15	3.15	3.20	3.35	3.45	3.50	3.55	3.65	3.70
30-Year Gov't Bond	3.59	3.55	3.50	3.55	3.65	3.75	3.75	3.80	3.85	3.90
Canada - US T-Bill Spread	-1.70	-1.70	-1.35	-1.15	-1.20	-1.20	-1.15	-1.05	-0.85	-0.90
Canada - US 10-Year Bond Spread	-0.95	-1.00	-1.00	-1.00	-0.95	-0.80	-0.85	-0.80	-0.75	-0.80
Canada Yield Curve (10-Year — 2-Year)	0.70	0.75	0.70	0.65	0.55	0.50	0.45	0.45	0.40	0.35

US	Today	Dec 2025	Mar 2026	Jun 2026	Sep 2026	Dec 2026	Mar 2027	Jun 2027	Sep 2027	Dec 2027
Federal Funds Rate (midpoint)	3.875	3.625	3.375	3.375	3.375	3.375	3.375	3.375	3.375	3.375
91-Day Treasury Bills	3.76	3.60	3.30	3.35	3.40	3.45	3.50	3.50	3.55	3.60
2-Year Gov't Note	3.47	3.50	3.40	3.60	3.80	3.95	4.05	4.10	4.25	4.35
5-Year Gov't Note	3.57	3.60	3.65	3.80	3.90	3.95	4.10	4.20	4.30	4.30
10-Year Gov't Note	4.00	4.05	4.10	4.25	4.35	4.30	4.35	4.40	4.45	4.50
30-Year Gov't Bond	4.65	4.70	4.70	4.75	4.70	4.70	4.75	4.90	5.05	5.05
US Yield Curve (10-Year — 2-Year)	0.53	0.55	0.70	0.65	0.55	0.35	0.30	0.30	0.20	0.15

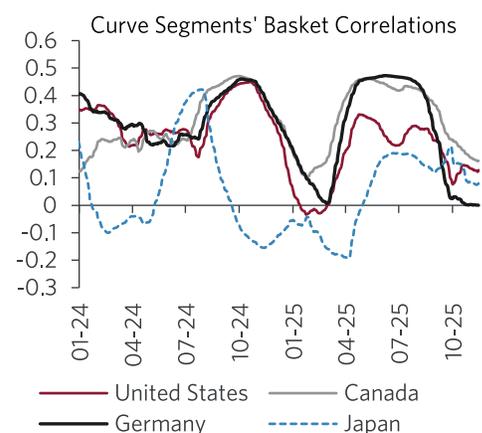
Source: CIBC Capital Markets.

Part of this reflects the lack of coupon growth in longer-dated bonds, in addition to real term premiums already looking quite elevated. This duration backdrop lends itself to some meaningful changes in the shape of the CAD curve, with the major theme in the US curve being that the easy steepening is now behind us. In both regions, the interesting development is the curve is no longer internally consistent, with core curves like 2s5s, 5s10s and 10s30s failing to 'speak to one another'. We can see this clearly in Chart 13, which shows the correlation of the entire curve.

The last time we saw such a breakdown was around the US election, which made sense at the time given the sharp bear steepening we saw. While fiscal policy uncertainty remains elevated, inflation is also uncertain and curve correlations begin to breakdown the closer we get to the end of an easing cycle. The decline in correlations makes sense for regions like Canada and Europe, given that the ECB and the BoC are done their respective easing cycles. Remember that curves don't exit easing cycles uniformly. Rather, we 'usually' see 10s30s begin to flatten, followed by 5s10s and eventually by 2s5s.

Our CAD curve forecast for next year is consistent with these patterns. We forecast 10s30s to have already reached its steepest point, and to flatten to 30.0bps by the end of next year. 5s10s is expected to flatten to 25.0bps (-20.0bps over the course of 2026), while 2s5s should steepen to 35.0bps by the end of Q2-26, before flattening marginally over the balance of next year. This suggest the 'best' flattening is earmarked for the 'big curves', like 2s30s and 5s30s, both of which we expect to flattening by over 30.0bps in 2026. For the macro butterfly, our duration profile means that 2s5s10s maintains its cheapening trend, while 5s10s30s begins to richen as 5s10s flattens (see Table 2).

Chart 13: Lack of internal consistency



Source: Bloomberg, CIBC Capital Markets.

Table 2: CIBC Curve Forecasts

Canada - Today	Dec 2025	Mar 2026	Jun 2026	Sep 2026	Dec 2026	Mar 2027	Jun 2027	Sep 2027	Dec 2027
2s5s	30	35	35	25	25	20	20	10	10
5s10s	45	35	30	30	25	25	25	30	25
2s30s	115	105	100	85	80	70	70	60	55
5s30s	85	70	65	60	55	50	50	50	45
10s30s	40	35	35	30	30	25	25	20	20
2s5s10s	-15	0	5	-5	0	-5	-5	-20	-15
2s5s30s	-55	-35	-30	-35	-30	-30	-30	-40	-35
2s10s30s	35	35	30	25	20	20	20	20	15
5s10s30s	5	0	-5	0	-5	0	0	10	5
CA/US 2s	-125	-130	-125	-105	-95	-85	-90	-80	-85
CA/US 5s	-105	-100	-95	-90	-75	-70	-75	-70	-80
CA/US 10s	-100	-100	-100	-95	-80	-85	-80	-75	-80
CA/US 30s	-115	-120	-120	-110	-95	-100	-100	-110	-120

US - Today	Dec 2025	Mar 2026	Jun 2026	Sep 2026	Dec 2026	Mar 2027	Jun 2027	Sep 2027	Dec 2027
2s5s	10	10	25	20	10	0	5	10	5
5s10s	43	45	45	45	45	35	25	20	15
2s30s	118	120	130	115	90	75	70	80	80
5s30s	108	110	105	95	80	75	65	70	75
10s30s	65	65	60	50	35	40	40	50	60
2s5s10s	-33	-35	-20	-25	-35	-35	-20	-10	-10
2s5s30s	-98	-100	-80	-75	-70	-75	-60	-60	-70
2s10s30s	-12	-10	10	15	20	-5	-10	-20	-40
5s10s30s	-22	-20	-15	-5	10	-5	-15	-30	-45

Source: CIBC Capital Markets.

But the US is perhaps the most interesting in this regard, especially as markets continue to redistribute cuts rather than remove them outright. One reason for the curve correlations to be breaking down, despite considerable distance from the end of the easing cycle, likely reflects the adjustment to the WAM of supply, in addition to a more traditional relationship between short rates and the curve.

On that last point, the easy explanation for 2024/25 structural steepening is that supply concerns were undermining the long-end. But if we look over long time frames, curves had fairly stable relationships between 2yrs and 2s10s. But in 2014/15, the curve suddenly lurched to a dramatically flatter relationship. Presumably because inflation risk premiums were absent, and because expectations about QE on any signs of stress kept curve from steepening as rates fell. Curves remained very flat until 2024, then steepened meaningfully.

This has put the spot US 2s10s curve back into the middle of the old relationship to the level of 2yrs, with forwards slightly steeper than the old relationship. This raises the question as to whether the current curve shape is really distorted by supply fears, or whether the curve is just reverting back to its old shape as inflation risks and QE risks have normalized. If that is the correct interpretation, and we think it is, then going forward the traditional bear-flattening/bull steepening pattern should reassert itself. And it means the easy steepening is behind us—major steepening will need aggressive Fed cuts.

That is an important observation, especially compared to a market like Canada which is yet to suggest the 'old' relationship is as reliable. To that end, we see the CAD curve exhibiting more signs of bull-flattening/bear-steepening as the front-end should be underwritten by inactive monetary policy.

Risks to the base-case – *The tail hedges to consider*

1. Trade certainty, or trade uncertainty fatigue, eats-up non-inflationary growth faster than expected.
 - This risk is for outside the United States. Pent-up Capex, most likely in smaller-open economies like Canada, eats through economic slack faster than expected. Hikes are priced earlier and the curve will flatten faster.
 - Relative flattening is how you trade this in cash, which should support an even steeper swap spread curve like 2s30s or 5s30s.
2. More noise than expected around the USMCA that would force the Bank of Canada to take the policy interest rate below neutral, delaying the start of cuts but raising the risk that an eventual hiking cycle is more rapid.
 - This is a real possibility, and should have more visibility early in 2026.
 - The hedge to this risk is a Reds/Greens steepener, as any BoC response would be front-loaded, with risks to be unwound more rapidly in 2027 and 2028.
3. Fed independence issues materialize, more cuts delivered than expected.
 - The market is pricing for somewhat lower odds of a Fed ease at Powell's last meeting, and elevated odds of a cut at the new Chair's first meeting.
 - We see the odds quite high that the nomination is a fairly-traditional choice, or, a nomination for a non-traditional choice is floated and causes enough market reaction to trigger a pivot back to a traditional choice.
 - If we are wrong, and there really is an 'inappropriate' post-Powell period, we like flattening SFR M6/M7 versus COR M6/M7.
4. AI investment boom slows, impacting R^* and the curve.
 - We believe R^* amid an infrastructure boom is $>$ steady-state R^* . Therefore, if a material slowdown in AI investment occurs, it will materially raise the probability of a recession.
 - But the risk that triggers the AI vulnerability is a widening in credit spreads. But hedging a flattener with something like a long CDX position just doesn't work very well unless the steepener is predicated on much higher inflation. And if that is the case, then it makes sense to own intermediate breakevens like 5y5y against flatteners, which would also benefit from a more post-Powell inappropriate period.

Balance Sheet Outlook: On to greener pastures (BoC, Fed, ECB & BoE)

Ian Pollick, Michael Cloherty, Arjun Ananth, Noah Buffam

Bank of Canada – Liability led growth

2025 saw meaningful changes in the way the Bank of Canada manages its balance sheet, most notably the early year cessation of Quantitative Tightening (QT) and the subsequent start of new asset purchases (term repos & treasury bill purchases). At the same time, ongoing ‘activist’ policies to stabilize reserves, to manage CORRA, was an important feature of this past year. And as we look ahead to 2026, we see two core themes that will drive balance sheet dynamics, including: i) a return to liability led balance sheet management, and; ii) maintenance of reserve stabilization efforts through the Receiver General (RG) account. Between the two themes the former is more interesting, while the latter should see very similar patterns as in 2025, albeit less reactive.

2025 in context

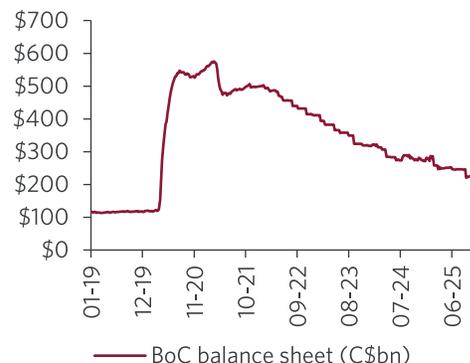
Despite the Bank of Canada ending its QT program earlier this year, a relatively slow pace of asset purchases meant that the size of the balance sheet still shrank. If 2025 ended today, the balance would have contracted by some C\$47.0bn, representing the largest annual decline since 2023. The bulk of the decline seen in 2025 reflected ongoing bond maturities, with two particularly outsized maturities spread across the year. Over the coming year, we expect a further reduction in the balance sheet of ~C\$30.0bn, leaving the size of the total sheet around C\$200.0bn (see Chart 2).

On the asset side of the balance sheet, the level of repos was broadly unchanged year-on-year, falling just under C\$2.0bn since the end of 2024. That is because in 2024 the Bank was very active in Overnight Repo (OR) operations, which were replaced with Term Repos at the end of Q1-25. But as a proportion of the balance sheet, repos now represent ~10.0% from 8.50% last year. Allowing for this proportional increase was a net-decline in GoC bonds, which notionally declined by C\$42.0bn this past year, which represents ~76.0% of the balance sheet (see Chart 3).

Importantly, as the BoC ended QT it also reintroduced asset purchases in order to replace reserves but, also to begin providing an offset to the liability side of the balance sheet. As discussed by the Bank earlier in the year, this ‘new’ approach to the balance sheet is meant to better match assets with liabilities, both fixed (currency in circulation) and floating (reserves).

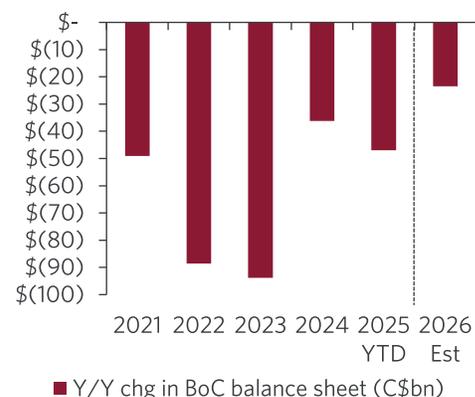
In terms of changes in liabilities, a net decline in Lynx balances of ~C\$49.0bn has been the most meaningful adjustment. Against that, there was marginal growth seen in the other ‘main’ line items such as: i) currency in circulation (+C\$0.9bn); ii) Receiver General (RG) balances (+C\$0.30bn), and; iii) ‘other’ (+C\$0.20bn). The decline in reserves relative to currency in circulation now means that the latter represents a larger share of the balance sheet, which is the opposite dynamic from the start of the year. For context, currency in circulation now represents some 52.0% of the balance sheet, versus Lynx balances at 36.0%.

Chart 1: Snapshot of Bank of Canada balance sheet



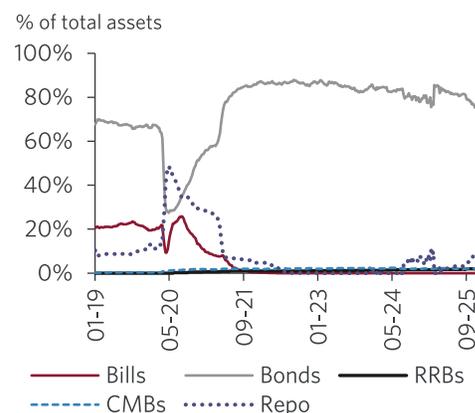
Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

Chart 2: A smaller decline likely in 2026



Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

Chart 3: Asset side of the sheet in context



Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

In terms of asset purchases this past year, since March the Bank has been conducting term repos. The newest innovation in this regard has been an expansion of accepted collateral, most notably NHA MBS, resulting in a new shorter-tenor 1m operation to compliment the more traditional tenors for non-MBS operations (14-day, 28-day, 84-day). Additionally, the Bank expanded the pledged collateral to include inflation-linked bonds from both the federal and provincial governments. Note that unlike prior iterations when term repos were utilized, the underlying composition of collateral has changed. As shown in Chart 4, as of Q3-25 GoCs represented 57.0% of total pledged collateral, with provincial bonds representing the balance. As an example, during the pandemic the distribution was closer to 60%/40% provincials vs GoCs.

At time of writing, treasury bill purchases have yet to occur, though they have been announced. The Bank noted that they will resume bill purchases as part of their normal balance sheet management, restoring a “more balanced mix of assets on the Bank’s balance sheet”. Purchases will begin mid-month, in the primary market, and over time be aimed at matching the size of Lynx balances with the help of term repos.

Liability led management

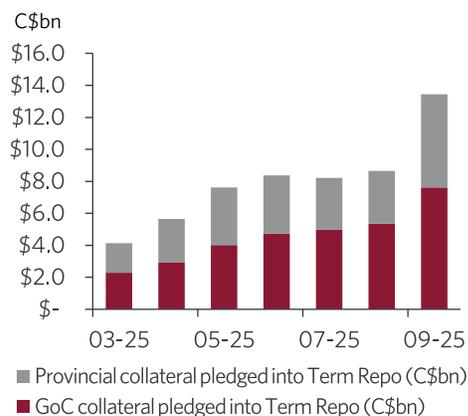
As a reminder, Lynx balance (i.e. reserves) stand at just under C\$80.0bn. Of that, cash provided from the Bank via term repos and RG auctions represent ~45.0%, or C\$35.0bn. That appears to be the steady state proportion and we see little reason for that to materially adjust in the coming year. Said another way, it is not likely that asset purchases obviate the need to maintain liquidity injections. As previously mentioned, a big theme in the coming year is going to be a more forceful return to the liability led growth of the balance sheet. While the Bank has not yet provided any guidance as to the size of bill purchases, we can help calibrate the terminal size of auction participation given our estimated path of reserves.

In Chart 5 we provide our view as to where settlement balances will finish by the end of Q1-26, which we estimate to be just above C\$50.0bn. Note that number includes cash injections provided by the Bank of Canada. Now one of the consequences of purchasing bills in the primary market is that, technically, it doesn’t actually create reserves. Rather, it provides more cash available to the RG and reduces the need to drain reserves faster given that the private sector is purchasing fewer bills as the BoC, unlike the Fed, doesn’t purchase via add-on, it is a net-reduction. And if we assume that the level of term repos outstanding stays around current levels, it suggests the Bank would need to buy ~10.0% of the stock of bills next year. Recall, in the most recent Debt Management Strategy (DMS) the Department of Finance projected total bill issuance of C\$291.0bn in FY26/27. That implies the Bank will need to purchase, on average, 10.0% of each bill auction going forward. However, failure to initially communicate the sizing of purchases suggest a more ‘dynamic’ purchase profile is likely, ranging slightly below to slightly above that level, likely reflecting seasonality in cash flows and RG needs around bigger maturities.

On that, we also expect the Bank to utilize Cash Management Bills (CMBs) around big maturity dates, similar to how they operated around the two big maturities in 2025. Note that the next big maturity in Canada occurs in March, which should see some C\$20.0bn of reserves drained and with a total sized maturity of C\$33.1bn.

