Rates Scenario for April 17, 2025

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Forecast Summary

(avg.)	Actual	Forecasts									
	2025	2025				2025		2026			
	Mar	Apr	May	Jun	Jul	Q3	Q4	Q1	Q2	Q3	Q4
BoC overnight[1]	2.75	2.75[2]	2.75	2.50	2.50	2.25	2.00	2.00	2.00	2.00	2.00
10-yr Canadas	3.01	3.05	3.05	3.00	3.00	2.95	2.90	2.80	2.75	2.80	2.95
Fed funds[1]	4.38	4.38	4.38	4.38	4.13	3.88	3.63	3.38	2.88	2.88	2.88
10-yr Treasuries	4.28	4.25	4.25	4.20	4.15	4.10	3.95	3.85	3.75	3.80	3.85
C$ per US$	1.44	1.40	1.40	1.40	1.41	1.41	1.40	1.39	1.38	1.37	1.36
US$/€	1.08	1.12	1.12	1.13	1.13	1.14	1.15	1.16	1.16	1.17	1.18
US$/£	1.29	1.31	1.31	1.32	1.32	1.32	1.33	1.33	1.33	1.34	1.34
¥/US$	149	144	144	143	143	142	141	140	139	139	138

[1] end of period; [2] actual value

Sources: BMO Economics, Haver Analytics

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Canada-U.S. Rates Outlook

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Tariff Twists and Turns

The U.S. Administration's hop-on hop-off tariff bus is running roughshod over global economic and financial market prospects. And it's emitting inflationary fumes into the U.S. economy, and into others as well—to the extent retaliatory measures or currency depreciation are road markers. The growth risks and stagflation stresses are complicating the work of central banks, but we reckon growth concerns will eventually dominate (if they don't already). While we can't predict the route the tariff bus will take, we're confident in our forecast for lower interest rates as this year unfolds.

Federal Reserve: The FOMC next meets on May 6-7, and we expect no change in policy rates, marking the third consecutive confab with such an outcome. The shift from 100 bps worth of rate cuts in the final four months of last year to nothing in at least the first five months of this year reflects two key factors. First, despite ebbing a bit, economic and labour market performance remains sturdy and inflation remains a little sticky. Chair Powell summed it up best in an April 16 speech: *"... the U.S. economy is still in a solid position. The labor market is at or near maximum employment. Inflation has come down a great deal but is running a bit above our 2 percent objective".*

The second reason is economic policy uncertainty. Again, Powell said, *"the new Administration is in the process of implementing substantial policy changes in four distinct areas: trade, immigration, fiscal policy, and regulation. Those policies are still evolving, and their effects on the economy remain highly uncertain."* Specifically, in the trade area, he said tariffs so far are *"significantly larger than anticipated"* likely leading to *"higher inflation and slower growth"* than anticipated. Powell opined that *"we may find ourselves in the challenging scenario in which our dual-mandate goals are in tension".* The thinking here seems to be to stand pat until the policy picture becomes clearer, and it's easier to see which side of the 'faster inflation vs. slower growth' policy scale is weighing heavier.

We reckon by the **July 29-30** meeting (a little over three months from now), there'll be sufficient clarity (with the scale clearly tipping to the slower growth side) to convince the **Fed to resume rate cuts**. But reflecting continued policy caution, we look for the rate cuts to come in back-to-back pairs, separated by a pause. This results in **three rate cuts by the end of this year** (one more than in our March 20 Rates Scenario) and **another three by June 2026**, leaving the range for the fed funds rate at 2.75%-to-3.00%. This is just a shade below the FOMC's median projection of the neutral level (3.00%).

Bank of Canada: The BoC paused on April 16, after reducing the policy rate by 225 bps over seven consecutive meetings. The last two rate cuts (since the start of the year… and the beginning of the Trump Administration) were motivated more by risk management considerations than by requisite policy recalibration in the wake of improved inflation readings. The Bank said: *"The major shift in direction of US trade policy and the unpredictability of tariffs have increased uncertainty, diminished prospects for economic growth, and raised inflation expectations."* Indeed, uncertainty has not only increased, it has become *"pervasive"*, which was a motivation to stand pat.

