

The Federal Reserve maintains the suspense

HIGHLIGHTS

- The U.S. 10-year yield edged below 1.70% on April 7, then started to trend up again, returning closer to 2% recently. Rising oil prices and remarks from some Federal Reserve (Fed) leaders have boosted expectations regarding U.S. monetary policy. Inflation expectations have also gone up substantially in the last few weeks. Renewed investor optimism has favoured riskier bonds.
- The United States got the year off to a tough start, with its economy only growing by an annualized 0.5% in the first quarter. As has often happened in recent years, the surprising weakness should make way for stronger growth soon. The job market's strong performance and the fact that the ISM manufacturing index is back above 50 are encouraging.
- If a key rate status quo was a sure thing, the Fed meeting on April 27 represented an opportunity to either open or close the door more clearly on an increase in June. In the end, the Fed did not send a very clear message, indicating there was less concern about the international situation, but not putting any special emphasis on the next meeting.
- Canadian bond yields have gone up more steeply in the last few weeks. The Canadian 10-year yield recently went to 1.55%, its highest point since last December, while its negative spread from its U.S. counterpart fell to around 0.35% from where it stood at the start of the year, 0.85%. The substantial increase in upcoming federal securities issuances could have had something to do with the movement.
- In contrast with what is going on in the United States, Canadian economic numbers have been pummeling expectations in the last few months, and we are expecting real GDP growth of about 3.5% (annualized) in the first quarter. This pace is not sustainable, however, as the Canadian economy is still adjusting to the drop in energy prices.
- Despite the solid Canadian data, the Bank of Canada (BoC) only tweaked its growth outlooks when it released April's *Monetary Policy Report*. It stressed the Canadian dollar's rise and the less promising outlook for the world economy, as well as for investment in Canada's energy sector. However, the BoC was very positive about the stimulus measures of the last federal budget.

INTEREST RATE FORECASTS

- We are still expecting to see two 0.25% increases to U.S. key rates by the end of 2016. If the U.S. economy picks up steam as expected and the looming British referendum on the European Union does not create too much upheaval, the next increase could be ordered in June. The latest BoC communications bolster our outlook for an extended status quo on Canadian key rates. Governor Poloz even declared it would take a shock of some significance for the BoC to contemplate further monetary easing.
- In the near term, bond yields will be dependent on the Fed's June decision. Firming could take the U.S. 10-year yield to around 2.15%; a status quo should pull it down. Regardless of which way U.S. monetary policy moves, bond yields are expected to go up somewhat in the second half of 2016, as too much hesitation from the Fed could boost inflation expectations. Canadian bond yields should not move up as much as in the United States, making yield spreads between the two countries widen once again.

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

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Table 1
Key interest rates

| End of period in % | 2015 | | | | 2016 | | | | 2017 | | | |
|-----------------------|------|------|------|------|-------|-------|-------|-------|-------|-------|-------|-------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2f | Q3f | Q4f | Q1f | Q2f | Q3f | Q4f |
| United States | | | | | | | | | | | | |
| 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 |
| Canada | | | | | | | | | | | | |
| 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 |
| Euro zone | | | | | | | | | | | | |
| 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 |
| United Kingdom | | | | | | | | | | | | |
| 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 |
| Japan | | | | | | | | | | | | |
| Main key rate | 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 |
|----------------------|-----------------------------|----------|-------------|
| February 2016 | | | |
| 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 |
| March 2016 | | | |
| 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 |
| April 2016 | | | |
| 5 | Reserve Bank of Australia | s.q. | 2.00 |
| 13 | Bank of Canada | s.q. | 0.50 |
| 14 | Bank of England | s.q. | 0.50 |
| 18 | Bank of Korea | s.q. | 1.50 |
| 21 | European Central Bank | s.q. | 0.00 |
| 21 | Bank of Sweden | s.q. | -0.50 |
| 27 | Reserve Bank of New Zealand | s.q. | 2.25 |
| 27 | Bank of Brazil | s.q. | 14.25 |
| 27 | Bank of Japan | s.q. | -0.10 |
| 27 | Federal Reserve | s.q. | 0.25 / 0.50 |

Table 3
Coming soon

| Date | Central Bank |
|------------------|-----------------------------|
| May 2016 | |
| 3 | Reserve Bank of Australia |
| 5 | Bank of Mexico |
| 12 | Bank of England |
| 12 | Bank of Norway |
| 13 | Bank of Korea |
| 25 | Bank of Canada |
| June 2016 | |
| 2 | European Central Bank |
| 7 | Reserve Bank of Australia |
| 8 | Reserve Bank of New Zealand |
| 8 | Bank of Brazil |
| 9 | Bank of Korea |
| 15 | Bank of Japan |
| 15 | Federal Reserve |
| 16 | Bank of England |
| 16 | Swiss National Bank |
| 23 | Bank of Norway |
| 30 | Bank of Mexico |
| July 2016 | |
| 5 | Reserve Bank of Australia |
| 6 | Bank of Sweden |
| 13 | Bank of Canada |
| 14 | Bank of Korea |
| 14 | Bank of England |
| 20 | Bank of Brazil |
| 21 | European Central Bank |
| 27 | Federal Reserve |
| 28 | Bank of Japan |

