

# Rates Scenario for July 2, 2020

A Publication of BMO Capital Markets Economic Research · Douglas Porter, CFA, Chief Economist, BMO Financial Group

## Forecast Summary

	Actual	Forecasts									
	2020 Jun	2020 Jul	Aug	Sep	Oct	Nov	2020 Q4	2021 Q1	Q2	Q3	Q4
BoC overnight	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-yr Canadas	0.56	0.60	0.65	0.70	0.75	0.80	0.80	0.90	1.00	1.05	1.15
Fed funds	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
10-yr Treasuries	0.73	0.75	0.80	0.85	0.90	0.95	0.95	1.05	1.10	1.15	1.25
C\$ per US\$	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.34	1.34	1.33
US\$/€	1.13	1.13	1.13	1.14	1.14	1.15	1.15	1.15	1.15	1.16	1.16
US\$/£	1.25	1.25	1.25	1.26	1.26	1.26	1.26	1.27	1.28	1.29	1.30
MXN/US\$	22.30	21.90	21.55	21.15	20.75	20.40	20.40	19.65	19.15	18.65	18.15
¥/US\$	108	108	108	109	109	110	110	111	112	113	115

(policy rates are end of period; averages otherwise)

Sources: BMO Economics, Haver Analytics

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## North America

- We look for **Federal Reserve** and **Bank of Canada** policy rates to **remain at their zero lower bounds for the next few years**. Although we expect the U.S. and Canadian economies to have completely recovered from the recession by around the start of 2022, given underlying potential growth in the 1¾%-to-2% range, both economies will still sport sizable disinflationary output gaps deep into 2023. Also, given policymakers' apprehension about the pandemic's potential lasting economic damage along with its likely acceleration of (disinflationary) technological change, it appears that any shift toward monetary restraint is at least a few years away. Meanwhile, we judge monetary accommodation via quantitative easing and credit support will continue to be increased well into next year.
- We still look for **longer-term bond yields** to remain within their recent ranges, trading towards the upper bound on the combination of stronger-than-expected economic data and positive pandemic news, and trading toward the lower bound on the opposite combination. Once yields break out to the upside, the flatter longer-term profile for policy rates and more benign inflation prospects point to even more restrained rises over the forecast horizon. For example, we expect 10-year Treasury yields to mostly remain under 1% this year, 1.25% next year and under 1.5% during 2022.
- We had a taste of it during the mid-May/early-June interval (before COVID-19 cases began rising again in the U.S. and other countries), and we still look for the greenback to broadly weaken in the wake of improving pandemic and global economic prospects along with associated improvements in commodity prices and risk appetites. Against this background, we look for the **loonie** to average around C\$1.35 (US\$0.741) by the end of this year and C\$1.33 (US\$0.751) by the end of next year. This is a firmer profile for the Canadian dollar than we had previously expected as the worst pandemic, commodity (oil) market and Canadian economic scenarios now seem to have less risk of happening.