The Bank's response to the pervasive uncertainty was also to abandon the usual practice of publishing updated economic forecasts in the Monetary Policy Report. Instead, it presented two scenarios that embrace the bulk of plausible outcomes for the next couple of years. For the record, Scenario 1 assumes *"most of the new tariffs get negotiated away, but the process is unpredictable, and businesses and households remain cautious."* The economy stalls in Q2 but then begins to grow again only moderately. Inflation runs below the 2% target owing to the end of the carbon tax and the sluggish economy. Scenario 2 assumes *"a long-lasting global trade war."* The economy slips into a year-long recession before rebounding, but inflation still moves higher to peak above 3% before fading. We suspect the actual outcome will lie somewhere in between these two plausible extremes.

Going forward, the Bank said it *"will proceed carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include: the extent to which higher tariffs reduce demand for Canadian exports; how much this spills over into business investment, employment and household spending; how much and how quickly cost increases are passed on to consumer prices; and how inflation expectations evolve."* Note that the first two inclusions deal with the risks to growth and the last two deal with the risks to inflation. This is going to be a more difficult balancing act for the Bank, but we reckon the growth risks will eventually trump those for inflation. As before, **we still look for 75 bps worth of rate cuts by the end of this year** (to 2.00%… a bit below the Bank's 2.25%-to-3.25% estimate of the neutral range), but now expect them to occur more gradually as the year unfolds.

Bond yields: Ten-year Treasury yields are on track to average around 4.27% in April (based on the latest close), about where they averaged in March. The sideways move masks an extremely volatile start to the month. Bracing for the April 2 announcement of retaliatory tariffs (that turned out to be broader and more onerous than expected), and amid a sharp selloff in equities, bonds were rallying strongly. On April 8, the S&P 500 troughed, down more than 12% since the tariff announcement and nearly 19% from its mid-February record peak. Meanwhile, the (constant maturity) 10-year yield closed at 4.01% on April 4 (trading under 3.90% intraday), rallying more than 35 bps from late-March levels. A week later, on April 11, it closed at 4.48% (trading above 4.55% intraday). This was the largest five-day move since the Global Financial Crisis, apart from June 2022, when the Fed first lifted its rate hike cadence to 75 bps.

The juxtaposition of significant selloffs in both equities and bonds suggests margin calls triggered by the former may have sparked sales among the latter to raise cash. And, among leveraged investors in the bond market, there were margin calls as well as yields rose sharply. It sometimes doesn't take much to temper exuberance, particularly when the exuberance is exceptionally elevated owing to global growth-sapping reciprocal tariffs. As it was announced that reciprocal tariffs would be postponed (except for China), the bond market selloff continued in classic 'risk-on' form. Equity prices skyrocketed. The S&P 500 gained 9.5% on April 9, the largest daily gain in history except for two days in October 2008 (which were tied to coordinated central bank easing and the Fed's approaching first QE foray).

However, we can't stop thinking that some of the month's pressure on bond yields was owing to 'official' investors such as central banks and reserve fund managers. Potentially less net buying, or perhaps even net selling, would have been motivated mostly by escalating U.S. economic policy uncertainty; but, there may have been a bit of signaling about their role as a retaliatory tool.

On balance, with the Fed easing a little more and with the U.S. economy now sporting even higher average (growth-sapping) tariffs, **we look for 10-year yields to eventually average 3.75%** as Fed rate cuts unfold (it was 4.00% before). But the path to get there is now probably going to be even choppier.

Meanwhile, Canada-U.S. yield spreads are on track to average -120 bps this month (based on the latest closes), continuing to move away from the record level (-139 bps) averaged in January. The move has happened despite the typically supportive superfecta of relatively more central bank easing, weaker growth, and lower inflation, along with a better government budget position. Investors are likely looking further downfield, when Fed easing finally resumes and the U.S. economy (and not inflation) succumbs more to tariffs. On balance, while Canada-U.S. 10-year spreads could continue moving less negative as the year unfolds, we look for the -100 bp line to hold for the time being.

