

THE YIELD CURVE

The Situation Is Becoming More Complicated for Central Banks

HIGHLIGHTS

- ▶ Bond yields have resumed an upward trend since the beginning of the fall. The U.S. 10-year yield has risen from around 1.30% in mid-September to over 1.50%. The increase in shorter-term and in Canadian yields was more pronounced as investors positioned themselves for aggressive monetary tightening in 2022, particularly in Canada and the United Kingdom. Fears of a more sustained bouts of inflation continue to grow as supply constraints remain numerous and energy prices have surged again. As we recently explained in an [Economic Viewpoint](#), central banks are ill-equipped to respond to negative supply shocks that reduce economic activity and increase inflationary pressures.
- ▶ A major trigger for the new uptrend in bond yields was the September Federal Reserve (Fed) meeting where officials signalled an upcoming reduction in the pace of asset purchases and a faster hike in key rates. The Fed put its money where its mouth is on November 3 by announcing an initial US\$15B reduction in its purchases. The Fed judges that similar cuts are likely to be appropriate each month, suggesting that quantitative easing could end in June 2022. The Fed insists that this decision does not imply any direct signal on interest rate policy. However, Fed officials are beginning to recognize that temporary price pressures could be more persistent. The recent acceleration in wage growth and in some measures of inflation expectations will need to be closely monitored.
- ▶ The Bank of Canada (BoC) continued to normalize its monetary policy by announcing the end of quantitative easing and the beginning of the reinvestment period on October 27. Even though the latest Canadian inflation data surprised on the upside, the BoC is still committed to keeping its key rate at the effective lower bound until economic slack is absorbed. While supply constraints limit the potential for growth, this full recovery in activity is now expected in the second or third quarter of 2022, suggesting the onset of monetary tightening a bit earlier than previously signaled.
- ▶ The Governor of the Bank of England (BoE) has clearly signalled that he will not tolerate to see inflation above the target for very long. BoE leaders ultimately opted for the status quo in November, but indicated that a first key rate hike could come in the coming months. The European Central Bank remains in far less of a hurry to act and its president recently stated that a first rate hike in 2022 seemed unlikely.

INTEREST RATE FORECASTS

- ▶ Although we consider the increase in certain Canadian yields to be excessive, recent events support our scenario of a general uptrend in interest rates over the next few years. The increase in key rates is expected to be more gradual than the markets anticipate, but it could last longer and bring them back to around pre-pandemic levels. Long-term yields thus remain vulnerable to an upward adjustment.
- ▶ We have adjusted our scenarios slightly to reflect a monetary tightening starting one quarter earlier, in July 2022 in Canada and September 2022 in the United States.

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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 %	2020				2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75
Canada												
Overnight funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75
Zone euro												
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom												
Base rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.50	0.50	0.50
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 %	2020				2021				2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
UNITED STATES												
Treasury bills												
3-month	0.11	0.16	0.10	0.09	0.03	0.05	0.04	0.10	0.15	0.20	0.45	0.70
Federal bonds												
2-year	0.25	0.17	0.13	0.13	0.16	0.24	0.26	0.50	0.70	0.90	1.15	1.40
5-year	0.36	0.28	0.27	0.35	0.92	0.86	0.98	1.20	1.40	1.55	1.70	1.85
10-year	0.67	0.65	0.68	0.91	1.75	1.44	1.53	1.65	1.85	2.05	2.20	2.35
30-year	1.32	1.41	1.45	1.64	2.42	2.07	2.09	2.10	2.30	2.50	2.65	2.75
Yield curve slopes												
5-year - 3-month	0.25	0.12	0.17	0.26	0.89	0.81	0.94	1.10	1.25	1.35	1.25	1.15
10-year - 2-year	0.41	0.49	0.55	0.79	1.59	1.20	1.26	1.15	1.15	1.15	1.05	0.95
30-year - 3-month	1.21	1.25	1.35	1.55	2.39	2.02	2.05	2.00	2.15	2.30	2.20	2.05
CANADA												
Treasury bills												
3-month	0.21	0.20	0.12	0.06	0.09	0.15	0.12	0.15	0.25	0.35	0.60	0.75
Federal bonds												
2-year	0.42	0.28	0.25	0.20	0.22	0.45	0.53	0.95	1.05	1.15	1.30	1.45
5-year	0.60	0.36	0.36	0.39	0.99	0.97	1.11	1.35	1.50	1.65	1.80	1.90
10-year	0.71	0.52	0.57	0.67	1.55	1.39	1.51	1.70	1.85	2.00	2.10	2.20
30-year	1.32	0.99	1.11	1.21	1.97	1.84	1.98	2.10	2.25	2.35	2.40	2.45
Yield curve slopes												
5-year - 3-month	0.39	0.16	0.24	0.33	0.90	0.82	0.99	1.20	1.25	1.30	1.20	1.15
10-year - 2-year	0.29	0.24	0.32	0.47	1.33	0.94	0.98	0.75	0.80	0.85	0.80	0.75
30-year - 3-month	1.11	0.79	0.99	1.15	1.88	1.69	1.86	1.95	2.00	2.00	1.80	1.70
Yield spreads (Canada—United States)												
3-month	0.10	0.04	0.02	-0.03	0.06	0.10	0.08	0.05	0.10	0.15	0.15	0.05
2-year	0.17	0.11	0.12	0.07	0.06	0.21	0.27	0.45	0.35	0.25	0.15	0.05
5-year	0.24	0.08	0.09	0.04	0.07	0.11	0.13	0.15	0.10	0.10	0.10	0.05
10-year	0.04	-0.13	-0.11	-0.24	-0.20	-0.05	-0.02	0.05	0.00	-0.05	-0.10	-0.15
30-year	0.00	-0.42	-0.34	-0.43	-0.45	-0.23	-0.11	0.00	-0.05	-0.15	-0.25	-0.30