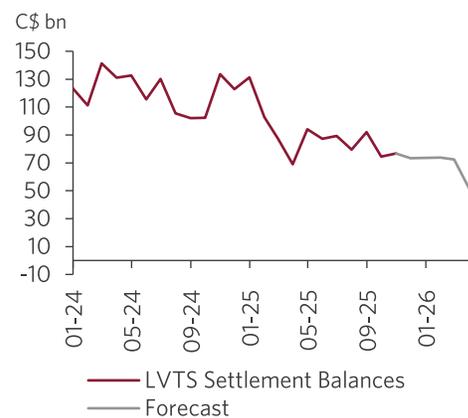
In thinking about the steady-state level of the RG on the liability side of the balance sheet, it is instructive to look at recent trends in 2025 compared to prior years. Chart 6 shows the average cash balance as a proportion of GDP by month in 2025, overlaid with the average balance as a percent of GDP in the subsequent five years. The pattern this past year was for the government to run materially higher-than-average RG balances in Q1, and lower balance of the year, particularly in Q3 and Q4. Given that issuance will not change in 2026 relative to 2025 and, given many of the expenditures laid out in the budget are back-loaded in the year, we see maintenance of those cash trends over H1-26, with some potential for more volatile balances in H2-26. To provide some numbers, RG balances as a percentage of GDP averaged 1.86% in 2025 and 1.92% in 2024.

Chart 4: Pledged Term Repo collateral, by type



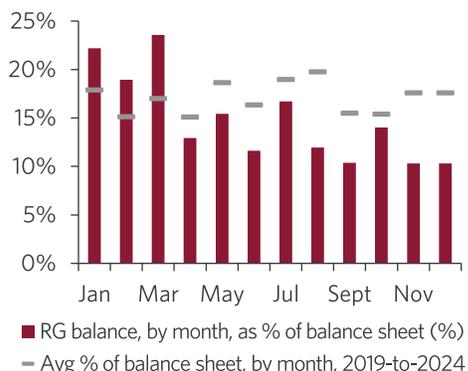
Source: Bank of Canada, CIBC Capital Markets.

Chart 5: Settlement balance forecast



Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

Chart 6: Comparing average RG balances, by month



Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

In addition to term repo and bill purchases, the Bank has also stated that it will at some point begin to purchase GoC bonds to match fixed rate liabilities such as currency in circulation. Recently, the Bank has suggested it does not expect to begin these purchases until 2027. It is our expectation that purchases will need to occur earlier, towards the tail-end of calendar 2026.

To provide some context, the size of outstanding currency in circulation stands around C\$125.0bn, meaningfully below the current size of the Bank's GoC portfolio. That gap, around C\$50.0bn, will begin to close over the next few years if recent growth trends persist (see Chart 6). To be sure, those growth trends in the demand for physical cash have been slowing, reflecting lower overall cash usage and tougher AML regulations. Additionally, demand for stablecoin in future years could slow this further, though with the regulatory framework only just introduced via the budget, this isn't a story for 2026, though will be in future years (see Chart 7).

If we extrapolate recent trends in the growth rate of currency in circulation and, adjust for some of the aforementioned factors, the size of currency liabilities do not match the assets of the GoC portfolio until the middle of 2029 (see Chart 8). Note we assume currency grows -1.10% per annum over the forecast horizon. The Bank had noted that the volatility in the growth of circulation would ultimately guide their purchases, suggesting there is no need to go 'too fast' in secondary market purchases of GoCs.

But given that bond purchases are also meant to replace reserves destroyed via maturities, we do expect a profile that doesn't leave too much purchasing in the out years, especially important if there are upside budgetary surprises that reduce overall financial requirements. To that end, we do expect purchases to begin towards the end of Q4-26. The Bank would bring purchases earlier into the year should there be evidence of more upward demand for reserves than currently projected. For example, if the Bank began purchasing GoCs in the secondary market at an equal pace given projections today, it would mean they need to buy some C\$20.0bn per year. Within the context of current borrowing programs this isn't very much, just under 8.0%. But in the spirit of reducing their footprint on the market, and remembering that these purchases will occur in the secondary market, 'early and slow' is a more optimal choice than 'late and fast'.

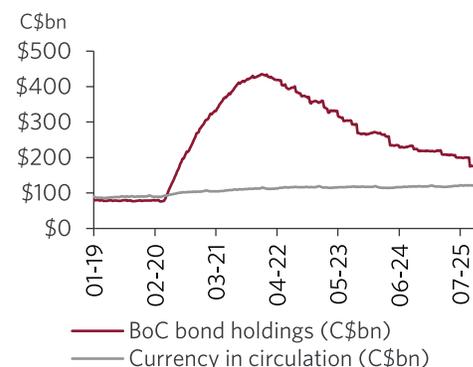
Reserve stabilization

Our view on liquidity injections remaining elevated means very little impediments in efforts to stabilize CORRA. And as a result of the recent stability we have seen in CORRA, we no longer see a reduction in the deposit rate as likely, barring a more material change in how the RG is being supplied. As such, policy implementation in the year ahead should be relatively uninterrupted compared to 2025 trends.

The large March 2026 maturity is likely to occur with less market impact than what we saw this past September. In part, that reflects a larger footprint of the RG, but also more utilization in term repos given the larger amount of tenors now available. And similar to this past year, we expect the Bank will utilize Cash Management Bills (CMB) ahead of key maturity dates. For reference, there were two large maturities in 2025, a C\$12.0bn maturity in March and a C\$26.0bn maturity in September. Ahead of both those instances, the Bank raised ~30.0% of the size of each maturity in CMBs in the week prior to the maturity. We look for something similar to occur in March 2026. This doesn't obviate pressure on the level of RG auctions, but bill purchases in the months prior will help to provide a bit of an offset. When it comes to reserves around the March maturity, they will initially go up before being pulled lower given that Lynx balances will have need to make up for the disproportionate ownership of the BoC.

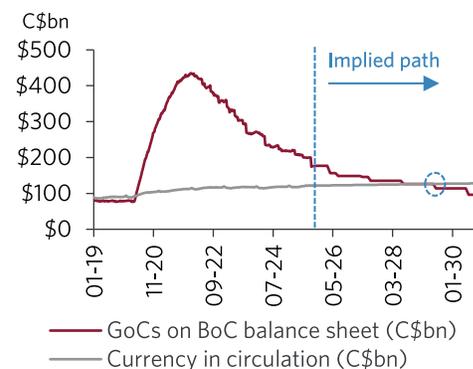
More generally, we have seen much better balance in the level of CORRA relative to target. For example, since term repos were introduced and RG auctions became larger, the average deviation of CORRA to target has compressed to 2.0bps. While frictions around CAD bank year-end took CORRA notably higher,

Chart 7: GoC portfolio vs currency in circulation



Source: Bank of Canada, Bloomberg, CIBC Capital Markets.

Chart 8: ALM will be binding for bond purchases by 2029



Source: Bank of Canada, CIBC Capital markets.

averaging 12.5bps above target in the 5 days pre-post October 31st, this is normal course wear-and-tear that shouldn't raise any eyebrows in Ottawa. Moreover, it appears the pressure seen in the 25th percentile relative to target has subsided since the September maturity and tweaks to the term repo operations, while the 75th percentile to target differential remains elevated. While we are cautiously optimistic that there will be no repo rate cut as of this time, more pressure on the 25th differential stemming from a change in approach to RG supply would make us look for an implementation change.

Our long-held view on the underlying core issues, including reserve concentration and higher LCR run-off assumptions, have not changed. Nothing has been addressed at fixing the underlying problems, meaning that the stabilization efforts conducted by the Bank remain a piecemeal approach. A potential catalyst for change next year could come from a trade deal with the United States, which promotes more business capital spending. That would begin to reduce the very high levels of corporate deposits idling in the banking system. But barring that, the reality is that the BoC balance sheet dynamics are about to get relatively boring compared to the events of 2025.

Federal Reserve – Fed will buy bills, but repo spike risk persists

QT is slowly winding down in the US, but we still don't have an end date yet. The Fed will start buying bills in December, but that won't fully stabilize reserves as we will see downward pressure from currency growth and Fed profits. This means repo spike risk will remain present, and we think the Fed will underdeliver on steps to stabilize repo until we see a significant financing spike.

We look for the Fed to start fully stabilizing reserves by accelerating bill purchases in Q1. More bill demand will ultimately cause the Treasury to issue more bills, which delays the first increase in coupon auctions but a couple of quarters. But even with bill demand from stablecoins, we think coupon auction sizes will start slowly rising in FY27, with a more significant increase in auction sizes coming in FY28.

Repo stabilization steps?

One of the near-term challenges for aggressive Fed intervention is that there has been a big effort to make the SRF an effective cap. We don't think the SRF will ever be particularly effective.

But if the Fed changes its strategy and goes with large term repos over year end/a tweak to the SRF rate/etc, it would likely be viewed as Fed acceptance that the SRF isn't working as planned. We think the Fed will view it as premature to risk being seen as throwing in the towel on the SRF, so we don't expect significant intervention into year end.

In addition, there is a long academic debate about the appropriate level of volatility in money markets. The fear is if the Fed completely eliminates vol, liquidity providers won't be able to make money, so they will exit the market. That will make the market more and more and more dependent on the Fed. Accordingly, we think the Fed is willing to accept dramatically more repo volatility than the average hedge fund. The incremental financing uncertainty means that RV trades will need to be a tick or two cheaper before hedge funds are likely to step in.

And it means that we think there will be better entry points to get long front end spreads in early 2026.

Fed bill purchase outlook

To keep reserves from falling, the Fed needs to buy Treasuries, but because the Fed portfolio is so underweight bills we expect all the buying to be in T-bills well into 2028. That means Fed buying will have a minimal direct impact on the amount of duration held by the market. But if an increase in bill demand causes bills to richen, we would expect the Treasury to issue more bills. And that will push back coupon auction increases slightly.

MBS: MBS runoff should be roughly \$15bn per month. An extremely large rally would be needed to significantly increase that pace (Chart 9). We don't think there is any meaningful risk of policy changes to that will alter that (transportable mortgages, etc). So MBS runoff should lead to about \$15bn per month of Fed bill buying.

Fed profits: Much of the Fed portfolio was purchased at extremely low yields in 2020/21. So the Fed has been running a negative cash flow since mid-2022 (Interest on Reserves payments, RRP payments, etc have been larger than interest accrual on the securities portfolio, Chart 10).

To cover this loss, the Fed has been printing reserves and offsetting it with a capital asset based on retaining future earnings once their cash flow turns positive again. Once the cash flow turns positive, they will pay down that asset (which they book as a negative liability) and reserves will fall.

The more the Fed cuts rates, the more IOR payments drop and the better the Fed's cash flow becomes. So aggressive rate cuts mean rapid destruction of reserves, requiring larger bill purchases. But even with our modest rate cut projections, we should see the Fed cash flow turn positive in 2026 which will marginally boost Fed bill purchases.

Currency growth: The long term trend in currency is about 6% growth per year, which would drain about \$12bn of reserves per month. But in the last three years currency growth has slowed to about 1.8%. On a log scale, currency now stands well below its long term trend (Chart 11).

It is premature to draw firm conclusions, but since most US currency is held overseas as a store of value/a transactions vehicle in gray markets, it is possible that the slowdown may be related to the substitution of crypto for currency.

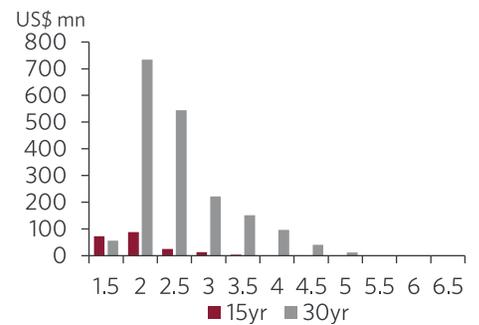
That means is that if Fed projections of massive overseas demand for stablecoin in the next few years play out, it would suggest a wider migration from other assets (including currency) towards crypto.

Accordingly, stablecoin demand is very large, we would sharply lower our expectations of Fed buying of Treasuries to offset currency growth. Potentially even into negative territory.

Bottom line: Aggregate bill demand is going to be large enough to push out coupon auction increases by a couple quarters, but we doubt it will have much of an impact beyond that. We think investors should move their focus on Treasury supply to the back burner for 2026, but in H2 2027 attention will need to come back toward supply issues (Chart 12).

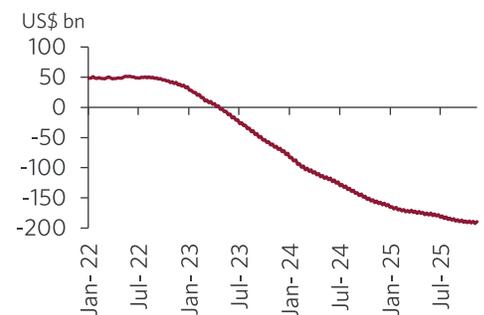
That is because coupons maturities will rise sharply in 2028, meaning larger coupon auctions will be needed simply to raise the same amount of cash.

Chart 9: Coupons of MBS held by the Fed: 15yr current coupon is 4.54%, 30yr current coupon is 5.21%. Very large rally needed to boost prepayments.



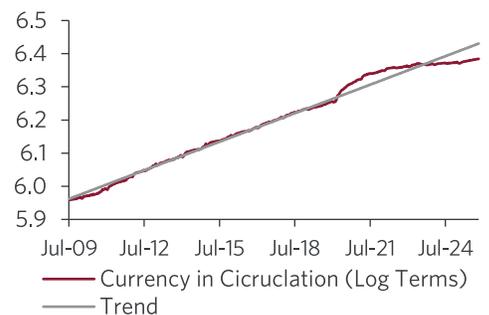
Source: New York Federal Reserve.

Chart 10: Fed Other Liabilities and Capital: Negative Fed cash flow/reserve created to offset that is slowing, and should flip sign in 2026



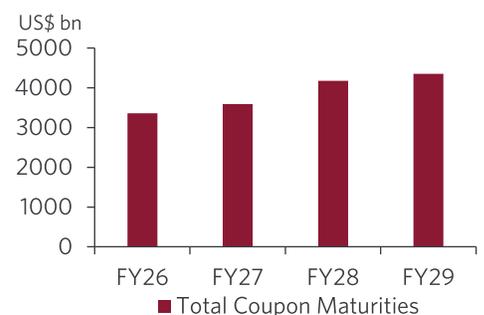
Source: Bloomberg.

Chart 11: Currency growth on a log scale is below its long term trend



Source: Bloomberg, CIBC Capital Markets.

Chart 12: Treasury coupon maturities by year, adjusted for our issuance expectations in FY26/27



Source: New York Federal Reserve, CIBC.

ECB – Proceeding carefully as planned

The recently renamed “Quantitative Normalization” process advanced carefully through 2025, with few signs of EUR funding pressure via repo, unsecured deposits, or xccy. We expect this process to continue smoothly through 2026, with small signs of funding pressure beginning in H2, as excess liquidity (EL) nears the Floor Required Level of Excess Liquidity (FREL) and European sovereign issuance continues to ramp up.

We’ve projected the 2026 path of excess liquidity using ECB guidance surrounding asset roll off and our forecasts for autonomous factors and MRO/LTRO take up. We expect excess liquidity will decline to €2.0 trln by 2026. This will imply that the top end of the FREL band (€0.6-2.2 trln) will be hit by July, around which point we expect small signs of funding pressure to begin to appear (Chart 13).

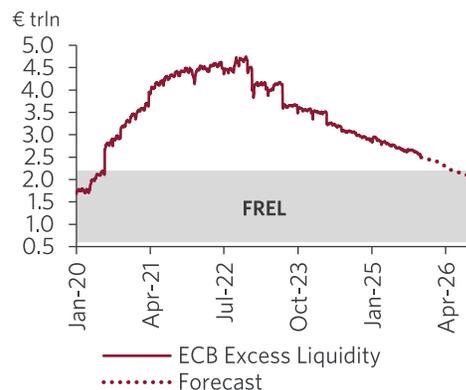
We have assumed that the ECB’s Asset Purchase Programme (APP) and Pandemic Emergency Purchase Programme (PEPP) roll off by €502.3 bn in 2026, as guided by the ECB. We assume that MRO and LTRO take up remains low through 2026, as the facility’s Deposit Facility Rate (DFR) + 15 bps cost should remain relatively punitive versus funding via repo or deposits. As EL moves into the top of the FREL, we expect that MRO/LTRO take up will increase towards roughly €70 bn, with the beta of APP/PEPP decline to facility take up rising to 0.3 by end of 2026. This assumption reflects a slightly slower/lower take up versus the BoE’s demand driven floor facilities, as ECB facilities are more punitive. We expect autonomous factors to remain around current levels, as banknotes in circulation have flatlined.

It’s notable that currently, with excess liquidity roughly 25% above the top end of the FREL, the Eurozone has yet to experience notable funding pressure, with GC repo averaging around the DFR (Chart 14). This is in contrast to the BoE, which at this point in their balance sheet normalization process saw GBP repo averaging roughly 5 bps above target. A partial explanation for this relative lack of funding pressure was explained in a recent Isabelle Schnabel speech, as she shows that reserves have thus far been redistributed efficiently among banks, as intra-Europe cross-border repo transactions involving non-HQLA collateral have risen significantly since mid-2024. The rise in this metric suggests that banks who are short on reserves have been able to obtain these funds without major repo pressure thus far.

We think that another reason for tame funding pressure within the Eurozone reflects the relative lack of sovereign issuance in recent years compared to other DMs. This is notable in chart 15, which shows that while sovereign free float has increased by roughly 85% and 75% in the UK and US, it has only increased by about 40% in the Eurozone. Less supply implies fewer bonds need to be financed, and repo pressures are less acute; which is also notable in still positive German swap spreads.

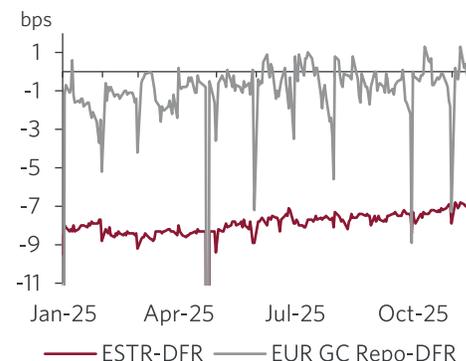
Moving into H2 of 2026, we expect that some of the factors behind tame repo pressures in Europe can reverse. Consider that as excess liquidity moves closer to the FREL, banks will be less willing to redistribute cash across borders, and reserve fragmentation will become more binding. Meanwhile, European net sovereign supply should continue to catch up to other DMs in 2026 amid rising German spending and increased defense spending by countries which have activated the National Escape Clause.

