Rates Scenario for September 17, 2020

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Forecast Summary

	Actual 2020 Aug	Forecasts 2020 Sep	Oct	Nov	Dec	2021 Jan	Feb	2021 Q1	Q2	Q3	Q4
BoC overnight	0.25	0.25[1]	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-yr Canadas	0.56	0.55	0.60	0.60	0.65	0.65	0.70	0.70	0.75	0.80	0.90
Fed funds	0.13	0.13[1]	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
10-yr Treasuries	0.65	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.90	1.00
C$ per US$	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.31	1.31	1.30
US$/€	1.18	1.19	1.19	1.20	1.20	1.20	1.20	1.20	1.21	1.21	1.22
US$/£	1.31	1.29	1.29	1.29	1.29	1.29	1.30	1.30	1.31	1.32	1.33
MXN/US$	22.20	21.50	21.00	20.50	20.00	19.85	19.65	19.65	19.15	18.65	18.15
¥/US$	106	106	105	105	105	105	105	105	106	106	107

(policy rates are end of period; averages otherwise); [1] actual value
Sources: BMO Economics, Haver Analytics

North America

- We look for Federal Reserve and Bank of Canada policy rates to remain at their effective (zero) lower bounds past the end of 2023. This pushes back our previous projection by about half a year, contributing to slightly lower forecasted bond yields.
- At the end of August, the **FOMC** announced changes to its policy framework. For the goal of maximum employment, policy will now be informed by an assessment of the "*shortfall*" of employment from its maximum level, no longer the "*deviation*" from its maximum level. The latter meant that, as the unemployment rate approached its longer-run, or natural, rate (4.1%), the Fed would be inclined to tighten policy. However, seeing what the pre-pandemic run of sub-natural jobless rates resulted in (social broadening of employment and wage gains) and didn't result in (generalized inflation), preemptive tightening will no longer transpire. For the goal of price stability, **the FOMC is now targeting inflation that averages 2% over time**. This means that, after a period of sub-2% prints, for a while, the Fed will aim for inflation to overshoot a bit.
- Reflecting these changes, along with the U.S. economy's still-uncertain recuperation from the pandemic, the Fed altered its forward guidance on September 16th. The policy statement said that *"it will be appropriate to maintain this target range [0%-to-0.25%] until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time."* The Summary of Economic Projections' median calls and 'dot plot' corroborated this messaging. Headline and core PCE inflation are not expected to run above 2% before 2023; they only manage to hit 2% by that year. In turn, the fed funds rate remains at 0.125% through 2023, with a high degree of conviction among policymakers. After unanimity over this call for this year and next, only one participant has a rate hike in 2022 and only four have them in 2023.

- On September 9th, the **Bank of Canada** reiterated its forward guidance, first introduced in the previous (July 15th) policy statement, that *"the Governing Council will hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved."* And, that *"as the economy moves from reopening to recuperation, it will continue to require extraordinary monetary policy support."* Although the guidance remained the same, the next day, Governor Macklem's speech revealed elevated concern over the *"slow and choppy"* recuperation phase *"as the economy copes with ongoing uncertainty and structural challenges."* This should make the Bank more cautious about rate hikes, particularly with the Fed mapping out a longer road with low rates.
- Longer-term bond yields hit their post-pandemic (and record) lows at the start of August (10-year Treasuries under 55 bps, Canadas under 45 bps). They have since backed up around 15 bps. Stateside, as the new COVID-19 case rate dropped from a July peak of over 65k/day on average to around 40k currently, deflation risks ebbed in the market's mind. For the TIPS segment, 5-year expected inflation (5 years forward) has now returned to pre-pandemic levels. Despite the urging of Fed Chair Powell, agreement on another fiscal stimulus package has proved difficult in this politically-charged environment. There's a growing chance it might only arrive after the election.
- On both sides of the border, markets have taken massive budget deficits and escalating debt levels in stride, but we still judge bond supply will become an increasing concern once domestic and global demand for Treasuries and Canadas starts waning owing to rising investor risk appetites, reflecting, in turn, domestic and global business conditions getting sturdier and less uncertain. This will also become a bigger issue once central bank purchases end, but that's likely a 2022 story at the earliest. In the meantime, we look for only a mild uptrend in yields; e.g., 10-year tenors should only move firmly above 1% in 2022.
- The (trade-weighted) U.S. dollar index continues to drift weaker, now at January levels after spiking to a record high on March 23. The greenback is garnering little support from the current pandemic high in the global new case rate, as the dollar's medium-term prospects appear to be weighing. The Fed has been very aggressive on the QE front and this dollar-unfriendly (other things equal) policy looks to continue (at least) through next year as part of a now more accommodative course past 2023. Meanwhile, a massive Treasury budget deficit combined with a U.S. trade deficit no longer flattered by an improving energy trade balance indicate some eventual investor concern over the "twin deficits" and current account pressures. Add to this some near-term domestic political uncertainty along with the potential for more "risk on" than "risk off" days as pandemic fears finally recede, and you have the makings of a persistent weakening trend for the U.S. dollar. The latter should be the major force pushing the loonie firmer.