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Schedule 2021 of Central Bank Meetings

Date	Central banks	Decision	Rate
January			
14	Bank of Korea	s.q.	0.50
20	Bank of Brazil	s.q.	2.00
20	Bank of Canada*	s.q.	0.25
20	Bank of Japan	s.q.	-0.10
21	European Central Bank	s.q.	0.00
21	Bank of Norway	s.q.	0.00
27	Federal Reserve	s.q.	0.25
February			
1	Reserve Bank of Australia	s.q.	0.10
4	Bank of England	s.q.	0.10
10	Bank of Sweden	s.q.	0.00
11	Bank of Mexico	-25 b.p.	4.00
23	Reserve Bank of New Zealand	s.q.	0.25
24	Bank of Korea	s.q.	0.50
March			
1	Reserve Bank of Australia	s.q.	0.10
10	Bank of Canada	s.q.	0.25
11	European Central Bank	s.q.	0.00
17	Bank of Brazil	+75 b.p.	2.75
17	Federal Reserve	s.q.	0.25
18	Bank of England	s.q.	0.10
18	Bank of Norway	s.q.	0.00
18	Bank of Japan	s.q.	-0.10
25	Bank of Mexico	s.q.	4.00
25	Swiss National Bank	s.q.	-0.75
April			
6	Reserve Bank of Australia	s.q.	0.10
13	Reserve Bank of New Zealand	s.q.	0.25
14	Bank of Korea	s.q.	0.50
21	Bank of Canada*	s.q.	0.25
22	European Central Bank	s.q.	0.00
26	Bank of Japan	s.q.	-0.10
27	Bank of Sweden	s.q.	0.00
28	Federal Reserve	s.q.	0.25
May			
4	Reserve Bank of Australia	s.q.	0.10
5	Bank of Brazil	+75 b.p.	3.50
6	Bank of England	s.q.	0.10
6	Bank of Norway	s.q.	0.00
13	Bank of Mexico	s.q.	4.00
25	Reserve Bank of New Zealand	s.q.	0.25
26	Bank of Korea	s.q.	0.50
June			
1	Reserve Bank of Australia	s.q.	0.10
9	Bank of Canada	s.q.	0.25
10	European Central Bank	s.q.	0.00
16	Bank of Brazil	+75 b.p.	4.25
16	Federal Reserve	s.q.	0.25
17	Bank of Norway	s.q.	0.00
17	Bank of Japan	s.q.	-0.10
17	Swiss National Bank	s.q.	-0.75
24	Bank of England	s.q.	0.10
24	Bank of Mexico	+25 b.p.	4.25

Date	Central banks	Decision	Rate
July			
1	Bank of Sweden	s.q.	0.00
6	Reserve Bank of Australia	s.q.	0.10
13	Reserve Bank of New Zealand	s.q.	0.25
14	Bank of Canada*	s.q.	0.25
14	Bank of Korea	s.q.	0.50
15	Bank of Japan	s.q.	-0.10
22	European Central Bank	s.q.	0.00
28	Federal Reserve	s.q.	0.25
August			
3	Reserve Bank of Australia	s.q.	0.10
4	Bank of Brazil	+100 b.p.	5.25
5	Bank of England	s.q.	0.10
12	Bank of Mexico	+25 b.p.	4.50
17	Reserve Bank of New Zealand	s.q.	0.25
19	Bank of Norway	s.q.	0.00
25	Bank of Korea	+25 b.p.	0.75
September			
7	Reserve Bank of Australia	s.q.	0.10
8	Bank of Canada	s.q.	0.25
9	European Central Bank	s.q.	0.00
21	Bank of Sweden	s.q.	0.00
21	Bank of Japan	s.q.	-0.10
22	Bank of Brazil	+100 b.p.	6.25
22	Federal Reserve	s.q.	0.25
23	Bank of England	s.q.	0.10
23	Bank of Norway	+25 b.p.	0.25
23	Swiss National Bank	s.q.	-0.75
30	Bank of Mexico	+25 b.p.	4.75
October			
4	Reserve Bank of Australia	s.q.	0.10
5	Reserve Bank of New Zealand	+25 b.p.	0.50
11	Bank of Korea	s.q.	0.75
27	Bank of Brazil	+150 b.p.	7.75
27	Bank of Japan	s.q.	-0.10
27	Bank of Canada*	s.q.	0.25
28	European Central Bank	s.q.	0.00
November			
1	Reserve Bank of Australia	s.q.	0.10
3	Federal Reserve	s.q.	0.25
4	Bank of England	s.q.	0.10
4	Bank of Norway	s.q.	0.25
11	Bank of Mexico		
23	Reserve Bank of New Zealand		
24	Bank of Korea		
25	Bank of Sweden		
December			
6	Reserve Bank of Australia		
8	Bank of Brazil		
8	Bank of Canada		
15	Federal Reserve		
16	European Central Bank		
16	Bank of England		
16	Bank of Norway		
16	Bank of Mexico		
16	Bank of Japan		
16	Swiss National Bank		

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.