Chart 13: We expect excess liquidity to fall to €2.0 trln in 2026



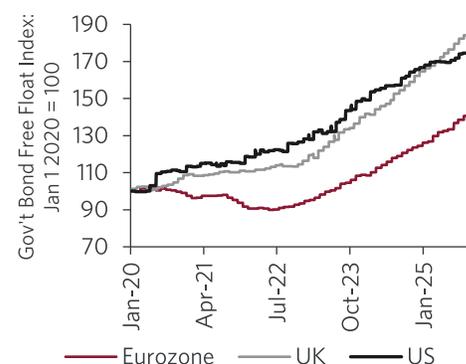
Source: ECB, CIBC Capital Markets.

Chart 14: EUR funding pressure has been contained thus far



Source: Bloomberg, CIBC Capital Markets.

Chart 15: Eurozone sovereigns have issued significantly less than other DM Governments



Source: BoE, CIBC Capital Markets.

Our forecast for excess liquidity at €2.0trln by end of year can be used to project the ESTR-DFR and GC repo-DFR spreads (using a polynomial trendline to capture the slope of the reserve demand curve). Chart 16 shows that we expect that ESTR-DFR could rise towards -4 bps by end of year, with the risks to the upside should the reserve demand curve have a steeper slope. A similar regression suggests GC repo-DFR could average 3 bps with a daily range between 0-6 bps.

These forecasts are in line with our view that liquidity will remain ample in 2026, but that small signs of funding pressure will begin to emerge in H2. We expect that this pressure will permeate into a tighter front end ESTR-SOFR xccy in H2, as the Fed will be in the process of buying bills to quell SOFR pressures.

Schnabel's steps

In Isabelle Schnabel's recent speech, "Towards a new Eurosystem balance sheet", she laid out the ECB's likely next steps to fully implement the remaining demand driven floor facilities. This includes i) a longer term structural refinancing operation to complement the shorter term MRO and LTRO, and ii) a structural securities portfolio. She notes that the longer term structural refinancing operation will only begin once there is persistent and broad-based take-up of the standard refinancing operations (MRO/LTRO), and that the structural securities portfolio is still far away, as it will come some time after the structural refinancing operation. We expect that the longer term refinancing operation could be introduced by the end 2026/start 2027, given our expectations around MRO/LTRO take up.

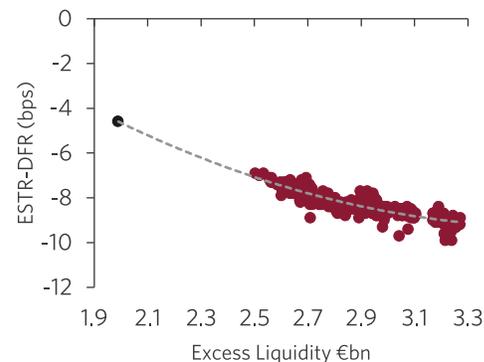
We think that the introduction of the longer term refinancing operation could flatten the FRA-ESTR curve should it provide funding beyond the 6M tenor. In this case, banks could substitute NSFR related funding being done at 6M+ EURIBOR, and draw instead upon the ECB's structural refinancing operation at DFR + spread. This could act to cap longer tenor FRA/ESTR at the spread to DFR, once ESTR returns closer to (Chart 17).

While the structural securities portfolio will not be introduced in 2026, we would note that Schnabel's speech provides early signs that the facility will tilt purchases to short tenor securities, so as to ensure the facility has a neutral policy stance (ie: little impact on term premia). The implication is that the introduction of the facility could flatten the EUR swap spread curve, as purchases are focused on the short end.

Bottom line

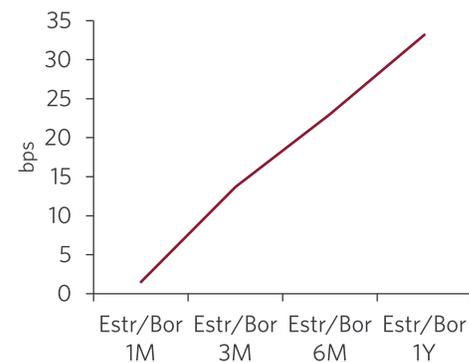
EUR funding pressures are likely to remain relatively muted in H1 of 2026, given reserve redistribution, relatively lower sovereign supply, and excess liquidity still above the FREL. But as ECB excess liquidity moves towards €2.0trln by end of year, we expect that demand driven facility take up will begin, as GC repo rises towards a 0-6 bps range, and rates for some participants making MRO/LTRO usage suitable amid increased reserve fragmentation. We look for front end ESTR-SOFR xccy to start to tighten in H2, on a catch up to trend in G5 xccy basis once EUR funding pressures show up.

Chart 16: We expect ESTR-DFR to reach -4 bps by end of 2026



Source: ECB, Bloomberg, CIBC Capital Market.

Chart 17: The FRA/ESTR curve could flatten on the implementation of a structural refinancing operation



Source: Bloomberg, CIBC Capital Markets.

Bank of England - The risks of dependence

The BoE stood out relative to other DM central banks this past year, as they pledged to increase the pace of active QT to £21 bn in 2026 from £13 bn in 2025; with the asset purchase facility (APF) being reduced by £70.0bn into October 2026. The decision to continue shrinking the balance sheet, even as repo pressures are becoming more acute, reflects the fact that i) the BoE is attempting to shift their operational framework to a demand driven floor system, and ii) the BoE targets an unsecured rate and so is less perturbed by repo pressures.

We expect that through 2026, BoE reserves will remain slightly above the Preferred Minimum Range Of Reserves (PMRR). However, we expect that GBP funding conditions will continue to tighten, with some periods of acute funding pressure, given banks increasing dependence on weekly demand driven reserve facilities and emerging signs of reserve concentration issues. For these reasons, we expect that SONIA will continue to converge towards Bank Rate, with an estimate of roughly -1 bps spread by end of year, and that repo pressure will continue to crop up between demand driven reserve facility operations. We also expect that front end SONIA-SOFR xccy can tighten further from current levels, as GBP funding tightens relative to the US given that the BoE's reaction function to funding pressure is more relaxed relative to the Fed.

For the year-ahead, we project that BoE reserves will shrink from £643.3bn in mid November to £617.0bn (Chart 18). This suggests that reserves are unlikely to reach the PMRR in 2026, as the BoE's most recent guidance from November 2025 suggested that the PMRR is an upwardly revised £375-540 bn.

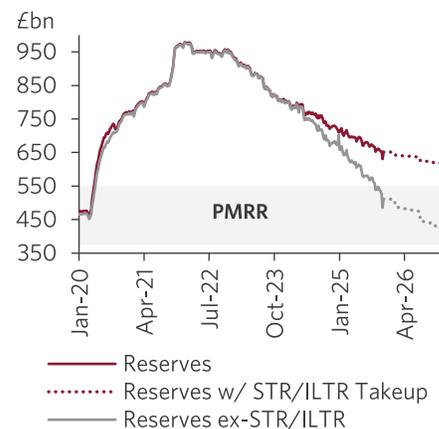
This forecast is based on active and passive gilt reduction and TFSME repayment proceeding in line with BoE guidance, and our own expectations for currency growth and Short Term Repo (STR)/Indexed Long Term Repo (ILTR) facility take up.

The forecast for STR/ILTR take up is subject to the most uncertainty and is also most important for market implications. In our base case, we see STR and ILTR take up continuing at a 0.6 beta to the reduction in the APF and TFSME (Chart 19). This assumption is higher than the 2025 beta of 0.5, as banks will increasingly use the BoE's facilities as the PMRR is approached. We do not expect the reserve beta to rise materially above 0.6 in the year ahead, as recent guidance surrounding the PMRR was likely estimated within recent months. But going forwards, this metric will be important to watch when assessing the risks of funding spikes.

Facility Reliance + Reserve Concentration = Funding Risks

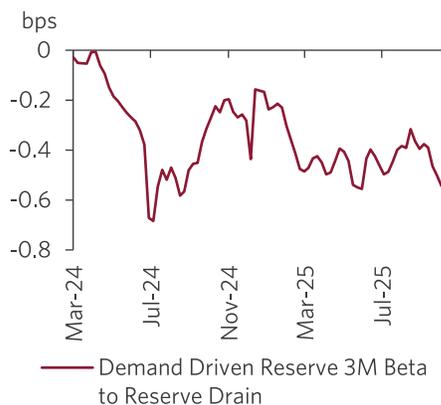
Even though we do not expect reserves to hit the PMRR in 2026, we expect that funding pressures will trend tighter, with some further period of acute pressures unrelated to month-end. We've recently seen the first signs of this pressure, when a significant £22.8 bn in TFSME loans were repaid over a week. The increased demand for funding had RONIA spiking ~30 bps above Bank Rate and 3m SONIA-SOFR xccy tightening 4 bps on the day. This funding squeeze is a result of the design of the BoE's demand driven facilities, as they provide funds only on Thursday mornings (or afternoon on BoE meeting dates), leaving funding through the rest of the week vulnerable to unexpected shocks. Our expectation is that these periods of funding tightness will become more usual as banks increase their dependence on the BoE's STR and ILTR programs. We look to the dates of large gilt issuances and further TFSME repayments for possible spikes in gilt repo and SONIA xccy. These pressures can become most acute in H2 2026, as banks become increasingly reliant on demand driven facilities post the July 22 £29.3bn gilt redemption and as TFSME loans are paid back.

Chart 18: STR/ILTR take up will continue to ramp up materially as we approach the top of the PMRR



Source: BoE, CIBC Capital Markets.

Chart 19: Demand driven reserves are being taken up at a faster pace to reserve reduction



Source: BoE, CIBC Capital Markets.

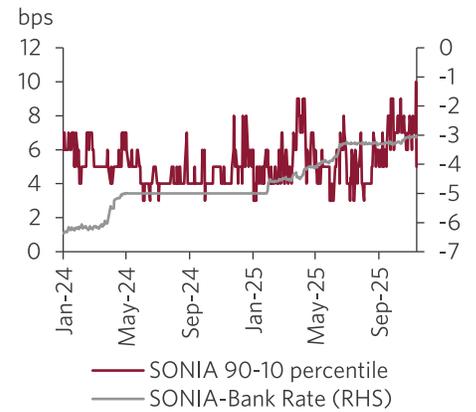
Another risk to funding comes from the emerging signs of reserve concentration issues among UK banks, as the spread between the 90th and 10th percentile SONIA distribution has been widening as reserves shrink (Chart 20). We expect that reserve concentration means that the PMRR is on the upper end of the guided range (£540.0 bn), as the banks with the most pressing need for reserves will be the marginal price setter in UK funding markets.

Our reserves forecast suggests that the SONIA-Bank Rate spread will rise from -3 bps today to roughly -1 bps by the end of 2026. However, the risks are to the upside of this forecast, given reserve concentration could imply a steeper reserve demand curve.

Bottom line

To sum up, we expect an increased dependence on the BoE's demand driven facilities in the year ahead, but we do not expect full implementation of the demand driven floor, as reserves should remain above the PMRR. At the same time, a combination of reserve concentration and gaps in STR/ILTR funding imply rising risks of gilt repo spikes and a continued tightening in front end SONIA-SOFR xccy basis. We expect these pressures will become most acute in H2 2026, as banks become increasingly reliant on demand driven facilities post the July 22 £29.3bn BoE held gilt redemption and as TFSME loans are paid back.

Chart 20: There are emerging signs of reserve concentration issues



Source: BoE, CIBC Capital Markets.

FX Outlook: A tale of two halves, a story of volatility decay

Sarah Ying, Jeremy Stretch, Maximillian Lin, Luis Hurtado, Noah Buffam

Our 2026 FX Outlook is organized into Three Parts:

- [Part 1 page 32](#): DM Themes: Not a Lot of Cycle Left
- [Part 2 page 37](#): EM Themes: Volatility Decay and the Rise of Carry – At Least in H1
- [Part 3 page 41](#): Asia Themes: The Big Risks into 2026 – Tariffs, China, AI

Part 1: DM themes: Not a lot of cycle left

The overarching macro theme into 2026 is that central bank cycles are very mature in most developed economies. The ECB and the Bank of Canada are likely done, and will enter a period of an extended pause. The RBA, RBNZ and the SNB are expected to deliver a final cut before achieving terminal, while the Fed and BoE will likely have two more. On the flip side, the BoJ is in the later stages of its hiking cycle, with only one more hike left bringing rates to 0.75%. All this to say we are entering the turn of the year with not much cycle left, and the bulk of 2026 should be marked by a period of global central bank inactivity.

And assuming that global growth ‘muddles through’ (see section *Economic Outlook: Middling, and muddling through* on [page 5](#), by Avery Shenfeld), there is no reason for the market to reprice terminals materially below or above neutral (r^*). This leaves very limited room for currencies to squeeze out additional alpha from the central bank story: the gap between market implied terminals and central bank estimated r^* is extremely narrow (Chart 1).

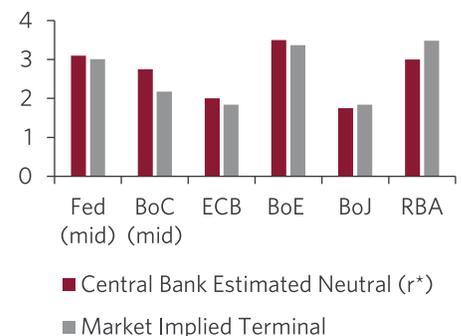
To illustrate what that looks like in the FX market, we can recalibrate FX valuations (using trade weighted indices, TWI) at r^* estimated by each central bank (Chart 2). Unsurprisingly, for most currencies, especially USD, EUR, and GBP, there is very little deviation from current spot values: r^* is mostly priced, and as consequence so is FX^* .

Of the extremes in Chart 2 (CAD cheapness & AUD richness), both are small open economies with minimal impact on the broader currency bloc. The big take away is that USD^* is rightly sized. And because the Fed’s return-to-neutral is already priced, there is very limited room for the greenback to trend into 2026 unless r^* itself changes. As a consequence, we are highly convicted that first half of 2026 will be characterized by a period of volatility decay and heavy mean-reversion in the bilateral USD-pairs.

Consider that over the past couple of decades, market volatility cycles have often coincided with the Fed’s interest rate cycle. In Chart 3, we show the average change in volatility (CVIX for currency markets, and VIX for equity markets) over different Fed cycles since 2000.

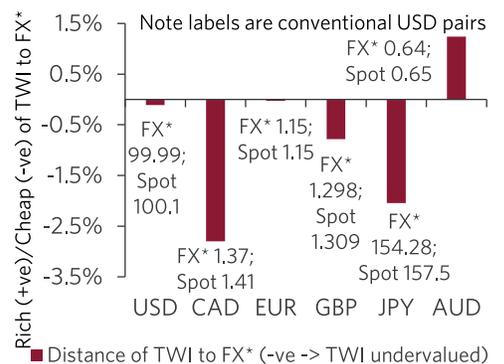
Fed easing cycles are generally marked by a spike in volatility given the asymmetry of tail-events (such as 2008 and 2020). Volatility during hiking cycles is more sporadic, and depends on the speed of hikes. Consider over the 2015 hiking cycle, an extremely patient Fed continued to push volatility lower between late 2015 to late 2018. In contrast over 2022/2023, the sharp velocity of the hiking cycle caused volatility to spike. So the behavior of volatility is inconsistent when interest rates are rising and dependent on urgency. But luckily for 2026, we are ways away from the Fed’s next hiking cycle.

Chart 1: The market has already priced in a return-to-neutral narrative



Source: Respective central bank websites, Bloomberg, CIBC Capital Markets.

Chart 2: Rich/cheap valuations of trade weighted indices assuming convergence to r^* from market implied terminals



Source: Bloomberg, CIBC Capital Markets.

In the current environment when the late stages of the easing cycle is already priced (akin to 'Inertia' in Chart 3), there is a heavy drag on volatility that is consistent over macro cycles. Therefore for the majors, most of 2026 is therefore as much about respecting the ranges as it is about assessing the risks.

Because we are highly convicted on our volatility call (of lower volatility), we are less convicted on spot directionality. We believe USD weakness still has legs, but sometime around mid-year, there will be an inflection point where USD bulls start to materialize. For this reason, we see 2026 as a tale of two halves.

USD - Our USD call is u-shaped

Because the Fed's return-to-neutral narrative is already deeply in the price, we suspect the market will spend a lot of time weighing difficult-to-quantify risks into early next year. To us, such risks will push the USD lower in the next couple of quarters, even though there could be modest upside risks to inflation. To us, downside risks to the US labour market, and to growth would be more impactful.

Firstly, consider that the tariff puzzle has yet to be solved: who is paying for these? In Chart 4, we show the impact of tariffs on vulnerable sectors across the distribution chain, measured YTD to include both the impact of tariffs themselves, and tariff uncertainty. The 'who' of tariff costs is stagflationary and should push USDs lower in the early months of 2026. If consumers bare it, we are likely to see some inflationary impulses. If firms instead take the hit, they may be forced to protect margin via other cost cutting initiatives including scaling back labour, impacting the labour market.

We suspect that Fed independence will be a big theme early next year given some uncertainty around the composition of the Federal Reserve Board. Oral arguments for the legality around Lisa Cook's dismissal is scheduled for January 21, 2026, with a Supreme Court ruling likely anticipated for the months to follow. Stephen Miran's term also expires on January 31, 2026, leaving another spot open. Most importantly, the appointment of the Federal Reserve Chair has yet to be decided, but recent guidance from Bessent suggests an announcement will be likely by the end of this year.