s.q.: status quo; b.p. : basis points
Source: Desjardins, Economic Studies

Source: Desjardins, Economic Studies

Table 4
United States: fixed income market

| End of period in % | 2015 | | | | 2016 | | | | 2017 | | | |
|-----------------------|------|------|------|------|------|------|------|------|------|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2f | Q3f | Q4f | Q1f | Q2f | Q3f | Q4f |
| Key rate | | | | | | | | | | | | |
| 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 |
| Treasury bills | | | | | | | | | | | | |
| 3-month | 0.03 | 0.01 | 0.00 | 0.16 | 0.21 | 0.55 | 0.55 | 0.80 | 1.05 | 1.05 | 1.30 | 1.55 |
| Federal bonds | | | | | | | | | | | | |
| 2-year | 0.54 | 0.60 | 0.60 | 1.04 | 0.75 | 1.15 | 1.30 | 1.50 | 1.60 | 1.65 | 1.85 | 2.00 |
| 5-year | 1.37 | 1.63 | 1.33 | 1.65 | 1.21 | 1.60 | 1.80 | 2.00 | 2.15 | 2.20 | 2.35 | 2.45 |
| 10-year | 1.93 | 2.35 | 2.03 | 2.27 | 1.78 | 2.15 | 2.30 | 2.50 | 2.65 | 2.65 | 2.75 | 2.80 |
| 30-year | 2.54 | 3.12 | 2.85 | 3.02 | 2.62 | 2.85 | 2.95 | 3.05 | 3.10 | 3.10 | 3.15 | 3.20 |
| Yield curve | | | | | | | | | | | | |
| 5-year - 3-month | 1.34 | 1.62 | 1.33 | 1.49 | 1.00 | 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 | 1.03 | 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 | 2.41 | 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 | Q1 | Q2f | Q3f | Q4f | Q1f | Q2f | Q3f | Q4f |
| Key rate | | | | | | | | | | | | |
| 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 |
| Treasury bills | | | | | | | | | | | | |
| 3-month | 0.56 | 0.58 | 0.44 | 0.50 | 0.44 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.65 | 0.85 |
| Federal bonds | | | | | | | | | | | | |
| 2-year | 0.50 | 0.48 | 0.52 | 0.48 | 0.54 | 0.70 | 0.80 | 0.85 | 0.90 | 0.95 | 1.15 | 1.35 |
| 5-year | 0.76 | 0.82 | 0.80 | 0.73 | 0.67 | 1.00 | 1.10 | 1.15 | 1.30 | 1.35 | 1.55 | 1.75 |
| 10-year | 1.36 | 1.69 | 1.43 | 1.40 | 1.23 | 1.65 | 1.70 | 1.75 | 1.85 | 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 |
| Yield curve | | | | | | | | | | | | |
| 5-year - 3-month | 0.20 | 0.24 | 0.36 | 0.23 | 0.23 | 0.40 | 0.50 | 0.55 | 0.70 | 0.75 | 0.90 | 0.90 |
| 10-year - 2-year | 0.86 | 1.21 | 0.91 | 0.92 | 0.69 | 0.95 | 0.90 | 0.90 | 0.95 | 0.90 | 0.85 | 0.75 |
| 30-year - 3-month | 1.42 | 1.73 | 1.76 | 1.65 | 1.56 | 1.55 | 1.60 | 1.70 | 1.80 | 1.80 | 1.85 | 1.75 |
| Spreads (Canada - U.S.) | | | | | | | | | | | | |
| 3-month | 0.53 | 0.57 | 0.44 | 0.34 | 0.23 | 0.05 | 0.05 | -0.20 | -0.45 | -0.45 | -0.65 | -0.70 |
| 2-year | -0.04 | -0.12 | -0.08 | -0.56 | -0.21 | -0.45 | -0.50 | -0.65 | -0.70 | -0.70 | -0.70 | -0.65 |
| 5-year | -0.61 | -0.81 | -0.53 | -0.92 | -0.54 | -0.60 | -0.70 | -0.85 | -0.85 | -0.85 | -0.80 | -0.70 |
| 10-year | -0.57 | -0.66 | -0.60 | -0.87 | -0.55 | -0.50 | -0.60 | -0.75 | -0.80 | -0.80 | -0.75 | -0.70 |
| 30-year | -0.56 | -0.81 | -0.65 | -0.87 | -0.62 | -0.70 | -0.75 | -0.75 | -0.70 | -0.70 | -0.65 | -0.60 |

f: forecasts

Sources: Datastream and Desjardins, Economic Studies