

# The Yield Curve

March 31, 2016

## The Federal Reserve is hesitant due to the year's tough start

### HIGHLIGHTS

- After plunging early in the year, North American bond yields have gone up overall since mid-February. Below 1.65% at the start of February, the U.S. 10-year yield was thus close to 2.00% in mid-March. The upswing in yields primarily reflects renewed investor optimism, which also pushed the stock markets and oil prices up sharply. Riskier bonds benefited from the rise in confidence, and credit spreads narrowed.
- The major financial market trend change in mid-February is partly due to the European Central Bank's (ECB) commitment to take steps to support its banking system. The ECB went into action on March 10, announcing a new string of measures, including a small key rate cut, an increase in its asset purchases, and another series of operations to inject liquidity into European banks. At the press conference, the ECB's president stated that he did not anticipate further cuts to key rates. In Japan, too, monetary authorities seem less at ease with negative interest rates.
- The more positive trend in the financial markets and promising signs for inflation seemed to be slowly paving the way for a second key interest rate increase in the United States. The Federal Reserve (Fed) delivered a surprise, however, taking a very cautious tone at its March 16 meeting and signalling only two 0.25% key rate increases by the end of 2016. Previously, Fed officials' median forecast had been for four increases. Since then, some officials had intimated that a key rate increase could come as early as the April meeting. Downgraded statistics on consumer spending, suggesting weak U.S. economic growth at the start of 2016, and comments from Janet Yellen have however confirmed that we are unlikely to see monetary firming before the June meeting.
- The latest Canadian economic numbers have been encouraging, especially for exports and manufacturing sales. Following fourth quarter growth of 0.8%, Canada's real GDP should advance about 3% in the first quarter of 2016. The Canadian economy's solid performance and higher oil prices confirm that no further cut to Canadian key rates will be needed, particularly after the fiscal stimulus announced in the federal budget.
- The Trudeau government's first budget pointed to financial requirements totalling more than \$170B over the next five years, this will result in a substantial increase in issuances. The federal government has even decided to start reissuing 3-year bonds. The market's initial response was limited. The jump in public spending and investment will stimulate economic growth, especially next year. We have therefore upgraded our Canadian growth forecast for 2017 from 1.9% to 2.3%.

### INTEREST RATE FORECASTS

- Fed officials' forecasts are now in line with our scenario, which calls for U.S. key rate increases of 0.25% at the June and December meetings. The U.S. economy will, however, have to send signals of somewhat livelier growth soon to convince the Fed to go into action.
- In Canada, the recent events have substantially decreased the likelihood of seeing the Bank of Canada proceed with further monetary easing. It would take another major shock to convince it to act and we continue to expect an extended status quo.

**François Dupuis**  
Vice-President and Chief Economist

514-281-2336 or 1 866 866-7000, ext. 2336  
E-mail: [desjardins.economics@desjardins.com](mailto:desjardins.economics@desjardins.com)

**Mathieu D'Anjou**  
Senior Economist

**Benoit P. Durocher**  
Senior Economist

**Francis Généreux**  
Senior Economist

**Jimmy Jean**  
Senior Economist

**Hendrix Vachon**  
Senior Economist

NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

IMPORTANT: This document is based on public information and may under no circumstances be used or construed as a commitment by Desjardins Group. While the information provided has been determined on the basis of data obtained from sources that are deemed to be reliable, Desjardins Group in no way warrants that the information is accurate or complete. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. Desjardins Group takes no responsibility for the consequences of any decision whatsoever made on the basis of the data contained herein and does not hereby undertake to provide any advice, notably in the area of investment services. The data on prices or margins are provided for information purposes and may be modified at any time, based on such factors as market conditions. The past performances and projections expressed herein are no guarantee of future performance. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the opinions of any other person or the official position of Desjardins Group. Copyright © 2016, Desjardins Group. All rights reserved.

**Table 1**  
**Key interest rates**

End of period in %	2015				2016				2017			
	Q1	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>United States</b>												
Federal funds	0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.25	1.25	1.50	1.75
<b>Canada</b>												
Overnight funds	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
<b>Euro zone</b>												
Refinancing rate	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>United Kingdom</b>												
Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.25
<b>Japan</b>												
Overnight funds	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

**Table 2**  
**Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>January 2016</b>			
13	Bank of Korea	s.q.	1.50
14	Bank of England	s.q.	0.50
20	Bank of Brazil	s.q.	14.25
20	Bank of Canada	s.q.	0.50
21	European Central Bank	s.q.	0.05
27	Federal Reserve	s.q.	0.25 / 0.50
28	Reserve Bank of New Zealand	s.q.	2.50
29	Bank of Japan	s.q.	-0.10
<b>February 2016</b>			
1	Reserve Bank of Australia	s.q.	2.00
4	Bank of England	s.q.	0.50
4	Bank of Mexico	s.q.	3.25
11	Bank of Sweden	-15 b.p.	-0.50
15	Bank of Korea	s.q.	1.50
17	Bank of Mexico	+50 b.p.	3.75
29	Reserve Bank of Australia	s.q.	2.00
<b>March 2016</b>			
2	Bank of Brazil	s.q.	14.25
9	Bank of Korea	s.q.	1.50
9	Reserve Bank of New Zealand	-25 b.p.	2.25
9	Bank of Canada	s.q.	0.50
10	European Central Bank	-5 b.p.	0.00
14	Bank of Japan	s.q.	-0.10
16	Federal Reserve	s.q.	0.25 / 0.50
17	Bank of England	s.q.	0.50
17	Bank of Norway	-25 b.p.	0.50
17	Swiss National Bank	s.q.	-0.75
18	Bank of Mexico	s.q.	3.75