Table 1: The composition of the Fed Board likely a focus in early 2026

Appointed by	FOMC Board 2025	Hawk/Dove	FOMC Board 2026	Hawk/Dove
Trump	Powell	-2	To Be Announced	Likely Dove
Biden	Jefferson	-3	Jefferson	-3
Biden	Barr	0	Barr	0
Biden	Cook	-2	Cook (Pending SCOTUS Ruling)	-2
Trump	Miran	-5	To Be Announced	Likely Dove
Trump	Waller*	-4	Waller	-4
Trump	Bowman	-4	Bowman	-4

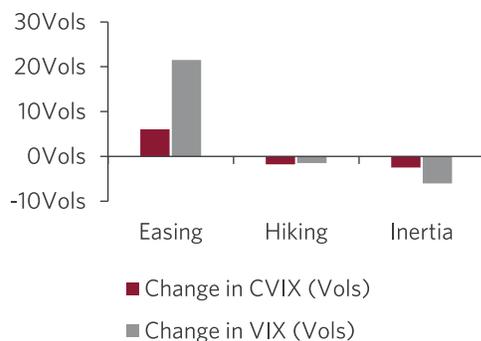
Regional Fed Rotation

	2025	Hawk/Dove	2026	Hawk/Dove
	Boston - Collins	-1	Philadelphia - Paulson	1
	Chicago - Goolsbee	0	Cleveland- Hammack	5
	St Louis - Musalem	2	Dallas - Logan	3
	Kansas - Schmid	4	Minneapolis - Kashkari	-4
	NY - Williams	-2	NY - Williams	-2

* -5 is most dovish, 0 is centrist, +5 is most hawkish; Miran's term expires January 31, 2026.

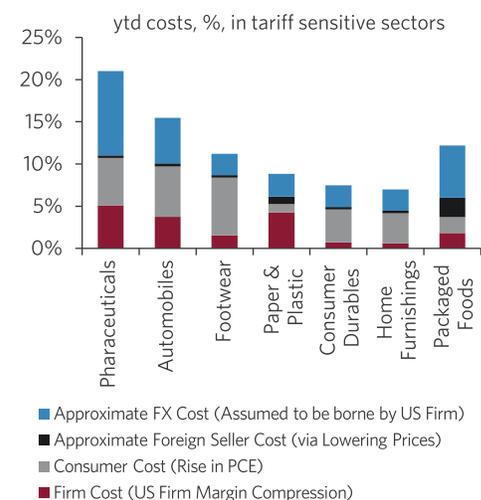
Source: CIBC Capital Markets.

Chart 3: Average swing in volatility during Fed cycles



Source: Bloomberg, CIBC Capital Markets.

Chart 4: Who bears the cost of tariffs and tariff uncertainty?



* Note given that we are including the impact of tariff uncertainty, the total cost of tariffs may not equate to the amount of the tariffs themselves. The cost to firms is reflected in margin compression over the course of the year as they are forced to accept higher input costs if they are unable to pass them on. The cost to the consumer is measured in the rise in PCE in these sectors, which is the extent of the price hikes that firms can pass along. Foreign sellers can also incur a cost, via charging US firms lower prices to make up for the tariff increase. Lastly, there is an implied cost stemming from the rise and fall of the USD: in periods of USD strength, then foreigners implicitly bear the cost via a reduction in their purchasing power - but this year, because USD has fallen, it is the US firm (or consumer) that takes the hit.

Source: PIIE, BEA, Bloomberg, CIBC Capital Markets.

As well, there is some ambiguity around the legality of Trump's IEEPA tariffs. Should Trump's tariffs be deemed illegal, a rally in trade sensitive currencies like the CNY, MXN, and EUR can prop up other pro-cyclical currencies including AUD, NZD and SEK. This will mechanically lead to a weaker greenback. And while it is possible for Trump to find ways around IEEPA (like Section 122 or 301 tariffs), these are more legally cumbersome to implement and could conflict with existing trade agreements such as USMCA.

In summary, risks into early next year include: the ramification of tariffs which is stagflationary, Fed independence, and the legality around Trump's IEEPA tariffs — all of which should drive the greenback lower into the first half of 2026.

Second-order effects – The USD pivot in H2

In our view, the risks tilted towards USD downside into early 2026 are not long lasting. Once they go away, we suspect the market would start to realize that Fed terminals have gone too far. CIBC Economics believes that the current Fed estimate of r^* at 3.0% is mispriced, and the true value is 50bps higher. CIBC Rates Strategy argues that there needs to be higher real rates in the US to incentivize savings back into the economy. Inflation premia could also show up at the back end of the curve. Further, CIBC Equity Strategy believes the equity market rally could run out of steam in H2, increasing the propensity of a USD rally in risk off.

For these reasons, we think we are in the final innings of USD downside, especially with midterms in November. By the middle of the year, we are looking for an inflection point for the greenback to turn slightly higher. Our forecast for the USD is therefore U-shaped falling to lows of 96.0 in Q2 end, and recovering slightly to 97.30 by the end of the year.

CAD – The Canadian Dollar is undervalued by most metrics

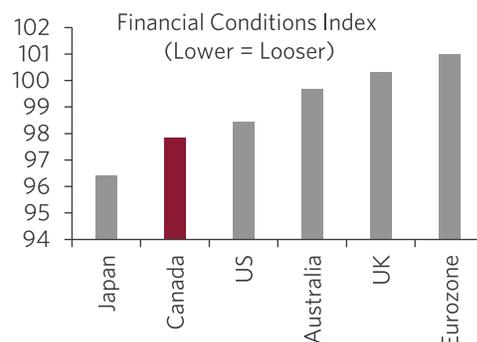
Relative to most major economies (except Japan), financial conditions in Canada are relatively loose (Chart 5). Consider that interest rates are at the lower end of the Bank's neutral rate range of 2.25%-3.25%, domestic credit spreads have reached the tightest levels since 2007, the S&P TSX has outperformed the S&P 500 year-to-date in local currency (at 22% and 12% respectively), and the Canadian dollar remains weak, with the trade weighted CAD falling 3.3% from highs in June.

Next year, the fundamental story in Canada is one of slow recovery as peak tariff uncertainty is behind us. Looser financial conditions and fiscal policy should also provide some tailwinds to growth.

In spite of fundamental tailwinds, the CAD is likely one of the most undervalued currencies in G10. This is because the biggest driver of the currency market is US dollars, and the CAD has not benefited from USD decline this year. Consider the largest beneficiaries of USD depreciation year-to-date have been extremely concentrated in the European currencies (SEK, CHF, NOK, EUR). In fact, if we map USD/CAD against DXY since the GFC (Chart 6), we can see that when DXY is roughly trading at 100, the range of USD/CAD has averaged around 1.3250. The fact that we are still trading above 1.40, a level that is highly abnormal given current DXY at roughly 100, suggests USD/CAD is extremely rich.

Of course, a key reason why the CAD has been an underperformer in recent months stems from tariff uncertainty as the USMCA joint review is scheduled for July 1st 2026. And given that roughly 90% of Canadian goods are USMCA compliant, any threat to nullify this agreement is meaningful. However, the market should know the fate of USMCA by early next year, as Trump will likely present intensions to Congress in January. In our base case view, it would be extremely difficult for Trump to convince Congress to withdraw from USMCA without a close alternative. But because USD/CAD is pricing in an extremely pessimistic outcome

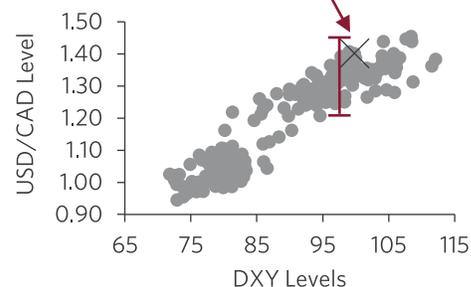
Chart 5: Financial conditions – Major economies



Source: Bloomberg, CIBC Capital Markets.

Chart 6: USD/CAD is trading abnormally high with DXY at 100

With DXY=100, USD/CAD on average is trading at 1.32. 1.40 is unique to the current period



Source: Bloomberg, CIBC Capital Markets.

for USMCA, the big risk is that CAD sees an outsized rally—in the event USMCA risks don't actualize and short positioning accumulated over the course of 2025 will need to course correct.

For these reasons we are calling for a lower USD/CAD, declining gradually to 1.35 by the end of next year.

EUR – Monetary policy in ‘a good place’

We believe the ECB is likely finished its easing cycle, and will enter policy inertia with the depo rate at 2.0%, the midpoint of the ECB's neutral rate range of 1.75% – 2.25%. Inflation expectations, measured by 5y5y inflation swaps (Chart 7), consistently hover around the ECB's 2.0% target and pose little threat. In fact inflation expectations have not been this well anchored in history, reinforcing Lagarde's sentiment that monetary policy remains in a 'good place'. At neutral, the ECB has a greater degree of optionality by taking a wait-and-see approach, which is more important in our view.

The market continues to expect small downside risks to the ECB's policy path, pricing in 10bps of insurance cuts. We believe the risks actually tilt the other way given the impending impact of German fiscal expansion, and accelerated EU defense spending into early 2026. The ReArm Europe plan has resulted in the European Commission relaxing its fiscal rules to permit more borrowing; and most spending is likely to remain within the Eurozone. We believe fiscal tailwinds are underpriced—especially given that the Eurozone economy has suffered from a weak starting point, so 2026 could witness the strongest growth we have seen in four years. If we are correct, the market has room to price out near-term insurance cuts. Further, tightening expectations into 2027 could be pulled forward, providing a tailwind for EUR.

At some point however, fiscal enthusiasm will run out of steam, likely around mid-year. As well, there will be meaningful staffing changes on the ECB's Executive Board into the end of 2027—most notably, Vice President Guindos' term expires May 31, 2026, President Lagarde's term expires October 31, 2027, and Chief Economist Lane's term expires May 31, 2027. The market could place some uncertainty premium late 2026 ahead of these changes which could weigh on EUR in H2.

For these reasons, we are calling for a higher EUR/USD peaking at 1.21 by Q2 end and thereafter falling towards the 1.18 level by 2026 end.

GBP – Relying on the ‘kindness of strangers’

The UK remains reliant on the “kindness of strangers” (Mark Carney, 2015) to fund a current account shortfall that remains around 3% of GDP. But international investors remain highly sensitive to fiscal largesse since the Liz Truss era of 2022. For this reason, the Labour government has been forced to face some difficult decisions surrounding the UK budget this year, and has seen an erosion in public confidence as ratings decline. But while the political fortunes of the Labour government remain precarious, the next election remains years away (2029), leaving the UK in a period of relative political stability.

A possible catalyst that could reignite the Labour governments' political fortunes is a reacceleration in growth, spurred on by lower interest rates next year. As UK inflation has likely peaked, the BOE has been more open to easing interest rates more deliberately, and we think at a faster pace than current market expectations. We believe the BoE will deliver two more consecutive cuts, bringing rates to neutral of 3.50% by February. For reference, the market is only looking for one more cut by that time, with neutral not achieved until at least April.

Chart 7: Inflation expectations have stabilized in the Eurozone around the ECB's target



Source: Bloomberg, CIBC Capital Markets.

While a faster pace of cuts could initially weigh on the sterling, they will likely be offset by insurance cuts getting priced out in later meetings. Current market implied terminal is roughly 3.35% by December 2026, implying 15bps of additional easing after cycle end that likely don't need to be there. The right-sizing of the BoE's easing cycle is one of give-and-take and therefore won't cause major sterling fluctuations.

Instead, the bigger catalyst for cable is growth—and while we are not super optimistic per se, our focus is one of recovery after coming off a relatively low base. Uncertainty around tariffs, the labour market, and high interest rates has weighed on consumer spending this year. Uncertainty over the UK budget has also stymied investment in recent quarters. As a result, prior data cycles have been weak, with the UK economic surprise Index recently plummeting to levels not seen since the start of 2025. The Misery Index has risen again, exceeding levels seen at the start of 2024 (Chart 8).

Into the year ahead, we think the big risk is an economy that could see growth outperform a very low base. This could be spurred on by lower interest rates, or a less turbulent political climate relative to this year. Our target for GBP/USD is one of modest recovery, in part helped by the USD leg, to peak of 1.36 by H1 end, falling back down to 1.34 by year end.

JPY - The boring BoJ

Even before Sanae Takaichi's surprise victory in the October LDP leadership contest, we thought the next BoJ hike (from 0.50% to 0.75%) would likely be the final one for this cycle, given Japan's lower neutral rate (estimated around the 1% range) and the uncertainty from US tariffs. The prime minister—a known devotee of Abenomics—has reiterated this recently, arguing that Japan “has not yet escaped deflation.” The subdued verbal warnings by officials have also surprised us; the Ministry of Finance appears comfortable with yen at 160, but could warn more vocally at 165.

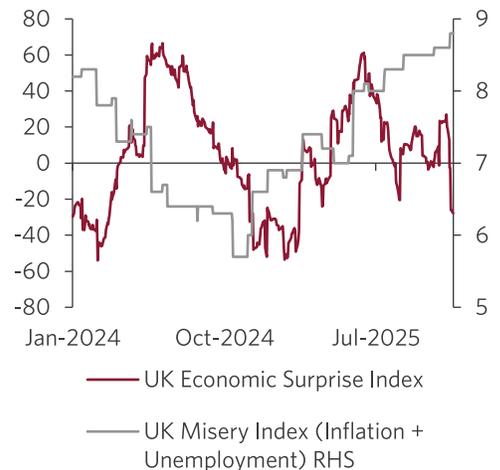
The BoJ will remain cautious into next year. Although markets cheered “low” 15% tariffs announced in July, the levy could still prove problematic if US consumer sentiment continues to weaken—especially if they end up bearing more of the tariff cost (Chart 4). Under a US slowdown, Japanese exporters will be less willing to pay wage increases, leading the BoJ to be more patient. As a result, we think January is the earliest hike window, allowing the BoJ a better read on annual wage talks. But given uncertainty around the US consumer, however, it's possible that this hike from the BoJ is delayed until March or April.

Our base case forecast for USD/JPY is a gradual decline to 150.00 by 2026 end. A stable BoJ outlook means the downside thesis for USD/JPY will therefore need to lean on i) a more dovish than anticipated Fed or ii) yen repatriation amidst global risk-off. We believe the scope of further Fed easing beyond the three cuts currently priced is unlikely—but the risk is that an additional Fed cut (or market belief of such) pushes USD/JPY to our 2026 target of 150 a lot sooner. Yen appreciation from a potential risk off move in equity markets is another potential catalyst.

Summary of DM Views

In light of mature central bank cycles, our base case view is that nothing happens. Risks around tariffs, Fed independence, and IEEPA could cause temporary upticks in volatility that will likely fade quickly. For the greenback, these risks could continue to drag the USD lower into the first half of the year

Chart 8: The UK has been miserable enough this year



Source: Bloomberg, CIBC Capital Markets.

Part 2: EM themes: volatility decay and the rise of carry – at least in H1

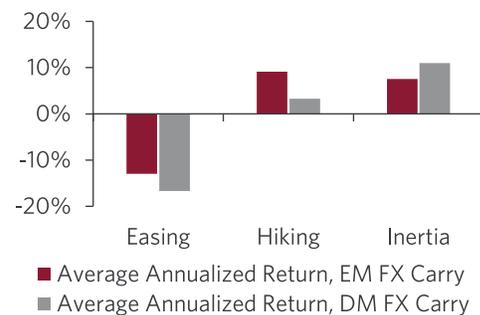
We have already demonstrated that volatility tends to decay as macro cycles fade (Chart 3). A corollary here is that carry tends to outperform as a lack of directional alpha pushes investors to seek yield. In Chart 9, we show average annualized returns of both EM and DM carry averaged across Fed cycles, similar to the volatility chart in Chart 3. Just as volatility decays during Fed inertia, carry tends to outperform as well—the two are closely related.

We note on average, DM FX carry has historically been propped up by USD strength during periods of Fed inertia, especially over the post GFC period where most other developed economies saw negative interest rates. We would caution that this time around, DM FX Carry returns could be stymied by USD weakness. There are also alternatives to USD carry, of which EM carry looks the most attractive. Consider Chart 10 where we chart 3m carry (y axis) against 3m implied volatility, with EM currencies highlighted in yellow. Consider that the curve of best fit (Chart 10, burgundy) is exponentially increasing, suggesting that investors will get more carry per unit of risk out the risk curve (i.e. as volatility rises). This is in part driven by investor risk aversion requiring more return to compensate for each marginal unit of risk. However, in periods where volatility decays, the (mathematical) convexity of this curve is further amplified as realized vols come in lower than market implied. Said simply, **we expect carry to perform and EM carry should deliver significantly better risk adjusted returns relative to DM counterparts.**

This is something that we've already seen in 2025 as popular carry trades in the EM space experienced a significant rally, with LATAM FX leading performance (see Chart 11). Looking ahead to 2026, the key is whether the appeal of high-yielding currencies relative to more boring DM counterparts amid a late-cycle Fed will be sufficient to ignite a self-reinforcing carry cycle. We believe that it is—at least over the first half of the year.

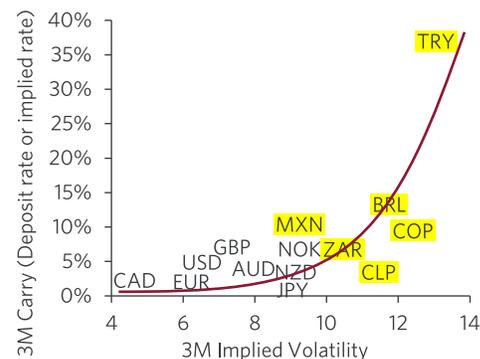
Perhaps the most important driver of carry is total returns (spot returns + interest returns). History shows that the biggest threat to total returns is adverse spot moves caused by carry unwinds—most of which correspond with global shocks (Chart 12). Data for our equally weighted LATAM carry (Long BRL, MXN, COP against the USD) and EMEA carry (Long ZAR + HUF against the USD) baskets show that prolonged periods of gains that have been met by sharp reversals in 2008 (GFC), 2011 (US Credit Rating Downgrade), 2013 (taper tantrum), 2014-15 (commodity super cycle bust), and 2020 (Covid-19 pandemic). Hence, it is not a surprise that geopolitical and tariff risks have inflicted some damage on EM FX at the start of 2025. However, with the market more accustomed to the tariff narrative, global growth just 'muddling along', and DM central banks at or close to inertia, we expect movements in spot to be less pronounced. This supports the performance of high carry currencies into the first half of 2026.