Overseas

- This year, the most commonly used words by policymakers likely have been "*uncertainty*" and "*downside risk*"; and, understandably so. The health crisis that has slammed the global economy has prompted central bankers to consider previously unused tools as the effectiveness of traditional ones has hit its limit. And with interest rates slashed to record lows, and likely remaining there for years to come, fiscal policy has also come out swinging. The combination of accommodative monetary and fiscal policies has helped economies recover, some at a faster-than-expected pace. But, momentum is cooling, and with a second wave of infections hitting some parts of the world, central bankers are waiting and watching, prepared to do more if needed.
- The one central bank that is facing, perhaps, additional uncommon hurdles, is the **Bank of England**. The BoE slashed its Bank Rate to a record-low 0.1% and raised its Asset Purchase Facility to £745 bln earlier this year. But its September 17 announcement was a surprise, as the Minutes indicated that, not only were all tools discussed, but "*the effectiveness of negative policy rates in particular*". In fact, the Committee was briefed about "*how a negative Bank Rate could be implemented effectively, should the outlook for inflation and output warrant it at some point during this period of low equilibrium rates. The Bank of England and the Prudential Regulation Authority will begin structured engagement on the operational considerations in 2020 Q4*." The more explicit language about the Bank's consideration of negative rates makes the possibility more real, particularly if the U.K. fails to secure a free-trade deal with the EU before the end of the transition period. This poses near-term downside risks to the British pound.
- The **ECB** has relied on record-low interest rates, the massive €1.35 trln Pandemic Emergency Purchase Programme, the Asset Purchase Program allowing for €20 bln/month of bond purchases, the €120 bln temporary envelope, and its refinancing operations (TLTRO III) to support the economy and to keep credit flowing. And because of those programs, the Euro Area economy has been recovering at a faster-than-expected rate, though it is beginning to falter. A resurgence in cases across Europe, particularly in Spain, poses a risk of another downturn, though governments are determined to avoid another widespread lockdown. Critical to the recovery will be the still-to-be-approved €750 bln EU Recovery Fund, which will give the ECB breathing room. But, further monetary stimulus cannot be ruled out, as the Governing Council is eyeing the euro's appreciation closely. As the ECB's Chief Economist Lane said, "*The euro-dollar rate does matter*."
- The **BoJ's** stance has been consistent and steady, even in the face of political change (Yoshihide Suga replaced Shinzo Abe as PM). At this week's meeting, the key policy rate was kept at -0.10%, and the Bank indicated that it would continue to target ~0% for 10-year JGBs. Its economic assessment of exports and industrial production was upgraded, with both now seen as turning up. This is quite the switch from the prior view that they were "*declining substantially*". However, capital spending is in the bad books.... at the last go around, the Bank said it was "*flat*"; now, it is on a declining trend. More broadly, the economic improvement is expected to be "*moderate*". And, of course, more action would be taken "*without hesitation, if needed*". No policy change is expected in the near term; but, it will be interesting to see what new policies PM Suga introduces in the coming months, unless he calls a snap election.