## Overseas

- We are quite happy to **close the chapter on the first half of 2020**. The first six months certainly didn't pan out the way anyone expected. At the beginning of the year, Christine Lagarde had just started her new job as the ECB President. While she described herself as not quite a dove or a hawk, but a wise owl, she morphed into a full-fledged dove with the onset of the pandemic. The ECB's plan to embark on a year-long overdue comprehensive Strategy Review was quickly shoved aside for a massive QE program. The BoE is still facing the possibility of a hard Brexit; but, it is also focused on damage control from the coronavirus. The Bank of Japan hasn't changed its communication. Although, these days, when Governor Kuroda says he will not hesitate to unleash more monetary stimulus if needed, he really means it. Most of the central banks' actions to protect their respective economies from being strangled by the effects of the virus have been done (mostly in March); now, all will wait and watch for the recovery to take hold. And, if necessary, more will be done.
- The **ECB** was a bit slower to react to COVID-19 but it made up for it. Now, it is armed with a "*temporary envelope*" of €120 bln for asset purchases until the end of the year, a €1.35 trln Pandemic Emergency Purchase Program (PEPP), which will run until June 2021, and the earlier Public Sector Purchase Program (PSPP), which allows €20 bln per month for bond purchases for as long as necessary. Plus, there's a series of non-targeted pandemic emergency longer-term refinancing operations (PELTROS), other instruments (the targeted longer-term refinancing operations, or TLTRO), and a new precautionary backstop facility called the Eurosystem repo facility (EUREP). On top of the over €1.4 trln of assets that it can buy, there is the yet-to-pass €750 bln EU Recovery Fund. And a big source of relief came from the settling of the recent dispute between the German constitutional court and the ECB as it had the potential to cause massive damage. All in, unless the Euro Area economy takes another turn for the worse, there should be enough monetary and fiscal stimulus to guide Europe through the pandemic.
- Andrew Bailey took over as head of the **BoE** in March, and threw his two pence into the decision to slash rates to a wafer-thin 0.1% and increase QE by £200 bln to £645 bln. Since then, the former regulator lifted QE again (to £745 bln), citing his concerns about a "*significant weakening in the labour market*". The broader economy shrank at its fastest pace in four decades in Q1, and Q2 promises to be far worse. However, with better data of late, Britain may avoid what the BoE had expected earlier this year .... the largest economic decline since the Great Frost of 1709. Still, the economy is just starting to recover from the COVID-19 shutdown, but it could easily get knocked down again if the EU/UK talks fail.
- The usual dovishness prevails at the **Bank of Japan** but more so now, as the economy recovers from the lockdowns. (Note that Japan's lockdowns were lighter than other countries.) Although policymakers will "*closely monitor*" the effects of their policy actions, Governor Kuroda describes the economy as being in an "*extremely severe situation*". The latest round was an introduction of Japan's own version of the Fed's Main Street Lending program, called the "*New Fund-Provisioning Measure to Support Financing Mainly of Small and Medium-Sized Firms*". Although the name doesn't exactly roll off the tongue, it will see interest-free loans lent to these firms for up to a year. On top of this, the government rolled out a record amount of stimulus (¥234.2 trln, or 42% of GDP) to support growth. Time will tell if more is needed.

## Foreign Exchange Forecasts

	Actual	Forecasts					2020 Q4	2021 Q1	Q2	Q3	Q4
	2020 Jun	2020 Jul	Aug	Sep	Oct	Nov					
<b>Canadian Dollar</b>											
C\$ per US\$	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.34	1.34	1.33
US\$ per C\$	0.738	0.738	0.739	0.739	0.740	0.740	0.740	0.743	0.745	0.748	0.751
Trade-weighted	116.5	116.3	116.1	116.0	115.8	115.6	115.6	115.5	115.5	115.5	115.5
<b>U.S. Dollar</b>											
Trade-weighted <sup>1</sup>	119.9	119.6	119.3	118.9	118.5	118.1	118.1	117.3	116.7	116.0	115.3
<b>European Currencies</b>											
Euro <sup>2</sup>	1.13	1.13	1.13	1.14	1.14	1.15	1.15	1.15	1.15	1.16	1.16
Danish Krone	6.62	6.60	6.55	6.55	6.55	6.50	6.50	6.45	6.45	6.45	6.45
Norwegian Krone	9.53	9.50	9.45	9.40	9.40	9.35	9.35	9.20	9.00	8.85	8.70
Swedish Krone	9.31	9.25	9.20	9.20	9.15	9.10	9.10	9.00	8.95	8.90	8.85
Swiss Franc	0.951	0.958	0.964	0.971	0.977	0.984	0.984	0.992	0.994	0.997	0.999
U.K. Pound <sup>2</sup>	1.25	1.25	1.25	1.26	1.26	1.26	1.26	1.27	1.28	1.29	1.30
<b>Asian Currencies</b>											
Chinese Yuan	7.08	7.08	7.07	7.07	7.06	7.06	7.06	7.03	7.01	6.98	6.96
Japanese Yen	108	108	108	109	109	110	110	111	112	113	115
Korean Won	1,207	1,205	1,205	1,205	1,200	1,200	1,200	1,195	1,190	1,185	1,185
Indian Rupee	75.7	75.6	75.5	75.4	75.2	75.1	75.1	74.7	74.2	73.7	73.2
Singapore Dollar	1.39	1.39	1.38	1.38	1.38	1.37	1.37	1.37	1.36	1.36	1.36
Taiwan Dollar	29.7	29.6	29.6	29.6	29.6	29.6	29.6	29.5	29.3	29.1	28.9
<b>Other Currencies</b>											
Australian Dollar <sup>2</sup>	0.690	0.692	0.693	0.695	0.697	0.698	0.698	0.702	0.704	0.707	0.709
New Zealand Dollar <sup>2</sup>	0.645	0.647	0.650	0.652	0.655	0.657	0.657	0.662	0.664	0.667	0.669
Mexican Peso	22.30	21.90	21.55	21.15	20.75	20.40	20.40	19.65	19.15	18.65	18.15
Brazilian Real	5.19	5.15	5.15	5.15	5.15	5.10	5.10	5.05	4.95	4.85	4.80
Russian Ruble	69.3	69.1	68.9	68.7	68.4	68.2	68.2	67.9	67.7	67.5	67.3
South African Rand	17.1	17.1	17.1	17.1	17.0	17.0	17.0	17.0	16.9	16.8	16.8
<b>Cross Rates</b>											
<b>Versus Canadian Dollar</b>											
Euro (C\$/€)	1.53	1.53	1.53	1.54	1.54	1.55	1.55	1.55	1.55	1.55	1.54
U.K. Pound (C\$/£)	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.71	1.71	1.72	1.73
Japanese Yen (¥/C\$)	79	80	80	80	81	81	81	82	84	85	86
Australian Dollar (C\$/A\$)	0.93	0.94	0.94	0.94	0.94	0.94	0.94	0.94	0.94	0.94	0.94
<b>Versus Euro</b>											
U.K. Pound (£/€)	0.90	0.90	0.90	0.91	0.91	0.91	0.91	0.91	0.90	0.90	0.89
Japanese Yen (¥/€)	121	122	123	124	125	126	126	128	129	131	133