Chart 9: Carry behaves opposite to vols over fed cycles



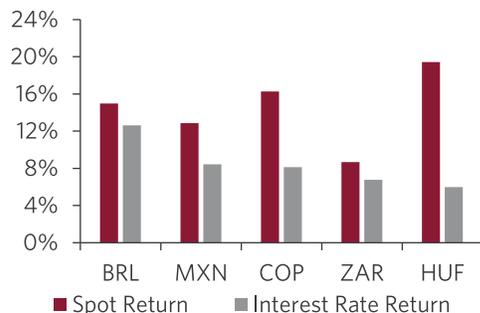
Source: Bloomberg, CIBC Capital Markets.

Chart 10: 3M carry vs 3M implied volatility is convex, EM highlighted in yellow



Source: Bloomberg, CIBC Capital Markets.

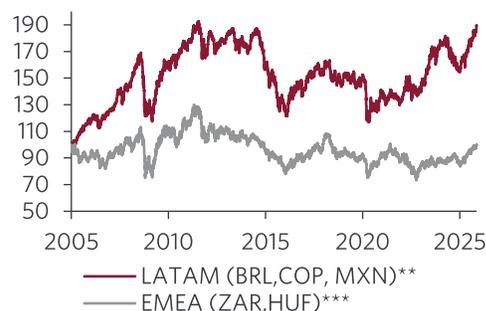
Chart 11: Performance of top 5 EM carry trades so far in 2025*



Source: Bloomberg, CIBC Capital Markets.

* As of November 17th, 2025.

Chart 12: Total returns* - LATAM vs EMEA carry basket



Source: Bloomberg, CIBC Capital Markets.

* Index Jan 3, 2005: 100. Buy and hold strategy.

** Equally weighted BRL, MXN, COP basket.

*** Equally weighted ZAR, HUF basket.

This trend is already evident in the rising carry-to-risk ratio of popular carry trades this year. For example, despite the conclusion of the tightening cycle in Brazil and Banxico's ongoing easing cycle, the volatility-adjusted carry for both the MXN and BRL has steadily increased since early April (see Chart 13). The primary driver of this trend has been the notable decline in volatility since early Q2 2025. Extrapolating, a further decline in volatility will continue to amplify the attractiveness of carry.

Moreover, despite the negative performance of the LATAM carry trade (long MXN, BRL, COP) during previous Fed easing cycles (see Chart 14), LATAM FX has outperformed in the current cycle. Remember the current easing cycle is different: this one is slow and gradual—a return-to-normal as global inflation normalizes. It lacks the urgency of cuts required in 2008 or 2020 for example. The uniqueness of the current easing cycle has limited the space for EM central banks to increase the pace of rate cuts: labour markets remain relatively tight and growth forecasts for this year have so far exceeded expectations.

BRL - the BRL keeps the upper hand into early 2026

With this mind, we favour the BRL among the most popular carry trades into H1 2026. We highlight that the BCB maintained its cautious message, keeping the Selic rate at 15% in November. All in, unanchored inflation expectations and solid labour market data will force the BCB to maintain a cautious approach, and implement a very gradual pace of rate cuts in 2026 (Chart 15). We expect the Selic rate reaching 12.50% by the end of next year—a view shared by current market pricing and the latest BCB survey.

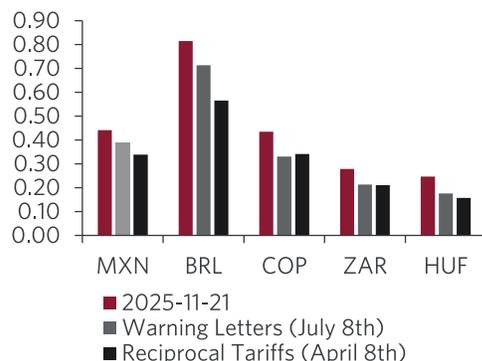
On the trade front, recent high-level meetings between US/Brazil have been positive, including a possible reduction of tariffs on Brazilian exports to the US. Moreover, despite some setbacks in Brazil's Congress in October, government efforts to reduce expenses and increase revenue in recent weeks should help reduce fiscal concerns into early 2026. Thus, we would not rule USD/BRL to briefly test the 5.00 mark before electoral uncertainty and fiscal/monetary risks become more prominent into the latter part of H1 2026.

COP - Selling USD/COP rallies for now...

Looking at Colombia, three of the four members who voted to keep rates on hold have already explicitly mentioned the possibility of increasing rates in the near term—a stance likely to support the COP into early 2026. However, we highlight that among the remaining three board members, two voted for a 50bps cut and one for a 25bps cut at the end of October, implying the next few decisions will be a coin toss. The government's decision on the 2026 minimum wage increase (currently expected at around 10-11%) will be the most important piece of the puzzle for Banrep's monetary policy path into 2026.

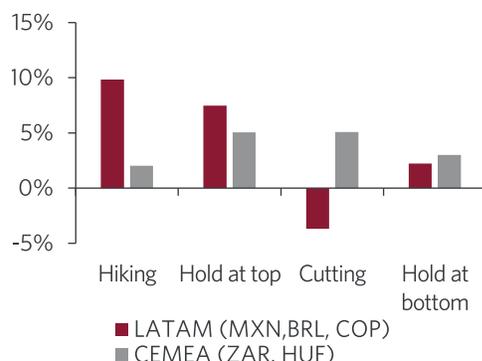
Although the central bank's current cautious stance is justified given the upside surprises to inflation, market pricing of more than 100 bps in rate hikes for next year suggests that USD/COP could face significant upward pressure in Q1 2026, particularly if Banrep does not initiate a hiking cycle in the near term. This risk is further heightened as support for Colombian assets from the government's debt management operations wanes and the presidential election race intensifies, leading to increased volatility. Until then, we expect spikes in USD/COP to continue to be sold, but we caution against chasing the pair below 3,700.

Chart 13: 3M Vol-adjusted carry



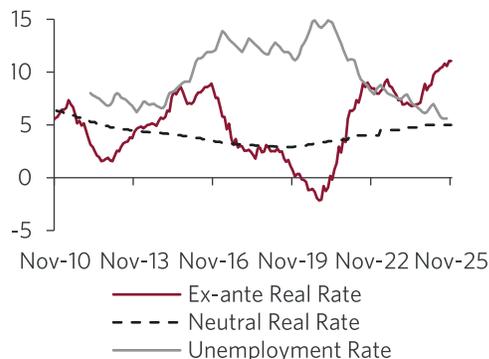
Source: Bloomberg, CIBC Capital Markets.

Chart 14: Annualized average total carry returns during the fed's monetary policy cycles since 2000



Source: Bloomberg, CIBC Capital Markets.

Chart 15: Unemployment rate hits new all-time low despite restrictive selic rate



Source: BCB, CIBC Capital Markets.

Table 2: Market implied rates vs CIBC forecasts and latest CB survey

	Mexico	Brazil	Colombia	Chile
1Y Reference Rate Priced in (%)*	6.98	12.42	10.51	4.28
Central Bank Survey	6.5	12.25	8.95	4.25
CIBC 1Y Reference Rate Forecast (%)	6.5	12.5	8.25	4.25
Potential for Dovish Surprises in 2026	Medium	Low	High	Low

Source: BCB, Banxico, Banrep, BCCh, Bloomberg, CIBC Capital Markets.

*End of Day November 7th.

MXN – Volatility decay is the MXN’s main ally...

Banxico latest rate decision suggested easing will continue but that pauses are likely in 2026. The subtle change in the Bank’s forward guidance has put market pricing of the terminal rate at 7.0%, providing some support to the MXN into the last CB meeting of 2025. That being said, should Banxico’s forecasts materialize and inflation reaches 3.0% by Q3 2026, the overnight rate could stand at 6.5% (vs market pricing ~ 7.0%) and still be near the upper end of the central bank’s real rate estimate (1.8%-3.6%), which aligns with our terminal rate forecast.

Moreover, it is worth noting that most board members are not concerned about the narrowing Banxico-Fed rate differential as it approaches the 2008–2025 low. This view is supported by the appreciation of the MXN during the current easing cycle.

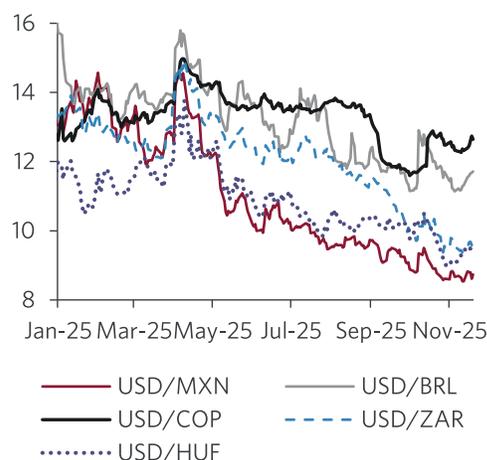
Thus, we underscore that the MXN strength will be dictated by the overall trend in USD/MXN vols into 2026. A smooth start of the 2026 USMCA review, and no significant surprises on the Fed’s 2026 easing cycle should be able to limit the impact from any dovish surprises from Banxico next year. We recognize this is a fragile equilibrium with speculative long MXN positions already approaching overbought territory. Nevertheless, we see USD/MXN topside at 19.20 throughout all of next 2026, at which point we expect sellers to pile up aggressively on the advantages provided by Mexico, such as its investments and the export sector given its proximity to the US.

Idiosyncratic risk of popular carry trades will increase in H2 2026

Heading into the second half of 2026, the top two carry trades of 2025—BRL and COP—are expected to encounter idiosyncratic risks. In Brazil, as is typical during the election cycle (general elections October 4th), fiscal and political developments are likely to drive upside momentum in USD/BRL. While presidential candidates have yet to be officially announced, early polls show leftist President Lula holding a slight lead over conservative contenders. As a result, markets will closely monitor populist promises, with particular attention to the next government’s ability to meet fiscal targets and ensure debt sustainability.

In Colombia, recent liability management operations have temporarily improved the outlook for Colombia’s USD and COP debt curves, especially regarding debt costs for 2026. However, these benefits are likely to be short-lived. Concerns persist about the credibility of the government’s fiscal guidance for 2026, particularly as the congressional election on March 8 and the presidential election draw near. Notably, Colombia’s Autonomous Fiscal Rule Committee estimates that an adjustment of over 2.0% of GDP will be required next year to achieve the nominal deficit target of 6.1% of GDP.

Chart 16: USD/EM FX 3M ATM vols



Source: Bloomberg, CIBC Capital Markets.

Note that demand for high-strike dollar calls in both the Mexican peso and Brazilian (Chart 17) real stands in contrast to the ongoing decline in implied volatility as seen in Chart 16. In the Andean currencies, the situation is reversed: upcoming presidential elections have increased overall volatility but compressed skews, as traders hedge directionally rather than for tail risk. That being said, market complacency toward fiscal and political risks in Colombia is striking—the 1Y Z-score for the 6M 25D risk reversal is at -0.94, significantly below the 0.23 observed for USD/MXN and 2.01 for USD/BRL. This stance is particularly concerning given that substantial USD inflows related to government debt management operations are expected to dissipate in early 2026.

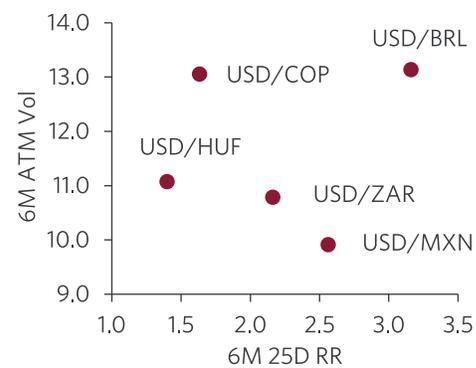
For this reason, we suspect investors will keep carry baskets diversified to dampen country-specific risks. This limits the extent that we can see a carry windfall in most majors—the nature of carry this time around suggests that carry unwinds will be more benign as opposed to spilling over to the rest of the currency bloc (unlike for example, the USD/JPY carry unwind seen in summer of 2024). We also see space for plays among carry FX crosses, leveraging the difference in the materialization (timing wise) of local risks. For instance, we prefer to reflect our view of significant fiscal, monetary, and political risks in Colombia towards the end of Q1 2025 via long BRL/COP positions.

CLP - Improving local fundamentals should unlock further CLP strength despite lack of carry advantage

Alternatively, while not a widely favored option among EM currencies, we view the Chilean peso (CLP) as an attractive choice for investors concerned about the idiosyncratic risks associated with more conventional carry trades. This outlook is supported by the anticipated dissipation of uncertainty following the Chilean Presidential elections in late 2025 and limited scope for dovish surprises from the BCCh next year (Chart 18). We highlight that with the overnight rate currently at 4.75%, the central bank has reiterated that the environment “still poses risks for the future trajectory of inflation,” maintaining a data-dependent approach as it continues its convergence toward neutral. We expect two additional 25bps rate cuts, bringing the terminal rate to 4.25%. Furthermore, the likely victory of market-friendly Jose Antonio Kast, a conservative majority in congress, and Chile’s effective tariff rate below 10% enhance the appeal of the CLP. We do not rule out the possibility of USD/CLP returning to the 880–900 range next year.

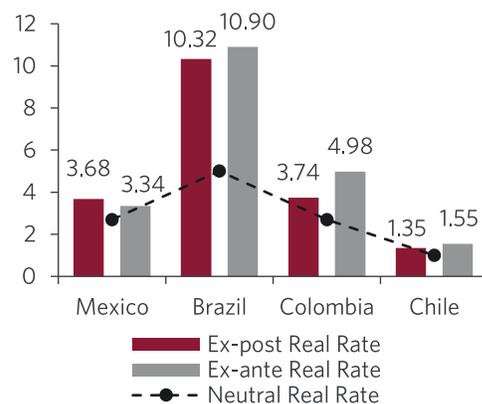
In summary, we believe the EM carry trade will have legs into the coming quarters of 2026. But by midyear next year, investors will need to be more cautious of idiosyncratic risks, especially in Brazil and Colombia. We recommend holding a diversified carry basket to partially mitigate against these country-specific risks, with the CLP a carry underdog into late 2026.

Chart 17: 6M 25D risk reversals vs 6M ATM vols



Source: Bloomberg, CIBC Capital Markets.

Chart 18: Ex-ante and ex-post real rates - limited room for dovish BCCh surprises



Source: Banxico, BCB, Banrep, BCCh, CIBC Capital Markets.

Part 3: Asia themes: the big risks into 2026 - tariffs, China, AI

We believe that the Asian currencies will be the most vulnerable to the 'big' risks next year, especially China given that trade negotiations with the US remain ongoing. And if the AI trade weakens, we prefer to be short AUD or CNH against JPY, with CNH/JPY the cheaper and more preferred option.

CNH - China's trade decoupling and AI correlation

The October Trump-Xi summit removed short-term risks, but did little to resolve longstanding issues. The state of US-China relations now is similar to that of the summer—stable but uneasy. Even though Trump lowered fentanyl-related tariffs on China by 10%, the current weighted-average US tariff on Chinese goods is still high at 47%. Beijing has temporarily suspended its rare earth export controls, but will maintain the threat of this as leverage in future talks.

That means that US companies will continue rotating supply chains away from China, a process which has been underway for years. Even before the Trump 2.0 tariffs, America's AI import surge skipped China in 2023-24. Chart 19 shows that US Imports from China peaked in early 2022, and have stagnated since, plummeting further in 2025. Meanwhile, China's 12-month rolling exports to other regions have grown strongly in 2025, and America now accounts for just 12% of China's exports.

All of these defensive measures by China to decouple from US trade has an insulating effect on the yuan. The chaos of Liberation Day saw USD/CNH swing modestly higher by 2.6% (from 7.25 to 7.43)—smaller than the 4% USD/CNH jump during the August 2019 tariff volley. Despite Trump's early October threats of 100% tariffs on China, USD/CNH spent that month within narrow ranges of 7.09-7.15 (less than 1%). We think there is decent chance that Trump escalates tariffs on China again in March. If the president feels emboldened by the stock market / US sentiment, the March timing is ideal because it is after US soy harvest has shipped, and he could use leverage to claims some "wins" during his planned April visit to Beijing. In that scenario, we expect brief yuan weakness (to 7.15).

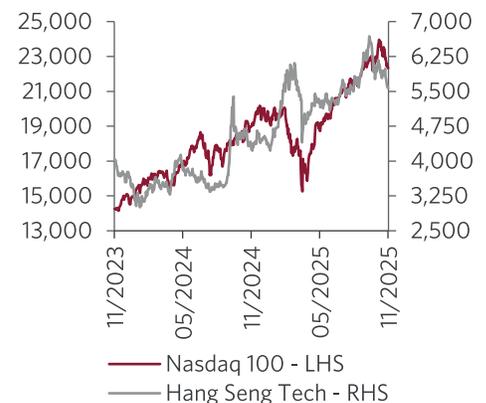
For China, a potential weakness is whether Trump's actions (or weak US data) causes global investors to further doubt the global AI rally. Amidst China's ongoing property slowdown, Beijing has embraced AI and tech investment as a way to prop up GDP. That has resulted in less monetary easing—and helped to stabilize the yuan. Inflows into Chinese AI stocks has also supported CNH. We expect slight CNH strength to 7.10 by mid year, and then slight weakness to 7.14 by December amid a H2 USD rebound. Note because the currency is also at risk of a global AI unwind (making the yuan a low-carry "insurance trade" funder), the yuan is still linked to US markets even in spite of tariff risk.