Foreign Exchange Forecasts

	Actual 2020 Aug	Forecasts 2020 Sep	Oct	Nov	Dec	2021 Jan	Feb	2021 Q1	Q2	Q3	Q4
Canadian Dollar											
C$ per US$	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.32	1.31	1.31	1.30
US$ per C$	0.756	0.758	0.758	0.758	0.758	0.759	0.759	0.759	0.762	0.765	0.768
Trade-weighted	117.9	117.4	116.9	116.4	116.0	116.0	116.0	116.0	116.1	116.2	116.2
U.S. Dollar											
Trade-weighted[1]	117.4	116.2	115.5	114.8	114.0	113.8	113.6	113.6	112.9	112.3	111.6
European Currencies											
Euro[2]	1.18	1.19	1.19	1.20	1.20	1.20	1.20	1.20	1.21	1.21	1.22
Danish Krone	6.29	6.25	6.25	6.25	6.20	6.20	6.20	6.20	6.15	6.15	6.10
Norwegian Krone	8.94	9.00	8.95	8.90	8.85	8.80	8.80	8.80	8.75	8.75	8.70
Swedish Krone	8.71	8.75	8.70	8.65	8.60	8.55	8.55	8.55	8.50	8.50	8.45
Swiss Franc	0.910	0.910	0.907	0.903	0.900	0.901	0.902	0.902	0.904	0.907	0.909
U.K. Pound[2]	1.31	1.29	1.29	1.29	1.29	1.29	1.30	1.30	1.31	1.32	1.33
Asian Currencies											
Chinese Yuan	6.93	6.80	6.77	6.73	6.70	6.70	6.69	6.69	6.68	6.67	6.65
Japanese Yen	106	106	105	105	105	105	105	105	106	106	107
Korean Won	1,187	1,180	1,165	1,155	1,140	1,140	1,140	1,140	1,135	1,135	1,130
Indian Rupee	74.6	73.5	73.3	73.2	73.0	73.0	72.9	72.9	72.8	72.7	72.5
Singapore Dollar	1.37	1.36	1.35	1.35	1.34	1.34	1.34	1.34	1.34	1.33	1.33
Taiwan Dollar	29.4	29.3	29.0	28.7	28.3	28.3	28.3	28.3	28.3	28.2	28.1
Other Currencies											
Australian Dollar[2]	0.720	0.730	0.733	0.737	0.740	0.741	0.742	0.742	0.744	0.747	0.749
New Zealand Dollar[2]	0.660	0.670	0.673	0.677	0.680	0.681	0.682	0.682	0.684	0.687	0.689
Mexican Peso	22.20	21.50	21.00	20.50	20.00	19.85	19.65	19.65	19.15	18.65	18.15
Brazilian Real	5.47	5.25	5.20	5.20	5.15	5.15	5.15	5.15	5.15	5.10	5.10
Russian Ruble	73.8	75.0	73.6	72.2	70.8	70.7	70.6	70.6	70.3	70.1	69.8
South African Rand	17.2	16.8	16.7	16.6	16.5	16.5	16.5	16.5	16.4	16.3	16.3
Cross Rates											
Versus Canadian Dollar											
Euro (C$/€)	1.57	1.57	1.57	1.58	1.58	1.58	1.58	1.58	1.58	1.59	1.59
U.K. Pound (C$/£)	1.74	1.70	1.70	1.70	1.70	1.71	1.71	1.71	1.71	1.72	1.73
Japanese Yen (¥/C$)	80	80	80	80	80	80	80	80	81	81	82
Australian Dollar (C$/A$)	0.95	0.96	0.97	0.97	0.98	0.98	0.98	0.98	0.98	0.98	0.98
Versus Euro											
U.K. Pound (£/€)	0.90	0.92	0.92	0.93	0.93	0.93	0.93	0.93	0.92	0.92	0.92
Japanese Yen (¥/€)	125	125	125	126	126	126	127	127	128	129	130

Local currency per U.S. Dollar (averages); [1] Federal Reserve Broad Index; [2] (US$ per local currency)

Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

	Actual	Forecasts									
	2020	2020				2021		2021			
	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Q1	Q2	Q3	Q4
Cdn. Yield Curve											
Overnight	0.25	0.25[1]	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3 month	0.16	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
6 month	0.18	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
1 year	0.22	0.20	0.20	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
2 year	0.28	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.35
3 year	0.29	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.35	0.40	0.45
5 year	0.38	0.35	0.35	0.40	0.40	0.40	0.45	0.45	0.50	0.55	0.60
7 year	0.42	0.40	0.40	0.45	0.45	0.50	0.50	0.50	0.55	0.60	0.70
10 year	0.56	0.55	0.60	0.60	0.65	0.65	0.70	0.70	0.75	0.80	0.90
30 year	1.07	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.25	1.30	1.35
1m BA	0.48	0.50	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45
3m BA	0.51	0.50	0.50	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45
6m BA	0.72	0.70	0.65	0.65	0.60	0.55	0.55	0.55	0.50	0.50	0.50
12m BA	0.79	0.75	0.75	0.70	0.70	0.70	0.65	0.65	0.60	0.60	0.60
Prime Rate	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45
U.S. Yield Curve											
Fed funds	0.13	0.13[1]	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
3 month	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month	0.12	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
1 year	0.13	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.20
2 year	0.14	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.20	0.20	0.25
3 year	0.16	0.15	0.15	0.15	0.20	0.20	0.20	0.20	0.25	0.30	0.35
5 year	0.27	0.30	0.30	0.30	0.30	0.35	0.35	0.35	0.40	0.45	0.50
7 year	0.46	0.45	0.50	0.50	0.50	0.55	0.55	0.55	0.60	0.70	0.75
10 year	0.65	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.90	1.00
30 year	1.36	1.45	1.45	1.45	1.50	1.50	1.50	1.50	1.55	1.60	1.65
1m LIBOR	0.16	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
3m LIBOR	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
6m LIBOR	0.31	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
12m LIBOR	0.45	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.45	0.45	0.45
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Other G7 Yields											
ECB Refi	0.00	0.00[1]	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10yr Bund	-0.47	-0.45	-0.45	-0.40	-0.40	-0.40	-0.35	-0.35	-0.30	-0.25	-0.15
BoE Repo	0.10	0.10[1]	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10yr Gilt	0.21	0.20	0.25	0.25	0.25	0.25	0.30	0.30	0.35	0.40	0.50
BoJ O/N	-0.06	-0.05[1]	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05
10yr JGB	0.03	0.01	-0.01	-0.03	-0.05	-0.05	-0.04	-0.04	-0.03	-0.02	0.00

Percent (policy and prime rates are end of period; averages otherwise); [1] actual value

Sources: BMO Economics, Haver Analytics

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