

THE YIELD CURVE

Central Banks' Optimism Contrasts with Investor Concerns



HIGHLIGHTS

- ▶ The eleventh-hour signing of the United States-Mexico-Canada Agreement (USMCA), upbeat economic data and positive comments from Federal Reserve (Fed) leaders accelerated the uptrend in bond yields in early October. At that time, U.S. and Canadian 10-year yields reached 3.23% and 2.60%, respectively. As it did last February, however, the surge in bond yields unleashed a wave of concerns.
- ▶ At the worst point in the stock market correction, the U.S. 10-year yield fell a bit below 3.10%. That bond yields did not decline any further is still quite remarkable. For many years after the financial crisis of 2008, all flare-ups of market concerns led to big drop in bond yields, as central banks acted quickly to reassure investors. Things today are quite different, with central bankers sending clear signals that they are unperturbed by market volatility.
- ▶ Despite the melt-down on the stock markets, the comments made by Fed leaders in recent weeks have remained very positive. As such, the cadence of a 0.25% key rate hike per quarter seems set to continue, buoyed by strong economic growth and outlook. Accelerated wage growth and low unemployment also argue in favour of continued monetary tightening.
- ▶ The Bank of Canada (BoC) raised its key rate by 0.25% at the end of October, pushing it to 1.75%. This move was expected, but the BoC surprised by removing the reference that future increases would be gradual. It is preferring instead to signal a move towards a neutral rate, assessed at between 2.5% and 3.5%. This change in tone appears to be the result of the improved investment and export outlook following the signing of the USMCA. The BoC will nonetheless continue to keep a close eye on the impacts of rate increases on the economy, given the high level of household indebtedness.
- ▶ Despite the somewhat weaker economic data in the euro zone and the worrisome situation in Italy, the European Central Bank is still determined to end its financial asset purchases in December. It seems that the Bank of England would also like to keep normalizing its monetary policy, but uncertainty around Brexit could mean it has to wait a while longer.

INTEREST RATE FORECASTS

- ▶ We continue to view the rate hikes signalled by Fed leaders as the most likely scenario. A 0.25% increase in U.S. key rates is thus expected in December, followed by three additional rate hikes in 2019 and one final increase in early 2020. The uptrend in bond yields thus seems poised to continue.
- ▶ The BoC's very optimistic tone leads us to call for monetary tightening at a somewhat faster pace. While the rate hikes already seem to be having a significant impact on consumption and the real estate market, nothing justifies a new rate hike at the December meeting. A rate increase should be announced in the first quarter of 2019, however: a tad earlier than we had previously expected. We continue to call for only two rate hikes next year, but any favourable development could convince the BoC to opt for a slightly faster tightening.

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TABLE 1
Key interest rates

END OF PERIOD IN %	2017				2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25
Canada												
Overnight funds	0.50	0.50	1.00	1.00	1.25	1.25	1.50	1.75	2.00	2.00	2.25	2.25
Zone euro												
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.25
United Kingdom												
Base rate	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00
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
Fixed income market

END OF PERIOD IN %	2017				2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
UNITED STATES												
Treasury bills												
3-month	0.76	1.03	1.06	1.39	1.73	1.93	2.19	2.45	2.70	2.95	3.10	3.20
Federal bonds												
2-year	1.24	1.37	1.49	1.88	2.27	2.53	2.82	3.00	3.15	3.25	3.30	3.40
5-year	1.92	1.88	1.92	2.19	2.55	2.73	2.95	3.15	3.30	3.40	3.50	3.55
10-year	2.40	2.30	2.33	2.41	2.75	2.86	3.06	3.30	3.45	3.55	3.60	3.65
30-year	3.02	2.84	2.86	2.74	2.97	2.99	3.21	3.40	3.55	3.65	3.70	3.75
Yield curve slopes												
5-year - 3-month	1.16	0.85	0.86	0.80	0.82	0.80	0.76	0.70	0.60	0.45	0.40	0.35
10-year - 2-year	1.16	0.93	0.84	0.53	0.47	0.33	0.24	0.30	0.30	0.30	0.30	0.25
30-year - 3-month	2.26	1.81	1.80	1.35	1.24	1.06	1.02	0.95	0.85	0.70	0.60	0.55
CANADA												
Treasury bills												
3-month	0.52	0.71	1.00	1.06	1.10	1.26	1.59	1.80	1.95	2.05	2.20	2.30
Federal bonds												
2-year	0.75	1.09	1.52	1.68	1.77	1.91	2.21	2.40	2.50	2.50	2.55	2.65
5-year	1.12	1.38	1.75	1.86	1.96	2.06	2.33	2.55	2.65	2.70	2.80	2.85
10-year	1.63	1.75	2.10	2.04	2.09	2.17	2.42	2.65	2.75	2.85	2.90	2.95
30-year	2.31	2.13	2.47	2.26	2.23	2.20	2.41	2.70	2.80	2.90	2.95	3.05
Yield curve slopes												
5-year - 3-month	0.60	0.67	0.75	0.80	0.86	0.80	0.74	0.75	0.70	0.65	0.60	0.55
10-year - 2-year	0.88	0.66	0.58	0.36	0.32	0.26	0.21	0.25	0.25	0.35	0.35	0.30
30-year - 3-month	1.79	1.42	1.47	1.20	1.13	0.94	0.82	0.90	0.85	0.85	0.75	0.75
Yield spreads (Canada—United States)												
3-month	-0.24	-0.32	-0.06	-0.33	-0.63	-0.67	-0.60	-0.65	-0.75	-0.90	-0.90	-0.90
2-year	-0.49	-0.28	0.03	-0.20	-0.50	-0.62	-0.61	-0.60	-0.65	-0.75	-0.75	-0.75
5-year	-0.80	-0.50	-0.17	-0.33	-0.59	-0.67	-0.62	-0.60	-0.65	-0.70	-0.70	-0.70
10-year	-0.77	-0.55	-0.23	-0.37	-0.66	-0.69	-0.64	-0.65	-0.70	-0.70	-0.70	-0.70
30-year	-0.71	-0.71	-0.39	-0.48	-0.74	-0.79	-0.80	-0.70	-0.75	-0.75	-0.75	-0.70