AUD - External beta (for a cost)

The RBA has plenty of reasons to "wait and see" how external uncertainties play out, given Australia's exposure to external demand. For now, however, any concern about a US / global slowdown are not enough to shift the RBA more dovish. The RBA remains primarily focused on quarterly CPI, which remains high. The November RBA emphasized data dependence, Governor Bullock noted that the RBA "doesn't have any bias [whatsoever]." She did, however, acknowledge that the current cash rate of 3.60% is "near-neutral."

The effective change in bias has led us to push back our view for the next RBA cut from February 2026 to August 2026. By then, trimmed mean CPI (for Q2 2026) will still likely be above the 2-3% target, but the RBA will also have a better reading on inflation momentum and labour market slack.

Chart 19: Chinese tech companies keep up with US counterparts



Source: Bloomberg, CIBC Capital Markets.

As with the BoJ, the wildcard is how global markets navigate the slowdown in US hiring. The spillover from a US tech correction into China (via AI valuations for Chinese companies) is a dovish risk for the RBA. A stock market hit to Chinese wealth effects / consumption would hurt demand for Australian exports.

In the event of only gradual US equity weakness, AUD/USD should be stable around 0.64-0.65. For downside equity risks, we think 0.62 provides a reasonable “floor.” Unlike positioning before the August 2024 crash in AUD/JPY (when the RBA still emphasized hike risks), long AUD is now less crowded. Job gains have slowed since 2024 (see Chart 20), and the RBA has already shown a willingness to cut. The AUD leg will still provide additional beta for yen crosses, but we think CNH is a cheaper alternative with only slightly less beta. Furthermore, the CNH/JPY cross rate is near its August 2024 high (unlike AUD/JPY).

JPY – Go long as an insurance play against key 2026 risks

Our fundamental story advocates for a gentle decline in USD/JPY over the course of next year (see DM themes on [page 32](#)). However, risk dynamics could reaccelerate this trajectory if stocks sell off, a possibility that CIBC Equity Strategy has warned about in H2 2026. Because Japanese retail investors are overweight US stocks, we think there is more scope for a yen rebound if tech sentiment weakens. For example, during the August 2024 selloff in the Magnificent Seven, AUD/JPY fell by 14% in a month (Chart 21). Since then, AUD/JPY has not revisited the July 2024 highs, pointing to flatter AUD positioning. Stable AUD/USD and USD/CNH means AUD/JPY and CNH/JPY are effectively USD/JPY proxies. We prefer short CNH/JPY as an “insurance trade,” given lower CNH funding costs.

Closing remarks

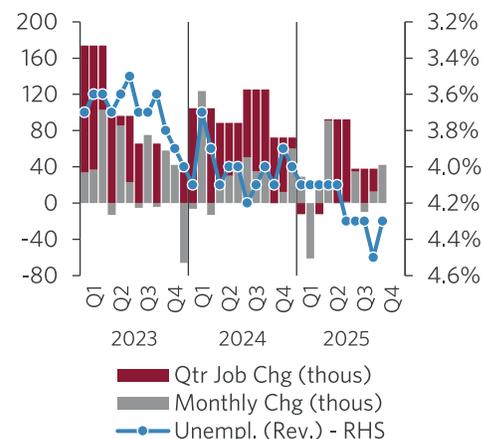
In our base case view, ‘nothing happens’ next year. Central bank cycles are mature, volatility decays, and all these isolated/un-priceable risks (USMCA, IEEPA, Cook, tariffs, AI, US midterms, etc.) are not strong enough to draw trend in G10. In this state of the world, carry outperforms and we suspect diversified carry baskets will be well loved. The risk of course, is if we are wrong about the risks—and that they are more material than we believe them to be. Even in this case, most risks will not be persistent. But for investors who disagree, short CNH/JPY is our preferred insurance trade.

Table 3: Global Central Bank Forecasts

Central Bank	Current	Q4/25	Q1/26	Q2/26	Q3/26	Q4/26
Fed	3.88	3.88	3.63	3.38	3.38	3.38
BoC	2.25	2.25	2.25	2.25	2.25	2.25
ECB	2.00	2.00	2.00	2.00	2.00	2.00
BoE	4.00	3.75	3.50	3.50	3.50	3.50
SNB	0.00	0.00	0.00	0.00	0.00	0.00
BoJ	0.50	0.50	0.75	0.75	0.75	0.75
RBA	3.60	3.60	3.60	3.60	3.35	3.35
RBNZ	2.50	2.25	2.00	2.00	2.00	2.00
Banxico	7.25	7.00	6.75	6.50	6.50	6.50
BCB	15.00	14.75	14.25	13.50	12.75	12.50
BCCh	4.75	4.75	4.50	4.25	4.25	4.25
Banrep	9.25	9.25	9.75	9.75	9.75	9.75

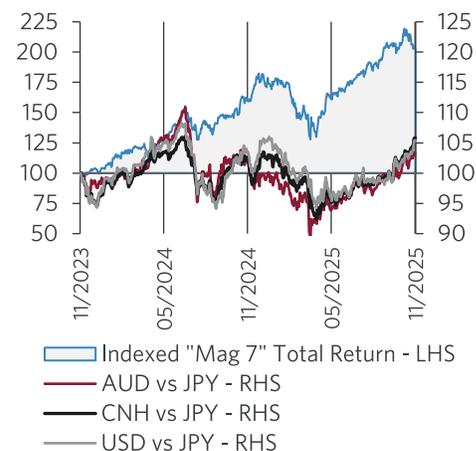
Source: Bloomberg, CIBC Capital Markets.

Chart 20: The Australian labour market is enough to keep the RBA patient



Source: Australian Bureau of Statistics, CIBC Capital Markets.

Chart 21: AUD/JPY, CNH/JPY correlated enough to the tech trade to act as a hedge to equity downside



Source: Bloomberg, CIBC Capital Markets.

Table 4: Global FX Forecasts

End of period:	November 21, 2025	Q4 '25	Q1 '26	Q2 '26	Q3 '26	Q4 '26
USD / CAD	1.41	1.38	1.38	1.37	1.36	1.35
EUR / USD	1.15	1.18	1.20	1.21	1.20	1.18
USD / JPY	157	160	157	155	152	150
GBP / USD	1.31	1.32	1.34	1.36	1.36	1.34
USD / CHF	0.81	0.79	0.78	0.78	0.79	0.81
USD / SEK	9.54	9.19	8.88	8.72	8.71	8.77
AUD / USD	0.65	0.65	0.64	0.64	0.64	0.64
NZD / USD	0.56	0.56	0.55	0.54	0.53	0.53
USD / NOK	10.22	9.83	9.58	9.46	9.42	9.49
USD / ZAR	17.30	16.95	16.85	16.70	16.50	16.35
USD / BRL	5.39	5.20	5.40	5.80	6.10	5.80
USD / MXN	18.46	18.85	19.00	19.20	19.20	18.80
USD / COP	3801	3800	4150	4350	4350	4100
USD / CLP	940	910	910	900	900	900
USD / CNH	7.11	7.12	7.15	7.10	7.12	7.14
CAD / JPY	111	116	114	113	112	111
CAD / CHF	0.57	0.57	0.57	0.57	0.58	0.60
AUD / CAD	0.91	0.90	0.88	0.88	0.87	0.86
GBP / CAD	1.85	1.82	1.85	1.86	1.85	1.81
EUR / CAD	1.63	1.63	1.66	1.66	1.63	1.59
NZD / CAD	0.79	0.77	0.76	0.74	0.72	0.72
CAD / SEK	6.76	6.66	6.43	6.36	6.40	6.50
EUR / JPY	181	189	188	188	182.40	177
EUR / GBP	0.88	0.89	0.90	0.89	0.88	0.88
EUR / CHF	0.93	0.93	0.94	0.94	0.95	0.96
EUR / SEK	11.00	10.84	10.66	10.55	10.45	10.35
EUR / NOK	11.79	11.60	11.50	11.45	11.30	11.20

Source: Bloomberg, CIBC Capital Markets.

Credit Outlook: What comes down must go up (eventually)

Vincent Zheng and Angela Jiang

To say that we were spot on a year ago with our view that “[CAD IG] index spreads [would be] trading in a relatively narrow range of 90-120 bps over the next 12 months” would almost be an understatement; the range turned out to be 85-123 bps (see Chart 1). Indeed, as our base case forecast suggested, “slow but steady growth and minimal inflation concerns [would] provide a glide path for central banks to get back to neutral and keep credit spreads well contained at tight levels.”

But to rest on our laurels would ignore the elephant in the room – the fact that we changed our view in April following Liberation Day to an expectation for “credit spreads to grind wider in lock-step with equity weakness as markets price in increased risk premia on recession or stagflation fears.” Mea culpa.

We could explain our missed call in April as the product of Liberation Day turning into TACO, but that would be facetious and reductive. The reality is that the US overall effective tariff rate is at levels last seen in the 1930s; however, its impact on the US economy has not been as quick nor as pronounced as expected; indeed, Polymarket pricing for a US recession in 2025 peaked at 65% in April but US growth remained resilient and inflation expectations well anchored.

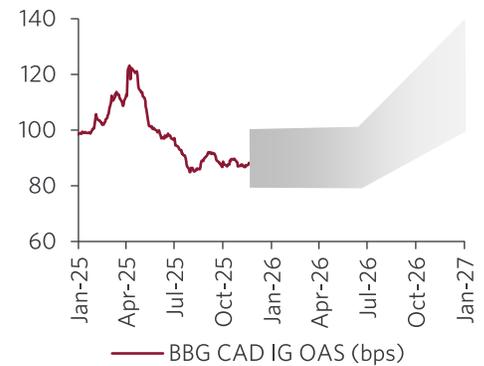
Besides the tariff uncertainty that buffeted markets this year, risk markets also largely brushed aside concerns about the erosion of Fed independence, an armed conflict flare up in the Middle East, and a US federal government shutdown. CAD IG index spreads in particular averaged 89 bps in H2/25 despite record corporate issuance.

Given our expectation that the macro backdrop will remain benign through the next 12 months, i.e., we will not see recession nor stagflation scenarios play out in the US, **we believe CAD IG spreads will continue to trade in a narrow and tight 80-100 bp range through the first half of 2026.** Our view is premised on a) a credit cycle that was effectively stuck in neutral for a few years and is just now exiting the middle innings whereby fundamentals are yet to be stretched, and b) idiosyncratic technical factors that will allow for continued strong corporate issuance without putting undue pressure on spreads.

That said, **we see the seeds for an eventual spread widening regime being sown through 2026 that will result in CAD IG spreads drifting wider in H2/26.** Overwhelming issuance will be the primary driver, in our view, whether it be to a) pre-fund a heavy 2027 maturity schedule, b) provide cash for M&A and share buybacks as we move firmly into the late innings of the credit cycle, and c) fund outsized capital spending in AI infrastructure. We also flag inaugural and returning issuance as likely significant wild cards in a tight credit spread environment.

Given this tale of two halves, **we recommend Canadian credit investors position for defensive carry heading into 2026—overweighting shorter-dated corporate hybrids, LRCN, and NVCC, as well as 7- to 10-year BBBs, and underweighting long BBBs.** As the year progresses, we believe CAD credit positioning should transition to playing defense—overweighting A-rated/lower beta sectors, and underweighting credit duration.

Chart 1: We expect CAD IG spreads to trade in a narrow and tight range through H1/26, then drift wider in H2/26



Source: Bloomberg, CIBC Capital Markets.

Foreseeable risks to our outlook include a) an unmooring of current inflation expectations that would pull credit back into the orbit of macro and central bank policy uncertainty, b) a greater than expected deceleration in Canada's economy as the stimulus from major capital initiatives take longer to flow through, and c) outsized inflows into fixed income from money market funds as investors search for more yield out the curve.

CAD IG spreads will stay rangebound at tight levels through H1/26

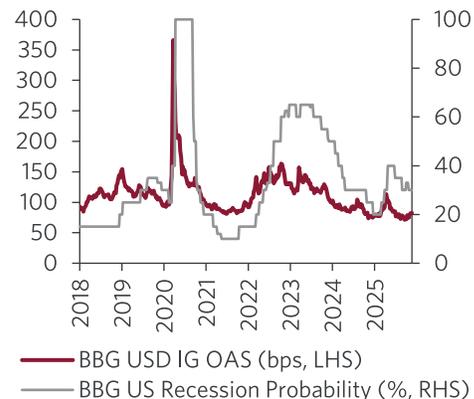
As shown in Chart 2, credit spreads have historically acted as a leading macroeconomic indicator; e.g., in 2020, spreads quickly retraced from COVID-induced wides, foretelling a short recession, and in 2022, spreads pre-emptively widened ahead of the Fed tightening cycle and peaked months before US recession probability forecasts. That credit spreads widened in lockstep with US recession probability forecasts in the period following Liberation day points to how uncertain markets were in pricing in tariff impacts. We believe credit spreads have since regained their leading indicator status as the fog of tariff uncertainty lifted and augur a benign macro environment heading into 2026.

A first in a generation rate hiking cycle caused a significant rise in the cost of capital and effectively left the credit cycle stuck in neutral from 2022 to 2024. This was followed by a tumultuous first half of 2025 as corporates navigated significant tariff uncertainty. As such, we believe the credit cycle is just now exiting the middle innings whereby fundamentals are yet to be stretched.

Within the Canadian D-SIBs, excess common equity tier 1 (CET1) capital vs the regulatory minimum have certainly come off from elevated pandemic levels, but we have seen banks prudentially increase capital buffers over the past four quarters in preparation for the mortgage renewal cliff. As renewals started to roll through 2025, write-offs in loans only increased slightly compared to what the banks reserved for in loan loss allowances (see Chart 3), reflecting strong underwriting quality, thereby leaving the banks well positioned going into 2026.

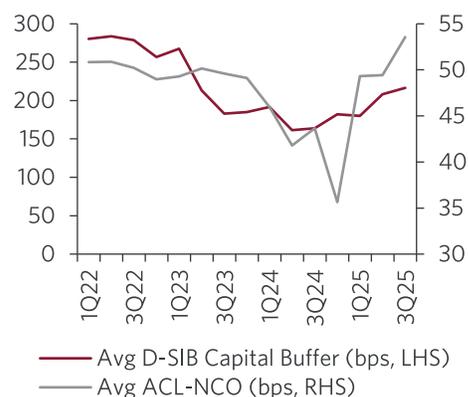
For non-financial corporates, Chart 4 shows aggregate debt/EBITDA for representative Canadian BBB-rated companies¹ only slightly higher compared to 2018 levels, thanks to deleveraging efforts in the past two years from pipelines/midstream and telcos/cablecos. Meanwhile, average capital intensity has come down meaningfully over the past few years as pipelines saw limited opportunities to expand egress and telcos/cablecos moved past peak 5G/fibre build-out capex. As macro uncertainty and rate volatility fade, we expect companies to increasingly prioritize shareholder returns—via share buybacks and accretive inorganic growth—over balance sheet preservation. That said, we believe the transition to the later innings of the credit cycle will be measured in quarters, not months.

Chart 2: Credit spreads have historically acted as a leading indicator for macro conditions and are indicating a benign environment going into 2026



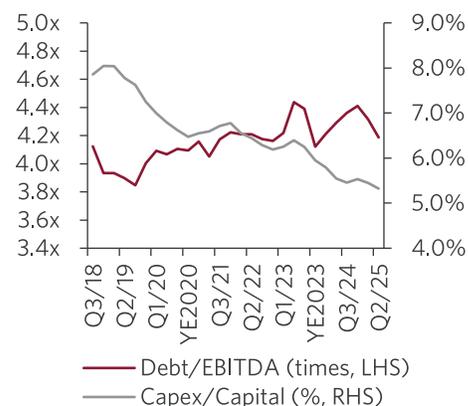
Source: Bloomberg, CIBC Capital Markets.

Chart 3: Average D-SIB capital buffers have trended up over the past four quarters, while banks have built additional loan loss allowances (ACL) despite benign net charge-offs (NCO).



Source: Company reports, CIBC Capital Markets.

Chart 4: Benchmark BBB corporate leverage improved over the past two years, while capital intensity declined substantially



Source: S&P Capital IQ, CIBC Capital Markets.

¹ Representative BBB companies include: AltaGas Ltd., Enbridge Inc., Inter Pipeline Ltd., Keyera Corp., Pembina Pipeline Corp., TC Energy Corp., Dollarama Inc., Loblaw Companies Ltd., Metro Inc., BCE Inc., Rogers Communications Inc., and Telus Corp.

Fundamentals aside, the CAD IG market will continue to benefit from supportive technicals as next-twelve-month (NTM) corporate index deletions will largely outpace maturities (see Chart 5) through H1/26. As bonds roll out of the index, credit investors typically exit these positions, leaving <1-year bonds to be inherited by money-market funds and thereby creating dry powder to be reinvested. Maturities, on the other hand, signal refinancing-driven issuance needs. The meaningful difference between these demand and supply impulses for CAD corporate bonds should continue to support strong positive net issuance as seen through H2/25. Furthermore, the rise in coupons and bonds outstanding over the past few years has resulted in a significant increase in coupon payments to be reinvested, from ~\$18B in 2021 to ~\$27B in 2025.

Overwhelming issuance will drive CAD IG spreads wider in H2/26

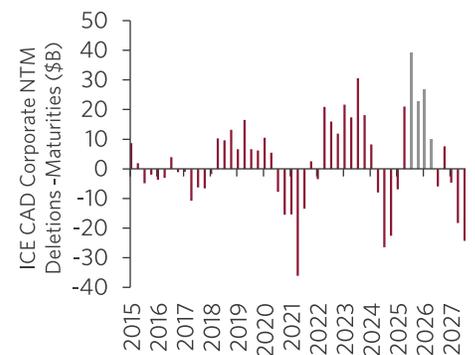
We believe the seeds for an eventual spread widening regime will be sown through 2026 and will result in CAD IG spreads drifting wider in H2/26. Note that the aforementioned technical tailwind that should support spreads in H1/26 will turn into a headwind in H2/26, as corporate maturities begin to outpace corporate index deletions (see Chart 5). Moreover, contrary to the previous instance this occurred in mid-2024, we do not expect markets to be supported by central banks engaged in an easing cycle.