U.S. dollar: This month, the Fed's broad trade-weighted dollar index is on track to average 1.3% weaker than March's level. This marks the third consecutive monthly decline (for a cumulative 3.2%) since the greenback averaged a record high in January. With tariffs having been expected to net boost the big dollar, the sag in their wake (recall the first official tariffs announcement was on February 1) is surprising. No doubt part of this is the classic buy-on-rumour, sell-on-fact phenomenon. But U.S. tariffs do contribute to U.S. dollar strength. They reduce the amount of U.S. dollars being converted into foreign currencies owing to consequent reduced U.S. demand for imports. Although retaliatory tariffs would cause the opposite—less buying of U.S. dollars—the reduced selling would still dominate the reduced buying given the size of America's trade deficit. And apart from China and Canada, there hasn't yet been much in the way of retaliation.

Instead, it seems that more hesitancy (or outright reluctance) among global investors (both official and private) to invest in U.S. financial and other assets is overwhelming the influence of tariffs. To put this in balance of payments terms, the less net dollar selling owing to America's current account deficit is being dominated by less net dollar buying owing to its capital account surplus.

Although the reasons for any hesitancy among net capital inflows (such as elevated economic policy uncertainty) could persist, once tariffs are felt more fully throughout the economy, we reckon dollar depreciation could slow or even reverse somewhat. However, once the Fed resumes rate cuts (and we're expecting 150 bps' worth), the greenback's slide should resume. On balance, **by year-end, we look for the currency to decrease more than 4% from January's peak**, with an additional 2½% depreciation next year.

Canadian dollar: The loonie is on track to average C$1.400 this month (US$0.714), after averaging C$1.436 (US$0.696) last month. In January, when the U.S. dollar was peaking, the Canadian currency had depreciated to its weakest level in nearly 22 years (C$1.439 or US$0.695). Apart from the big dollar's drumbeat, the Canadian unit is also marching a bit to its own tune. The Bank of Canada has become more cautious and is no longer expected to 'out ease' the Fed on a trend basis. And although tariffs still weigh heavy on the loonie's wings, they have, so far, not turned out to be as onerous as they could have been. Going forward, we judge that the weakening impact of continued tariffs on the Canadian dollar will offset much of the weakening impact of resumed Fed rate cuts on the U.S. dollar. **For this year, most of the loonie net appreciation is already in the bag.**

Overseas

Jennifer Lee, Senior Economist

Uncertainty is the overriding theme these days.

Indeed, has it been 90 days yet? Much like reciprocal tariffs have been paused for 90 days, so, it seems, is the rest of the world. Everyone has moved to a quiet corner to reassess the situation, and to figure out what to negotiate in order to bring tariffs down. We are unlikely to get to zero, so what is a reasonable level to land at, and what will one give up in order to get there? Let the talks begin. Meantime, the rally in the likes of the EUR, GBP and JPY is likely to continue (see Tables), even as rates are cut.

The **ECB** just concluded its April 17th meeting, and in the face of "*exceptional uncertainty*", it unanimously decided to cut rates 25 bps, bringing the deposit facility down to 2.25%. It didn't have to. The Press Release outlined the reasons why: the disinflation process is "*well on track*"; wage growth is "*moderating*", and the economy has been "*building up some resilience against global shocks*". One can also include the coming wave of fiscal support (Germany, Brussels, for example), and the fact that we are in a cooling-off period, where the U.S. has paused reciprocal tariffs, the EU has paused its retaliatory tariffs on the metals levy, and talks (vague as they are) have begun. Finally, Italy's PM Meloni sat down with President Trump on the same day and proved to be the 'Trump whisperer'. Italy agreed to boost LNG imports and work on nuclear together. Trump said "*100% there will be an EU tariff deal*"; and, he accepted an invite to visit Italy

Why cut? The negative demand shock, and the "*cloud of uncertainty*" has the potential to impact households' and firms' decisions to spend and invest (FYI... this is happening everywhere), and the stronger EUR could slow exports. President Lagarde also pointed out the possibility of exports being "*re-routed*" to Europe by markets that are "*subject to much higher tariffs*". China was never named, but it was pretty obvious that is who she was referring to. President Lagarde highlighted "*confidence, predictability and a reasonable level of certainty*", three factors needed by central bankers to make decisions. And the need for access to "*safe data*", and for transparency. Hence, the ECB will remain on a data-dependent, meeting-by-meeting, non-committal path, which requires readiness to act in the face of unpredictability, and agility. Frankly, like other central banks, the ECB has no idea where this trade war is headed. But it is clearly prepared to do more, and to lend more support as needed, alongside the fiscal stimulus coming from other governments. **We continue to look for the next cut to come in June.**