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Schedule 2018 of Central Bank Meetings

Date	Central banks	Decision	Rate
January			
17	Bank of Korea	s.q.	1.50
17	Bank of Canada*	+25 b.p.	1.25
22	Bank of Japan	s.q.	-0.10
25	European Central Bank	s.q.	0.00
25	Bank of Norway	s.q.	0.50
31	Federal Reserve	s.q.	1.50
February			
5	Reserve Bank of Australia	s.q.	1.50
7	Reserve Bank of New Zealand	s.q.	1.75
7	Bank of Brazil	-25 b.p.	6.75
8	Bank of England	s.q.	0.50
8	Bank of Mexico	+25 b.p.	7.50
14	Bank of Sweden	s.q.	-0.50
26	Bank of Korea	s.q.	1.50
March			
5	Reserve Bank of Australia	s.q.	1.50
7	Bank of Canada	s.q.	1.25
8	European Central Bank	s.q.	0.00
8	Bank of Japan	s.q.	-0.10
15	Bank of Norway	s.q.	0.50
15	Swiss National Bank	s.q.	-0.75
21	Reserve Bank of New Zealand	s.q.	1.75
21	Bank of Brazil	-25 b.p.	6.50
21	Federal Reserve	+25 b.p.	1.75
22	Bank of England	s.q.	0.50
April			
3	Reserve Bank of Australia	s.q.	1.50
11	Bank of Korea	s.q.	1.50
12	Bank of Mexico	s.q.	7.50
18	Bank of Canada*	s.q.	1.25
26	European Central Bank	s.q.	0.00
26	Bank of Sweden	s.q.	-0.50
26	Bank of Japan	s.q.	-0.10
May			
1	Reserve Bank of Australia	s.q.	1.50
2	Federal Reserve	s.q.	1.75
3	Bank of Norway	s.q.	0.50
9	Reserve Bank of New Zealand	s.q.	1.75
10	Bank of England	s.q.	0.50
16	Bank of Brazil	s.q.	6.50
17	Bank of Mexico	s.q.	7.50
23	Bank of Korea	s.q.	1.50
30	Bank of Canada	s.q.	1.25
June			
5	Reserve Bank of Australia	s.q.	1.50
13	Federal Reserve	+25 b.p.	2.00
14	European Central Bank	s.q.	0.00
14	Bank of Japan	s.q.	-0.10
20	Bank of Brazil	s.q.	6.50
21	Bank of England	s.q.	0.50
21	Bank of Norway	s.q.	0.50
21	Bank of Mexico	+25 b.p.	7.75
21	Swiss National Bank	s.q.	-0.75
27	Reserve Bank of New Zealand	s.q.	1.75

Date	Central banks	Decision	Rate
July			
3	Reserve Bank of Australia	s.q.	1.50
3	Bank of Sweden	s.q.	-0.50
11	Bank of Korea	s.q.	1.50
11	Bank of Canada*	+25 b.p.	1.50
26	European Central Bank	s.q.	0.00
31	Bank of Japan	s.q.	-0.10
August			
1	Bank of Brazil	s.q.	6.50
1	Federal Reserve	s.q.	2.00
2	Bank of England	+25 b.p.	0.75
2	Bank of Mexico	s.q.	7.75
7	Reserve Bank of Australia	s.q.	1.50
8	Reserve Bank of New Zealand	s.q.	1.75
16	Bank of Norway	s.q.	0.50
30	Bank of Korea	s.q.	1.50
September			
4	Reserve Bank of Australia	s.q.	1.50
5	Bank of Canada	s.q.	1.50
6	Bank of Sweden	s.q.	-0.50
13	European Central Bank	s.q.	0.00
13	Bank of England	s.q.	0.75
18	Bank of Japan	s.q.	-0.10
19	Bank of Brazil	s.q.	6.50
20	Bank of Norway	+25 b.p.	0.75
20	Swiss National Bank	s.q.	-0.75
26	Reserve Bank of New Zealand	s.q.	1.75
26	Federal Reserve	+25 b.p.	2.25
October			
2	Reserve Bank of Australia	s.q.	1.50
4	Bank of Mexico	s.q.	7.75
17	Bank of Korea	s.q.	1.50
24	Bank of Sweden	s.q.	-0.50
24	Bank of Canada*	+25 b.p.	1.75
25	European Central Bank	s.q.	0.00
25	Bank of Norway	s.q.	0.75
30	Bank of Japan	s.q.	-0.10
31	Bank of Brazil	s.q.	6.50
November			
1	Bank of England	s.q.	0.75
5	Reserve Bank of Australia		
7	Reserve Bank of New Zealand		
8	Federal Reserve		
15	Bank of Mexico		
29	Bank of Korea		
December			
3	Reserve Bank of Australia		
5	Bank of Canada		
12	Bank of Brazil		
13	European Central Bank		
13	Bank of Norway		
13	Swiss National Bank		
19	Federal Reserve		
19-20	Bank of Japan		
20	Bank of England		
20	Bank of Sweden		
20	Bank of Mexico		

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively. * Monetary Policy Report published.