s.q.: status quo; b.p. : basis points

Source: Desjardins, Economic Studies

**Table 3**  
**Coming soon**

Date	Central Bank
<b>April 2016</b>	
5	Reserve Bank of Australia
13	Bank of Canada
14	Bank of England
18-19	Bank of Korea
21	European Central Bank
21	Bank of Sweden
27	Bank of Brazil
27	Federal Reserve
27-28	Reserve Bank of New Zealand
27-28	Bank of Japan
<b>May 2016</b>	
3	Reserve Bank of Australia
5	Bank of Mexico
12	Bank of England
12	Bank of Norway
12-13	Bank of Korea
25	Bank of Canada
<b>June 2016</b>	
2	European Central Bank
7	Reserve Bank of Australia
8	Bank of Brazil
8-9	Bank of Korea
8-9	Reserve Bank of New Zealand
15	Federal Reserve
15-16	Bank of Japan
16	Bank of England
16	Swiss National Bank
23	Bank of Norway
30	Bank of Mexico

Source: Desjardins, Economic Studies

**Table 4**  
**United States: fixed income market**

End of period in %	2015				2016				2017			
	Q1	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>Key rate</b>												
Federal funds	0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.25	1.25	1.50	1.75
<b>Treasury bills</b>												
3-month	0.03	0.01	0.00	0.16	0.25	0.55	0.55	0.80	1.05	1.05	1.30	1.55
<b>Federal bonds</b>												
2-year	0.54	0.60	0.60	1.04	0.80	1.15	1.30	1.50	1.60	1.65	1.85	2.00
5-year	1.37	1.63	1.33	1.65	1.30	1.60	1.80	2.00	2.15	2.20	2.35	2.45
10-year	1.93	2.35	2.03	2.27	1.85	2.15	2.30	2.50	2.65	2.65	2.75	2.80
30-year	2.54	3.12	2.85	3.02	2.65	2.85	2.95	3.05	3.10	3.10	3.15	3.20
<b>Yield curve</b>												
5-year - 3-month	1.34	1.62	1.33	1.49	1.05	1.05	1.25	1.20	1.10	1.15	1.05	0.90
10-year - 2-year	1.39	1.75	1.44	1.23	1.05	1.00	1.00	1.00	1.05	1.00	0.90	0.80
30-year - 3-month	2.51	3.11	2.85	2.86	2.40	2.30	2.40	2.25	2.05	2.05	1.85	1.65

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

**Table 5**  
**Canada: fixed income market**

End of period in %	2015				2016				2017			
	Q1	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>Key rate</b>												
Federal funds	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
<b>Treasury bills</b>												
3-month	0.56	0.58	0.44	0.50	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.85
<b>Federal bonds</b>												
2-year	0.50	0.48	0.52	0.48	0.55	0.65	0.65	0.75	0.85	0.95	1.15	1.35
5-year	0.76	0.82	0.80	0.73	0.70	0.85	0.90	1.05	1.20	1.30	1.55	1.75
10-year	1.36	1.69	1.43	1.40	1.25	1.40	1.45	1.60	1.80	1.85	2.00	2.10
30-year	1.98	2.31	2.20	2.15	2.00	2.15	2.20	2.30	2.40	2.40	2.50	2.60
<b>Yield curve</b>												
5-year - 3-month	0.20	0.24	0.36	0.23	0.25	0.35	0.40	0.55	0.70	0.80	1.00	0.90
10-year - 2-year	0.86	1.21	0.91	0.92	0.70	0.75	0.80	0.85	0.95	0.90	0.85	0.75
30-year - 3-month	1.42	1.73	1.76	1.65	1.55	1.65	1.70	1.80	1.90	1.90	1.95	1.75
<b>Spreads (Canada - U.S.)</b>												
3-month	0.53	0.57	0.44	0.34	0.20	-0.05	-0.05	-0.30	-0.55	-0.55	-0.75	-0.70
2-year	-0.04	-0.12	-0.08	-0.56	-0.25	-0.50	-0.65	-0.75	-0.75	-0.70	-0.70	-0.65
5-year	-0.61	-0.81	-0.53	-0.92	-0.60	-0.75	-0.90	-0.95	-0.95	-0.90	-0.80	-0.70
10-year	-0.57	-0.66	-0.60	-0.87	-0.60	-0.75	-0.85	-0.90	-0.85	-0.80	-0.75	-0.70
30-year	-0.56	-0.81	-0.65	-0.87	-0.65	-0.70	-0.75	-0.75	-0.70	-0.70	-0.65	-0.60

f: forecasts

Sources: Datastream and Desjardins, Economic Studies