The **BoE** will make its announcement on May 8, and it is widely expected to cut rates 25 bps to 4.25% for a combined reduction of 100 bps. It was slower out of the gate to start easing last year, but inflation has been cooling noticeably, which makes the decision easier. Headline CPI slowed to a 2.6% in March, while core dipped to 3.4%, both the lowest in three months. Importantly, services inflation unstuck itself from the 5% mark (where it has been for the past two months) and cooled to a 2-month low of 4.7%. It can be argued that it is still too high, but it is finally moving in the right direction. Real GDP growth in the three months to February was surprisingly strong—but all of this is a look in the rearview mirror. Since the BoE's last meeting in March, the U.S. slapped a base tariff of 10% on the U.K. Remember: PM Starmer had hoped to avoid one altogether, so this will have a negative impact on growth. The Bank's Financial Policy Committee warned recently that "*the probability of adverse events, and the potential severity of their impact, has risen*", and that "*a major shift in the nature and predictability of global trading arrangements could harm financial stability by depressing growth.*" Clearly, despite having a trade deficit with the U.S., the U.K. is not immune from the global trade war. **We continue to look for two more rate cuts this year**, finishing at 4.00%, with the risk of more.

The trade war has tossed **any thoughts of a near-term BoJ rate hike out the window**. Although above-target inflation is still problematic for the Bank, the trade war is likely more concerning for policymakers. After all, Japan is dealing with the baseline tariff of 10%; its 'reciprocal' tariff, though paused, was calculated at a hefty 24%; and, there is the matter of the 25% levy on imported cars. And cars are one of Japan's main exports to the U.S. In fact, the U.S. is the destination for nearly 20% of Japan's exports, so the tariffs will hurt the domestic economy, which makes it more unlikely for the BoJ to keep tightening. It also helps the inflation outlook given that the JPY has returned to its safe-haven status and has rallied over 10% since the start of the year, while energy prices have tumbled. **We no longer expect the BoJ to raise rates this year**, at least, until the clouds part over the trade war.

For the first time in well over a year, the **RBA** finally unglued itself from the sidelines in February, lowering the cash rate to 4.10%. The Board had "*more confidence*" about inflation moving lower, but it was not dovish. In fact, Governor Bullock drummed home the point that the move did not "*imply that further rate cuts*" were coming. Sure enough, the RBA kept rates unchanged at the next meeting in April (the day before Liberation Day), noting the "*considerable risks*" around the outlook. Interestingly, a rate cut was not explicitly considered, even though the Board was "*gradually gaining more confidence*" about inflation. This is when the Minutes come in handy. The Board felt that the May 19-20 meeting would be an "*opportune time*" to revisit policy, as there will be new staff forecasts on hand and more data (including the Q1 and March CPI figures) to chew on. Given how markets have been roiled by the changing tariff landscape, **a 25 bp rate cut is likely in May**. The next meeting after that is July 8, which is around when the 90-day pause is lifted.