As the saying goes, the cure for tight spreads are tight spreads. The transmission mechanism for spread widening typically involves increased corporate supply and leverage, most notably from inaugural issuers, returning issuers (which we define as companies that last issued more than five years ago), and M&A related funding. Historically, these cohorts act as leading indicators of risk appetite with a notable inverse correlation to CAD IG spreads; when spreads are wide, first-time/returning issuers step back and when spreads tighten, they crowd into open primary windows (see Chart 6). In 2025, we saw MassMutual Global Funding, Definity Financial and BPC Generation Infrastructure Trust, amongst others, print first-time CAD deals. Among returning issuers, we flag Crédit Agricole and Glencore Finance Canada. Meanwhile, Gildan, Keyera, and Cenovus Energy were notable CAD debt issuers to fund M&A.

We believe the most recent trend started in H2/24 as corporates became more acclimated to the higher rate environment, paused in H1/25 due to elevated macro uncertainty, and returned with gusto in H2/25. We expect 2026 to be an acceleration of the theme and a clear signal of a shift from issuers toward greater growth and shareholder return focus and away from balance sheet preservation.

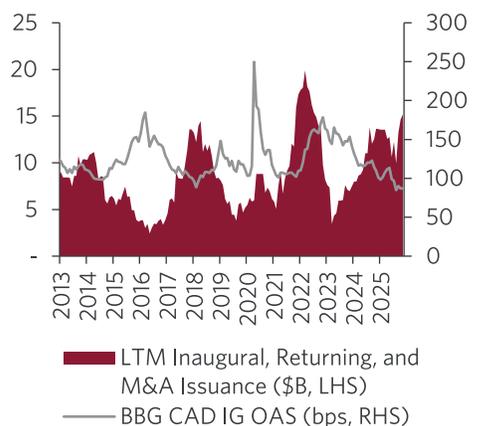
Last but not least, the AI buildout had a meaningful impact on US debt markets in 2025, with issuance tied to AI-focused companies up over 3.5x y/y by our estimates, comprising \$165B across 107 deals year to date (see Chart 7). Hyperscalers are signaling that 2026 won't slow down either with Microsoft expecting 2026 capex growth to exceed 2025's 58%, Meta pointing to notably larger dollar spend (implying >40% growth), and Alphabet and Amazon also flagging further increases; CreditSights forecasts capex from the top 5 hyperscalers to be over \$600B in 2026, up from ~\$440B in 2025 and ~\$250B in 2024. While Alphabet, Microsoft, Amazon and Meta generate significant cash flows from their base operations, it is worth noting that a growing proportion of hyperscaler capex is being directed towards short-lived assets (e.g., GPUs and CPUs) with yet uncertain returns. Oracle's negative ratings outlook highlights leverage risk when capex spend outruns operating cash flows. We expect AI-related debt issuance to produce another step-change increase in 2026, which could further pressure US credit spreads; we also see the potential for hyperscalers to tap CAD debt markets to help satisfy their funding needs.

Chart 5: Next-twelve-month index deletions will outpace maturities through H1/26, providing technical support for CAD IG credit spreads, but will reverse in H2/26 heading into 2027



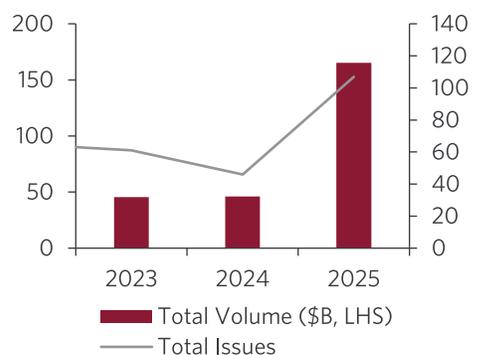
Source: ICE, CIBC Capital Markets.

Chart 6: We expect inaugural and returning issuers, as well as companies funding M&A, to drive an acceleration of net issuance in 2026



Source: Bloomberg, CIBC Capital Markets.

Chart 7: Issuance tied to AI-focused companies grew 3.5x y/y in 2025 and is expected to produce another step-change in 2026



Source: Bloomberg, CIBC Capital Markets.

Let's talk about - CAD corporate long bonds

The defining feature of the CAD corporate long bond market in the past few years has been structural scarcity; from 2012 through 2021, 12+ year paper represented ~10% of all CAD IG issuance, since 2022 that figure has fallen to ~7% (and below 6% if we exclude the one-off issuance from Coastal GasLink). Issuers have proven highly sensitive to absolute coupon levels and, more recently, steeper all-in coupon curves, and are favoring shorter tenors (see Chart 8). As a result, the corporate share of total CAD long bonds has slipped to 17.0% from a 21.9% peak in 2020. Restoring a long-term average share of ~20% would require more than \$20B of incremental corporate long bond issuance. With fiscal vulnerabilities and debt sustainability concerns pointing to rates remaining higher for longer through 2026, this supply scarcity looks persistent.

Moreover, when underlying rates are elevated, the corporate mid-to-longs credit curve tends to flatten in a generic spread widening regime, which points to the resilience of long spreads to a modest spread widening (see Chart 9). As such, when combined with expected supply scarcity, we remain constructive CAD corporate long spreads through the first half of 2026. However, there are practical limits to how much curve flattening can protect long carry; once widening extends, which we forecast to begin in H2/26, the cushion erodes and long-dated spread exposure becomes more vulnerable.

Quality selection is also relevant in this backdrop. The BBB - A long spread basis is at its tightest since 2010, and BBB long spreads display consistent beta to A-rated longs. With the quality differential compressed, incremental BBB carry offers limited breakeven protection if spreads drift wider, tilting the balance toward upgrading to A-rated (or better) exposure in 2026 (see Chart 10).

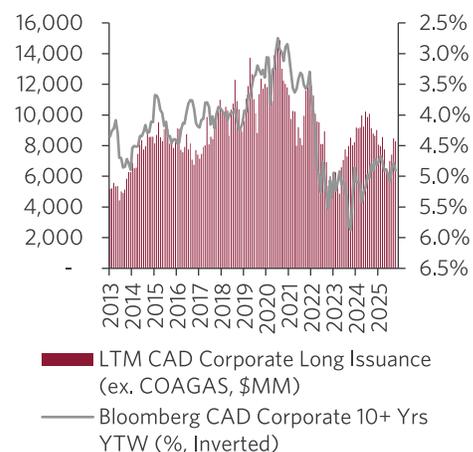
Let's talk about - D-SIB LRCNs

The inaugural batch of Canadian D-SIB LRCNs (i.e., 2080s) have all been redeemed as expected, with the majority of refinancing done in the US LRCNs callable in 2026 (i.e., 2081s), however, face a much higher probability of extension given their lower reset spreads.

We like LRCNs for their attractive yield carry and limited supply risk, and prefer shorter-dated workouts with higher back-ends that offer better breakeven protection against a potentially weaker spread environment in H2/26. Specifically, we like the 2082s coming up for call in 2027; the cohort has an average reset spread of 408 bps and offers low-4% yield-to-call for 1.5-2.0 year risk. Looking forward, we see limited LRCN supply in the domestic market as swapped-equivalent spread levels will likely continue to drive new issues south of the border.

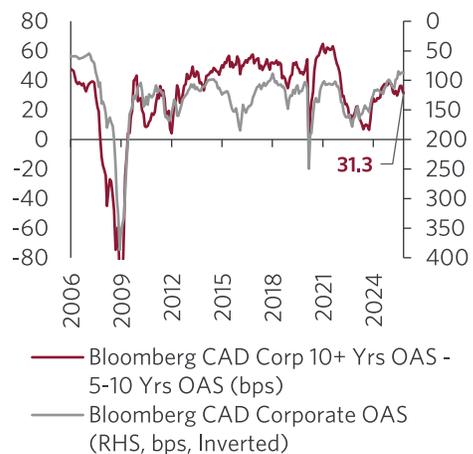
That said, we also believe low-reset LRCNs (2081s), although more prone to volatility, do present an interesting opportunity as their extension risk is currently fully priced in. With the Canadian D-SIBs averaging 200bps+ of excess CET1 buffer, we wouldn't rule out the possibility that the banks could potentially retire these securities without having to refinance them. On a yield-to-maturity basis, these low-reset LRCNs offer excess returns compared to the dividend yields of D-SIB common equity even after adjusting for the beneficial tax treatments on receiving dividend income.

Chart 8: CAD corporate long supply has largely tracked corporate long bond yields



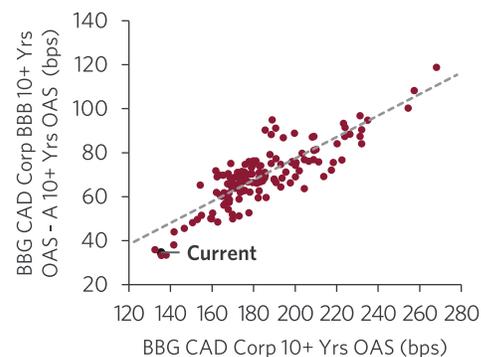
Source: Bloomberg, CIBC Capital Markets.

Chart 9: CAD corporate spread curves (mids to longs) have historically flattened in spread widening regimes



Source: Bloomberg, CIBC Capital Markets.

Chart 10: BBB CAD corporate long spreads provide insufficient excess carry in a spread widening regime (2010 to present)



Source: Bloomberg, CIBC Capital Markets.

Sector/quality/curve recommendations

Our sector/quality/curve recommendations, as shown in Table 1, reflect our view that CAD credit investors should carefully pick their spots to harvest spread carry going into 2026. We recommend expressing a generically overweight credit position primarily through the front end and via NVCC sub-debt, LRCNs and corporate hybrids. In the long end, we have a preference for lower beta sectors, in particular infrastructure. Finally, we see the 7- to 10-year area as best suited for BBB-rated exposure, but would tilt towards higher-quality BBB issuers.

Table 1: Our sector/quality/curve recommendations are driven by where we see the best risk-adjusted spread carry

Sector	Fundamentals	Event Risk	CAD Issuance	Recommendation		
				1Y to 5Y	5Y to 10Y	10Y+
Banks						
Bail-in	Neutral	Medium	Medium	Market Weight	Underweight	N/A
NVCC Sub-debt			Medium	Overweight	N/A	N/A
Insurance	Neutral	Medium	Low	Market Weight	Market Weight	Market Weight
Captive Finance	Negative	High	High	Overweight	N/A	N/A
REITs	Neutral	Medium	High	Underweight	Underweight	N/A
Retail	Neutral	Low	Low	Underweight	Underweight	Underweight
Telcos	Positive/Neutral	High	Low	Market Weight	Overweight	Underweight
Oil & Gas	Neutral	Medium	Medium	Market Weight	Market Weight	N/A
Pipelines	Neutral	Medium/High	Medium	Market Weight	Overweight	Underweight
Power/Holdcos	Neutral	Medium	Medium/High	Market Weight	Overweight	Market Weight
Regulated Utilities	Neutral	Medium/High	High	Underweight	Market Weight	Overweight
Infrastructure	Neutral	Medium/High	Medium	Underweight	Market Weight	Overweight
LRCNs	N/A	N/A	Low	Overweight	N/A	N/A
Corporate Hybrids	N/A	N/A	High	Overweight	Market Weight	N/A
A or Better	N/A	N/A	Medium	Market Weight	Market Weight	Overweight
BBB	N/A	N/A	High	Overweight	Overweight	Underweight
Overall	Neutral	Medium/High	High	Overweight	Market Weight	Market Weight

Source: CIBC Capital Markets.

Equity Outlook: Not the year for hero ball

Christopher Harvey and Will Stevenson

US executive summary

Overview. Looking into 2026, we do not believe the upcycle is over but we prefer a portfolio return distribution that allows for upside participation with meaningful downside outperformance. To drive upside we want attractive risk/rewards which we find with the Software, Med Tech, and Fin'l Svcs sectors and protection is sourced from risk aversion groups such as Utes, Staples, and/or Low Vol.

In the bull camp, we see solid economic and earnings growth. AI bubble fears appear overblown. The positive lag effect from changes in regulation filtering into M&A and earnings growth. We expect midterm concerns to drive government accommodation directly and indirectly, and home equity extraction could be a positive wildcard. In the bear camp, we believe risk has been bid too aggressively and needs to re-price. IG credit spreads are close to multi-decade lows with the potential to widen materially. Profit margins for the uber cap stocks are back to all-time highs and the market multiple is "healthy." There is the potential for consumer retrenchment driven by what seems like a decaying labour market. In addition, some investors fear the administration will be too close to the new Fed chairperson, and tariff turmoil is unlikely to be over with USMCA negotiations in 1H26.

Market Return. We anticipate further upside to the broader market in 2026 but believe market returns will be more pedestrian. We envision a high single digit return driven but double-digit EPS growth yet restrained by multiple compression. SPX EPS growth is seen decelerating in 2H26 helping to facilitate multiple compression (see Chart 1 and 2).

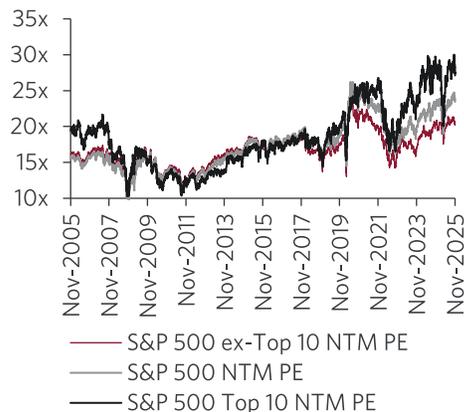
Market Volatility. For Bears, we do not feel it is time for "cash & canned goods" as we think systemic risk needs to rise more before the cycle ends. This may materialize by the end of 2026 driven by M&A, accommodation into midterms, and risk seeking behavior. Currently, we see risk stocks as technically overbought and the macro, in our analysis, not supportive longer term (see Chart 3).

In 2026, we expect bouts of risk aversion and volatility spikes to catalyze healthy periods of risk re-pricing. The vol spikes are anticipated to be a product of elevated expectations and optimism spurred by negative news both real and perceived. Tactically we want to add risk on 5%+ sell-offs / flare ups and then fade portfolio risk once near term vol decays/normalizes. Longer term, watch for IG credit spread widening and a possible liquidity pause.

Politics, Midterms, and Accommodation. We believe the midterms are and will motivate the administration to address affordability concerns with direct and indirect accommodation. This is evidenced by recent adjustments on coffee and fruit tariffs, changes to beef imports, proposed \$2000 tariff checks and potentially a more dovish Fed in May. We think the cumulative effect of accommodation may cause inflation and risk issues later in the year.

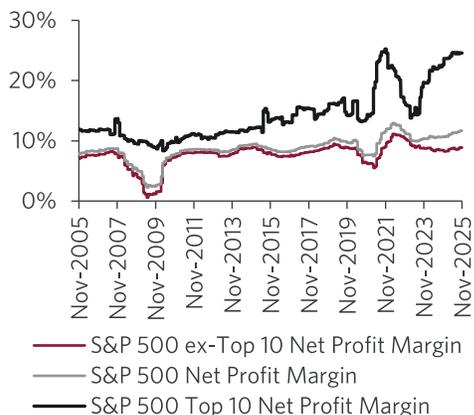
Consumer. Our consumer philosophy and our experience is that the US consumer will continue to spend until he/she cannot. What we currently see is a consumer that is selective yet stable with greater strength up the income ladder. What is still unclear is the degree that consumer choices are driven by financial stress vs a lack of value he/she is finding in the marketplace. What we do know is stocks with a distinct value proposition (WMT, COST, TJX, ROST, BURL) have provided

Chart 1: S&P 500 NTM price earnings ratio, top 10 names and bottom 490



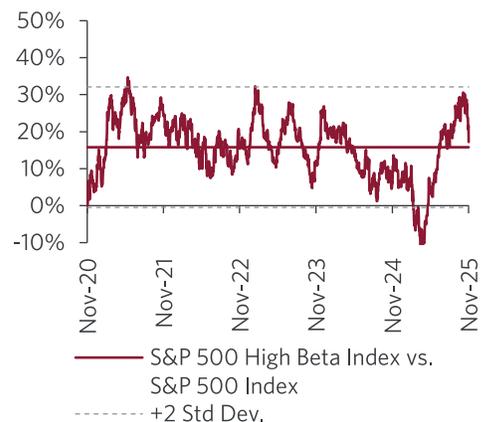
Source: Compustat and CIBC Capital Markets.

Chart 2: S&P 500 NTM net profit margin, top 10 names and bottom 490



Source: Compustat and CIBC Capital Markets.

Chart 3: S&P 500 high beta index vs S&P 500, last 5 years



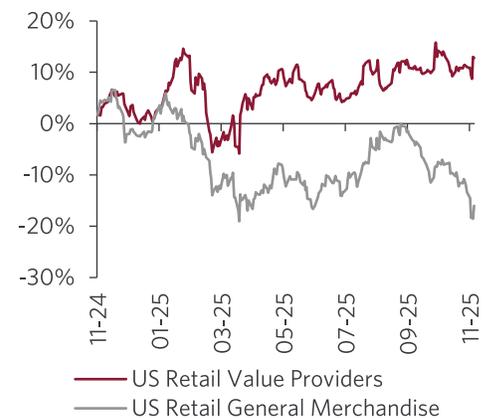
Source: Bloomberg, CIBC Capital Markets.

a positive double-digit gain over the last 12 months vs a negative double-digit return for Consumer Discretionary (TGT, HD, LOW, KSS, and LULU). One takeaway is this consumer behavior is unlikely to accelerate near term inflationary trends (see Chart 4).