Local currency per U.S. Dollar (averages); <sup>1</sup> Federal Reserve Broad Index; <sup>2</sup> (US\$ per local currency)

Sources: BMO Economics, Haver Analytics

## Interest Rate Forecasts

	Actual	Forecasts					2020	2021	Q2	Q3	Q4
	2020	2020	Aug	Sep	Oct	Nov					
	Jun	Jul	Aug	Sep	Oct	Nov	Q4	Q1	Q2	Q3	Q4
<b>Cdn. Yield Curve</b>											
Overnight	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3 month	0.19	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
6 month	0.23	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
1 year	0.27	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.35	0.35	0.35
2 year	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.45	0.45	0.45
3 year	0.30	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.55	0.60	0.65
5 year	0.40	0.45	0.45	0.50	0.55	0.60	0.60	0.65	0.70	0.75	0.80
7 year	0.42	0.50	0.55	0.60	0.65	0.70	0.70	0.80	0.85	0.90	0.95
10 year	0.56	0.60	0.65	0.70	0.75	0.80	0.80	0.90	1.00	1.05	1.15
30 year	1.08	1.15	1.20	1.25	1.30	1.35	1.35	1.45	1.55	1.65	1.75
1m BA	0.52	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3m BA	0.56	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
6m BA	0.78	0.75	0.70	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65
12m BA	0.85	0.80	0.80	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.80
Prime Rate	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45
<b>U.S. Yield Curve</b>											
Fed funds	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
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	0.18	0.20	0.20	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.35
2 year	0.19	0.20	0.25	0.30	0.35	0.35	0.35	0.40	0.45	0.45	0.50
3 year	0.22	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.65
5 year	0.34	0.40	0.45	0.50	0.60	0.65	0.65	0.75	0.75	0.80	0.85
7 year	0.55	0.60	0.65	0.70	0.75	0.80	0.80	0.90	0.95	1.00	1.05
10 year	0.73	0.75	0.80	0.85	0.90	0.95	0.95	1.05	1.10	1.15	1.25
30 year	1.49	1.55	1.60	1.65	1.65	1.70	1.70	1.80	1.85	1.95	2.00
1m LIBOR	0.18	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
3m LIBOR	0.31	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
6m LIBOR	0.43	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45
12m LIBOR	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.70	0.75	0.75	0.75
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
<b>Other G7 Yields</b>											
ECB Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10yr Bund	-0.40	-0.35	-0.25	-0.20	-0.15	-0.05	-0.05	0.05	0.05	0.10	0.15
BoE Repo	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10yr Gilt	0.23	0.30	0.30	0.35	0.40	0.45	0.45	0.55	0.60	0.65	0.75
BoJ O/N	-0.07	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04
10yr JGB	0.01	0.00	-0.02	-0.04	-0.06	-0.08	-0.08	-0.10	-0.10	-0.10	-0.10

Percent (policy and prime rates are end of period; averages otherwise)

Sources: BMO Economics, Haver Analytics

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