Foreign Exchange Forecasts

(local currency per US$: avg.)		Actual 2025 Mar	Forecasts 2025 Apr	May	Jun	Jul	2025 Q3	Q4	2026 Q1	Q2	Q3	Q4
Canadian Dollar												
C$ per US$		1.44	1.40	1.40	1.40	1.41	1.41	1.40	1.39	1.38	1.37	1.36
US$ per C$[1]		0.697	0.714	0.713	0.712	0.711	0.710	0.713	0.718	0.723	0.728	0.733
Trade-weighted		112.6	114.7	114.5	114.3	114.2	114.0	114.1	114.6	115.0	115.5	116.0
U.S. Dollar												
Trade-weighted[2]		126.5	124.5	124.6	124.6	124.7	124.7	124.2	123.4	122.6	121.8	121.0
European Currencies												
Euro[1]		1.08	1.12	1.12	1.13	1.13	1.14	1.15	1.16	1.16	1.17	1.18
Danish Krone		6.90	6.65	6.65	6.60	6.60	6.55	6.50	6.45	6.40	6.40	6.35
Norwegian Krone		10.68	10.60	10.60	10.55	10.55	10.50	10.45	10.35	10.30	10.20	10.15
Swedish Krone		10.13	9.80	9.80	9.75	9.70	9.70	9.60	9.55	9.50	9.40	9.35
Swiss Franc		0.88	0.83	0.83	0.82	0.82	0.82	0.81	0.80	0.80	0.80	0.80
U.K. Pound[1]		1.29	1.31	1.31	1.32	1.32	1.32	1.33	1.33	1.33	1.34	1.34
Asian Currencies												
Chinese Yuan		7.25	7.30	7.31	7.31	7.32	7.33	7.34	7.34	7.33	7.32	7.30
Japanese Yen		149	144	144	143	143	142	141	140	139	139	138
Korean Won		1,458	1,435	1,435	1,435	1,430	1,430	1,425	1,425	1,420	1,420	1,415
Indian Rupee		86.5	85.6	85.7	85.7	85.8	85.8	86.0	85.9	85.8	85.6	85.5
Singapore Dollar		1.34	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.31
Malaysian Ringgit		4.43	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.40	4.40
Thai Baht		33.8	33.7	33.6	33.6	33.6	33.6	33.5	33.4	33.4	33.3	33.3
Philippine Peso		57.4	56.9	56.9	56.9	57.0	57.0	57.0	57.0	56.9	56.8	56.7
Taiwan Dollar		33.0	32.7	32.7	32.7	32.7	32.7	32.7	32.6	32.6	32.5	32.5
Indonesian Rupiah		16,465	16,815	16,830	16,845	16,860	16,875	16,920	16,915	16,885	16,860	16,830
Other Currencies												
Australian Dollar[1]		0.630	0.628	0.630	0.631	0.633	0.634	0.639	0.642	0.644	0.647	0.649
New Zealand Dollar[1]		0.573	0.580	0.581	0.581	0.582	0.583	0.584	0.587	0.589	0.592	0.594
Mexican Peso		20.22	20.10	20.30	20.45	20.65	20.80	20.75	20.40	20.05	19.70	19.35
Brazilian Real		5.76	5.85	5.80	5.75	5.70	5.70	5.55	5.45	5.40	5.35	5.25
South African Rand		18.3	19.0	18.9	18.8	18.7	18.7	18.4	18.3	18.2	18.1	18.0
Cross Rates												
Versus Canadian Dollar												
Euro	(C$/€)	1.55	1.57	1.58	1.58	1.59	1.60	1.61	1.61	1.61	1.61	1.61
U.K. Pound	(C$/£)	1.85	1.83	1.84	1.85	1.85	1.86	1.86	1.86	1.85	1.84	1.83
Japanese Yen	(¥/C$)	104	103	102	102	101	101	100	100	101	101	101
Australian Dollar	(C$/A$)	0.90	0.88	0.88	0.89	0.89	0.89	0.90	0.89	0.89	0.89	0.89
Versus Euro												
U.K. Pound	(£/€)	0.84	0.85	0.86	0.86	0.86	0.86	0.86	0.87	0.87	0.88	0.88
Japanese Yen	(¥/€)	161	161	161	161	161	161	161	161	162	162	163

[1] (US$ per local currency); [2] Federal Reserve Broad Index
Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