A Fed chairperson could help consumers unlock a mountain of home equity as President Trump’s recent appointee, Stephen Mirin, has stated the neutral policy rate is somewhere around 2.5%. Fed fund rates approaching this level would increasingly unlock home equity through HELOCs and/or home purchases funded by more reasonable ARM rates. HELOC balances are slowly rising off 2021 lows and home equity is at all-time highs. If true, we would expect to see strong performance in consumer laggards such as general merchandizers, home improvement, and housing stocks. The risk continues to be the jobs picture and we remain vigilant of Initial and Continuing Claims numbers which are still “well behaved.”

AI Bubble Does Not Pass Our Litmus Test. The litmus test for the bubble is credit access and JPM. The Tech Wreck in the early 2000s was partly spurred by a freezing of the credit markets with important telco credits no longer seen as “money good.” If credit markets freeze today, we do not expect the hyperscalers to have anything close to solvency issues. We believe it is difficult to call for a popping of a AI/Tech bubble when JPM has outperformed MSFT, AAPL, TSLA, and AMZN over the last 3 years and over a 5-year basis those same names plus META (see Tables 1 and 2).

Chart 4: US retail “value creators” vs general merchandisers



Source: Bloomberg, CIBC Capital Markets.

Table 1: Top stocks in S&P 500 — Present day

Top 10 S&P 500 names	1-yr return	3-yr return	5-yr return
S&P 500	12.4%	74.5%	99.7%
Nvidia Corp	22.0%	1069.2%	1270.9%
Apple Inc	19.3%	86.2%	137.7%
Microsoft Corp	15.2%	99.7%	133.9%
Alphabet Inc	79.6%	215.6%	247.6%
Amazon Inc	11.2%	138.7%	42.4%
Broadcom Inc	109.5%	592.1%	892.5%
Meta Platforms Inc	5.9%	444.2%	121.7%
Tesla Inc	15.1%	133.0%	139.6%
Berkshire Hathaway Inc	6.8%	62.0%	122.0%
JP Morgan Chase & Co	24.4%	141.2%	196.3%

Source: Bloomberg, CIBC Capital Markets.

Table 2: Top stocks in S&P 500 — December 1999

Top 10 S&P 500 names	1-yr return	3-yr return	5-yr return
S&P 500	21.0%	107.5%	250.9%
Microsoft Corp	68.4%	465.2%	1428.0%
General Electric	53.6%	226.8%	565.4%
Cisco Systems Inc	130.8%	657.7%	2644.8%
Walmart Inc	70.4%	518.1%	572.7%
Intel Corp	39.1%	152.6%	940.8%
Lucent Technologies	36.6%	554.0%	-
Exxon Mobil Corp	12.6%	76.9%	209.3%
Citigroup Inc	70.1%	185.0%	726.8%
AT&T Inc	-7.4%	101.9%	178.1%
American International Group	40.2%	183.0%	372.7%

Source: Bloomberg, CIBC Capital Markets.

Macro Risks to Monitor. Spread widening related to a rise of systemic risk in 2H26, hawkish Fed as tariff inflation hits with a lag or affordability accommodation lifts inflation, and Fed credibility questioned new chairperson perceived too close to the administration.

Canadian executive summary

Upside Trend Continues. Equity valuation in Canada is above the longer term average but nowhere near bubble territory (see Chart 5). More importantly, continued tailwinds from data center buildout and government infrastructure priorities should provide plenty of support for earnings at these valuations (see Table 3 for earnings growth).

Table 3: S&P/TSX Composite sectors FY1 EPS growth and weight in S&P/TSX Composite

Sector	FY1 EPS growth	TSX weight
S&P/TSX Composite	19.3%	-
Energy*	-5.1%	15.7%
Materials	81.1%	16.7%
Industrials	4.6%	10.9%
Consumer Discretionary	16.7%	3.2%
Consumer Staples	8.7%	3.3%
Health Care*	275.9%	0.3%
Financials	21.8%	32.2%
Information Technology	21.7%	10.3%
Communication Services	3.6%	2.1%
Utilities	28.8%	3.7%
Real Estate	-22.2%	1.6%
S&P/TSX Composite ex-Materials	11.8%	83.3%

Source: Bloomberg, CIBC Capital Markets. Health Care makes up 0.3% of the S&P/TSX Composite.

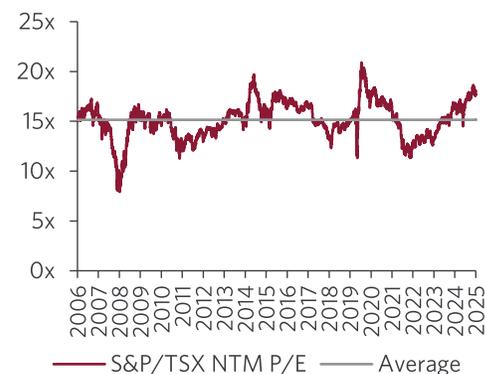
Politics and USMCA, A Source of Vol. The USMCA negotiations will likely be a major source of market volatility in 1H26. We anticipate plenty of headline volatility on issues like dairy/lumber, and renewed pushes for US-only content rules in autos which will impact industrials/consumer discretionary. On a positive note, we expect the distribution of more than \$280B in industrial policy spend over the next 5 years promised as part of the Federal Budget to benefit Industrials and Info Tech, with some benefit to Power Generators. Around \$30B has been earmarked for Defense, \$115B to Infrastructure, \$25B to housing, and \$110B to Productivity & Competitiveness — the latter largely R&D funding and accelerated deductions.

Contrarian Consumer Opportunities. The Canadian consumer remains under pressure and is expected to trade down next year as the job picture continues to weaken. We believe the job picture will drive spending toward value providers as it seems to be doing in the US but it will not be bad enough to cause wholesale consumer retrenchment. In our view, Consumer Discretionary and Staples sectors are interesting contrarian plays for 2026. The Consumer Discretionary sector, despite the label, possesses Staple-like characteristics making it an attractive 1H26 risk/reward in a period of trade uncertainty, value seeking, and USMCA negotiation.

Stay in the Game and Add a Contrarian Tilt. For portfolio positioning, we recommend adding cyclical/capex beta to the portfolio. We suggest the IT and Industrial sectors to exploit the capex trends. We are also recommending a contrarian tilt and some portfolio ballast with lower vol. In 2025, Momentum and Risk factors had very strong runs of +20% and +30%, respectively. We think an against the grain tilt is a reasonable call after such strong performance. Besides Industrials, we are constructive on contrarian exposure through Consumer Discretionary as stated above. Finally, we are adding Insurance to the mix to provide stability and mitigate tariff/USMCA inspired volatility.

No Canadian Bubble but We See Other Risks. Risk assets have performed exceptionally well in 2025 especially in the Materials group creating the potential for significant profit taking. With tariff and USMCA uncertainty, we do expect bouts of risk aversion. However, valuations across the broader market are nowhere near bubble territory.

Chart 5: TSX NTM P/E Multiple



Source: Compustat, CIBC Capital Markets.

Energy Outlook: Our expectations for oil & gas in 2026

Dennis Fong and Jamie Kubik

Oil markets experienced significant volatility throughout the year, primarily driven by ongoing geopolitical conflict, global trade uncertainty, and OPEC+ accelerating the resumption of curtailed production. Concerns of oversupply from the resiliency of US production, slower demand growth and the return of previously sanctioned barrels have continued to put downward pressure on oil prices, despite the recent temporary pause of OPEC+ production resumptions starting in January 2026. In the near-term, the market remains skewed towards a more pessimistic view on oil given the above drivers, but we suspect as concerns around production resiliency and well inventory in the US increase, we could see a more positive outlook for oil 18+ months out. At current price levels, energy companies have continued to prioritize free cash flow generation, rather than growth in an oversupplied world.

Natural gas pricing over the next 12 months is likely to be heavily influenced by weather patterns during the next three months, consistent with previous years. While both supply and demand can respond to price changes, we see greater elasticity on the supply side during commodity downturns. The commissioning of additional LNG trains and the expansion of data centers are expected to create a more visible demand outlook for natural gas, supporting a higher floor for NYMEX prices compared to historical levels. On the supply side, the construction of new pipelines in the southern United States could enable supply growth to meet increasing demand. However, the marginal cost of supply is expected to remain in the range of US\$4.00/MMBtu or higher. Table 1 shows historical WTI and Henry Hub spot pricing and current strip pricing.

Table 1: Energy - CIBC Commodities price assumptions, 2024-2028E

Commodity (year average)	2024A	2025E	2026E	2027E	2028E
WTI (US\$/Bbl)	\$75.91	\$66.39	\$65.00	\$65.00	\$65.00
Strip		\$65.17	\$59.48	\$58.99	\$59.95
Consensus		\$64.84	\$60.02	\$62.13	\$70.50
% difference vs Consensus		2%	8%	5%	-8%
Henry Hub (US\$/Mcf)	\$2.27	\$3.66	\$4.25	\$4.25	\$4.00
Strip		\$3.66	\$4.31	\$4.11	\$3.91
Consensus		\$3.67	\$4.15	\$4.15	\$4.15
% difference vs Consensus		0%	2%	2%	-4%

Source: FactSet, CIBC Capital Markets.

Crude oil

Cautious near-term, medium-term constructive. We maintain a cautious outlook for oil prices over the next 12 months, with a more constructive view 18+ months out. We continue to see resiliency in current demand levels but concerns surrounding demand growth which is being outpaced by supply drives a headwind for crude pricing. From an inventory perspective, we continue to see volumes near the five-year historical lows. This has been further supported by reported SPR buying by China helping keep a moderate floor for oil pricing. We expect this to purchasing to moderate in the near-term given the size of SPR purchases compounded by the sanctions announced by the US and EU on Russian producers.

In this environment, cost controls and capital efficiencies remain focal points for oil companies as profitability and managing through a volatile commodity price environment are themes followed by investors. Consolidation has continued over the past year as profitability and scale become key factors for investors. Production growth has remained modest for energy companies (1% to 5% per year) as many Management teams cite the oversupply in the market, resiliency of global

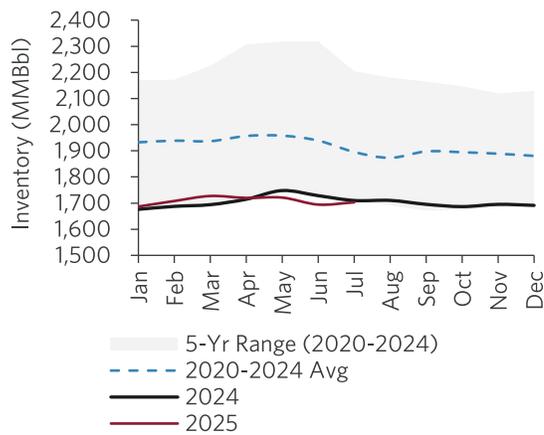
production and measured demand growth as key factors Boards are considering in Budget approvals.

As shown in Chart 1-4 area charts, Global OECD oil inventories remain near the bottom of historical ranges, but this has not meaningfully impacted the oil market, as attention remains focused on demand trends and the return of OPEC+ supply.

Canada is looking brighter, but we would like to see follow-through. Looking locally, the Canadian Federal Government has endorsed several major nation-building infrastructure projects which could help advance egress out of Western Canada for oil. We highlight optimization of existing pipelines including the Enbridge Mainline and the Trans Mountain Expansion Pipeline as providing a runway for producers to grow oil volumes in the correct environment. We've also seen more discussion around the possibility of a "grand bargain" for oil producers in Western Canada where a combination of lowering carbon intensity of production could help the government unlock policies which promote production growth and incremental (greenfield) export pipelines. There have been active dialogue among federal and provincial governments and industry stakeholders about establishing appropriate carbon policy, helping support projects like those proposed by Pathways Alliance and expedited review major project office for additional egress opportunities.

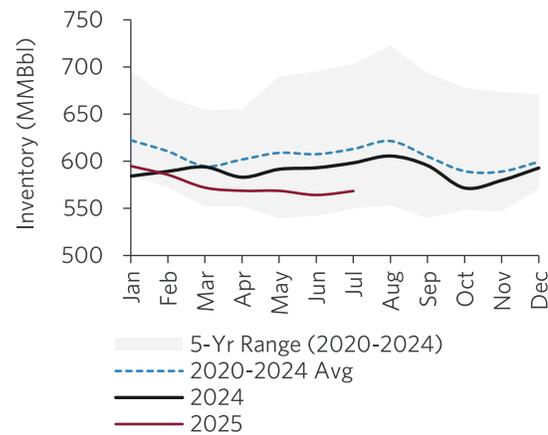
For refined products, US refining margins increased slightly year over year in 2025 and remained at the historical five-year average, despite ongoing concerns about the impact of US trade policies. In Canada, refiners continue to realize strong margins, which are modestly higher than last year.

Chart 1: Crude oil



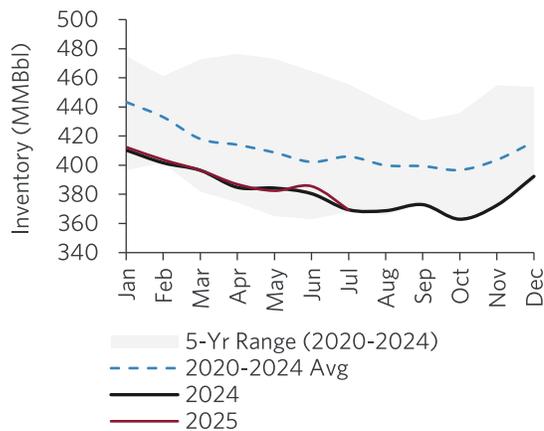
Source: JODI and CIBC World Markets Inc.

Chart 2: Distillate fuels



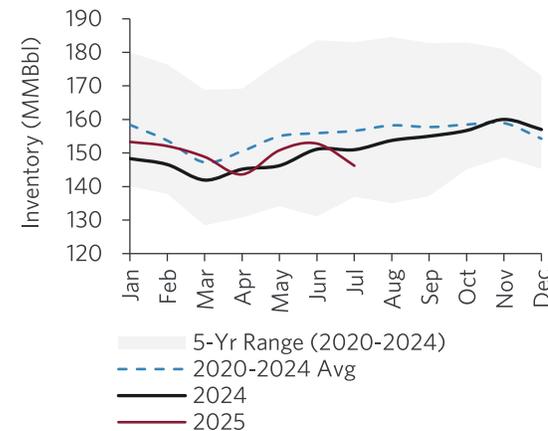
Source: JODI and CIBC World Markets Inc.

Chart 3: Gasoline



Source: JODI and CIBC World Markets Inc.

Chart 4: Kerosene/Jet fuel



Source: JODI and CIBC World Markets Inc.

Natural gas

The commissioning of LNG Canada and the normalization of inventories could help support Western Canadian natural gas prices in 2026. Western Canada is experiencing its largest demand driver in more than a decade with the commissioning of LNG Canada, which is expected to add approximately 2.0 Bcf/d of incremental demand to the Western Canadian Sedimentary Basin (WCSB). We anticipate that the pace of supply growth will not match the demand growth from this project, which should help bring elevated storage levels in Western Canada back to more normalized levels in 2026. Early data indicates that the gap between Western Canadian storage and the five-year average has narrowed from 133 Bcf in early July to 112 Bcf by the end of October. On the supply side, we expect operators to maintain capital discipline, and consolidation among producers should see the remaining companies manage supply more efficiently. Over the long term, we note a positive shift in government tone regarding natural resource development following the federal election in April 2025. We view the inclusion of two LNG projects among the nation-building projects as positive. These two projects could support a more robust demand outlook for the WCSB heading into 2030. Additionally, the potential expansion of data centers in Western Canada is noteworthy for both short- and long-term demand growth for natural gas-fired power generation.

The outlook for US natural gas demand remains strong, supported by the expansion of LNG projects and data center development. Feedgas flows to LNG facilities in the US have recently exceeded 18.0 Bcf/d, driven by the commissioning of additional LNG trains. Since the beginning of the Trump administration's second term in January 2025, commercial activity for LNG projects has accelerated, with new projects sanctioned and buyers for US LNG secured through bilateral trade agreements with major economies, including the European Union. Coal-to-gas switching and the continued buildout of data centers across the US are expected to further support demand for gas-fired power generation, strengthening the overall natural gas demand outlook. On the supply side, the Appalachia, Haynesville, and Permian basins have been the main sources of US supply growth in recent years. With Appalachia facing capacity constraints, the Haynesville and Permian could provide additional volumes to the market in 2026. However, with West Texas Intermediate (WTI) prices below US\$60/Bbl and Chevron's announced reduction in capital spending, activity in the Permian is expected to moderate, potentially limiting associated gas production growth from the region. As a result, the Haynesville is likely to become the marginal supplier of natural gas in 2026. We believe sustained NYMEX prices above US\$4.00/MMBtu will be needed to incentivize increased output from this play.

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Contacts:

Ian Pollick 416 594-7057 ian.pollick@cibc.com	Avery Shenfeld 416 594-7356 avery.shenfeld@cibc.ca	Benjamin Tal 416 956-3698 benjamin.tal@cibc.com	Jeremy Stretch +44 (020) 7234-7232 jeremy.stretch@cibc.com	Maximillian Lin +66 6962-1026 maximillian.lin@cibc.com
Angela Jiang 416 594-8631 angela.jiang@cibc.com	Luis Hurtado 416 594-8284 luis.hurtado@cibc.com	Sarah Ying 416 594-8302 sarah.ying@cibc.com	Tom Bognar, CFA 416 594-8275 tom.bognar@cibc.com	Andrew Grantham 416 956-3219 andrew.grantham@cibc.com
Dennis Fong 403 216-3400 dennis.fong1@cibc.com	Michael Cloherty 212 667-8478 michael.cloherty@cibc.com	Katherine Judge 416 956-6527 katherine.judge@cibc.com	Arjun Ananth 416 594-8193 arjun1.ananth@cibc.com	Vincent Zheng 416 594-8395 vincent.zheng1@cibc.com
Jamie Kubik 403 771-8152 jamie.kubik@cibc.com	Noah Buffam 416 594-8387 noah.buffam@cibc.com	Christopher Harvey 212 856-3696 christopher.harvey@cibc.com	Will Stevenson 416 594 8332 will.stevenson@cibc.com	

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