(% : avg.)	Actual 2025 Mar	Forecasts 2025 Apr	May	Jun	Jul	2025 Q3	Q4	2026 Q1	Q2	Q3	Q4
Canada											
Overnight target (period end)	2.75	2.75[6]	2.75	2.50	2.50	2.25	2.00	2.00	2.00	2.00	2.00
Overnight target	2.85	2.75[6]	2.75	2.54	2.50	2.47	2.20	2.00	2.00	2.00	2.00
CORRA[2]	2.86	2.76	2.76	2.54	2.51	2.47	2.20	2.00	2.00	2.00	2.00
3-month bills	2.67	2.60	2.65	2.45	2.40	2.35	2.10	1.95	1.95	1.95	1.95
6-month	2.65	2.60	2.60	2.45	2.40	2.40	2.20	2.05	2.05	2.05	2.05
1-year	2.60	2.55	2.50	2.40	2.35	2.30	2.10	2.05	2.05	2.10	2.10
2-year bonds	2.54	2.50	2.45	2.40	2.30	2.25	2.05	2.05	2.10	2.15	2.20
3-year	2.54	2.55	2.50	2.45	2.40	2.35	2.25	2.25	2.25	2.30	2.40
5-year	2.66	2.70	2.65	2.60	2.60	2.55	2.45	2.40	2.40	2.50	2.55
7-year	2.83	2.85	2.85	2.80	2.80	2.75	2.65	2.60	2.60	2.65	2.75
10-year	3.01	3.05	3.05	3.00	3.00	2.95	2.90	2.80	2.75	2.80	2.95
30-year	3.26	3.40	3.35	3.35	3.30	3.30	3.20	3.10	3.05	3.15	3.25
Prime rate	5.05	4.95[6]	4.95	4.74	4.70	4.67	4.40	4.20	4.20	4.20	4.20
United States											
Fed funds target (period end)	4.38	4.38	4.38	4.38	4.13	3.88	3.63	3.38	2.88	2.88	2.88
Fed funds target	4.38	4.38	4.38	4.38	4.36	4.17	3.82	3.45	3.17	2.88	2.88
EFFR[3]	4.33	4.33	4.33	4.33	4.32	4.13	3.79	3.43	3.16	2.88	2.88
SOFR[4]	4.33	4.34	4.31	4.31	4.30	4.11	3.78	3.42	3.15	2.87	2.87
3-month bills	4.34	4.35	4.35	4.35	4.30	4.10	3.75	3.40	3.10	2.80	2.80
6-month	4.27	4.20	4.20	4.20	4.20	4.00	3.70	3.40	3.15	2.90	2.90
1-year	4.06	3.95	3.95	3.90	3.85	3.75	3.50	3.25	3.05	2.90	2.95
2-year notes	3.97	3.80	3.75	3.65	3.60	3.55	3.35	3.15	2.95	2.95	3.00
3-year	3.96	3.80	3.75	3.70	3.65	3.60	3.45	3.30	3.15	3.15	3.20
5-year	4.04	3.90	3.90	3.85	3.80	3.75	3.60	3.50	3.35	3.35	3.45
7-year	4.16	4.10	4.05	4.00	3.95	3.90	3.80	3.70	3.55	3.60	3.65
10-year	4.28	4.25	4.25	4.20	4.15	4.10	3.95	3.85	3.75	3.80	3.85
30-year bonds	4.60	4.70	4.65	4.60	4.55	4.55	4.40	4.25	4.20	4.20	4.30
Prime rate	7.50	7.50	7.50	7.50	7.49	7.30	6.95	6.58	6.30	6.00	6.00
Other G7											
ECB Deposit Rate[1]	2.50	2.25[6]	2.25	2.00	2.00	1.75	1.75	1.75	1.75	1.75	1.75
10yr Bund	2.78	2.70	2.65	2.60	2.55	2.50	2.35	2.25	2.25	2.20	2.15
BoE Repo[1]	4.50	4.50	4.25	4.25	4.25	4.00	4.00	4.00	4.00	4.00	4.00
SONIA[5]	4.46	4.46	4.27	4.21	4.21	4.06	3.96	3.96	3.96	3.96	3.96
10yr Gilt	4.68	4.65	4.65	4.60	4.60	4.60	4.50	4.45	4.45	4.40	4.35
BoJ O/N[1]	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
10yr JGB	1.52	1.48	1.45	1.41	1.38	1.34	1.24	1.20	1.20	1.20	1.20

[1] end of period; [2] Canadian Overnight Repo Rate Average; [3] Effective Fed Funds Rate; [4] Secured Overnight Financing Rate; [5] Sterling Overnight Index Average; [6] actual value

Sources: BMO Economics, Haver Analytics

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