

# The Yield Curve

May 28, 2015

## UPDATE

### HIGHLIGHTS

- The upwards trend in long-term bond yields continued until mid-May, and the U.S. 10-year yield temporarily surpassed 2.35%, a peak since last November. This trend subsequently reversed course somewhat, taking that yield to around 2.15%. Bond yields in other countries followed a similar trend, with the German 10-year yield reaching 0.75% before dropping back to around 0.55%.
- The recent change in bond market trends occurred at the same time as oil prices softened and the U.S. dollar rallied. Currencies appear to be having an especially strong influence on the financial markets at the moment. Somewhat better U.S. data, promoting appreciation of the dollar, are tending to put downwards pressure on both oil prices and bond yields, which might seem counter-intuitive.
- The minutes of the latest Federal Reserve (Fed) meeting show that the officials are still expecting an acceleration of the U.S. economy after a disappointing start to the year. But they seemed a bit more worried, and noted some downside risks for the U.S. economy, relating to the strength of the dollar and less robust consumption than expected, among other things. Therefore, a key interest rate hike at the June meeting is increasingly improbable.
- After several disappointments, a few U.S. data have recently painted a somewhat rosier picture. In particular, job growth returned to a decent level in April, and housing starts surged to their highest point since November 2007.
- The Bank of Canada (BoC) left its target for the overnight rate at 0.75% at its May 27 meeting. After a weak first quarter, the BoC is still optimistic that the return to solid growth in the United States will soon support exports and business investment in Canada. It also notes that consumption is still relatively firm. However, The BoC points out that a lasting appreciation of the Canadian dollar could force it to re-assess the situation.
- Comments by an official that the European Central Bank (ECB) would temporarily accelerate its asset purchases before the summer slack period helped to reverse several financial market trends in the middle of May. The ECB subsequently exacerbated the euro's decline by dissipating speculations of a possible early halt to its bond purchases. The continued risk of default by the Greek government also contributed to the common currency's slump.
- Higher-than-expected economic growth in Japan in the first quarter reduced the likelihood of the Bank of Japan intensifying its quantitative measures in the near future. In the United Kingdom, the strength of the pound and the crossing of inflation into negative territory provide confirmation that the Bank of England will bide its time before embarking on monetary tightening.

### INTEREST RATE FORECASTS

- We are still predicting that the Fed will start very gradual monetary tightening when it meets this September. This scenario is however based on the assumption that U.S. economic data will keep improving, confirming that the weakness at the beginning of the year was only a temporary rough patch. In Canada, the key interest rate status quo will likely continue until the spring of 2016.
- The recent decline in long-term bond yields is bolstering our belief that the earlier upwards movement was a bit too fast, like that of oil prices. Bond yields will probably fluctuate close to their current levels in the months to come, and then start heading up more sustainably towards the end of the summer. We are maintaining our year-end targets.

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**Table 1**  
**Key interest rates**

End of period in %	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>United States</b>												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00	1.25	1.50
<b>Canada</b>												
Overnight funds	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25
<b>Euro zone</b>												
Refinancing rate	0.25	0.15	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
<b>United Kingdom</b>												
Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
<b>Japan</b>												
Overnight funds	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**  
**Schedule and key rates**

Date	Central Bank	Decision	Rate
<b>March 2015</b>			
11	Bank of Korea	-25 b.p.	1.75
11	Reserve Bank of New Zealand	s.q.	3.50
16-17	Bank of Japan	---	---
18	Bank of Sweden	-15 b.p.	-0.25
18	Federal Reserve	s.q.	0,00 / 0,25
19	Bank of Norway	s.q.	1.25
19	Swiss National Bank	s.q.	-0.75
26	Bank of Mexico	s.q.	3.00
<b>April 2015</b>			
7	Reserve Bank of Australia	s.q.	2.25
7-8	Bank of Japan	---	---
9	Bank of England	s.q.	0.50
9	Bank of Korea	s.q.	1.75
15	European Central Bank	s.q.	0.05
15	Bank of Canada	s.q.	0.75
29	Reserve Bank of New Zealand	s.q.	3.50
29	Bank of Sweden	s.q.	-0.25
29	Bank of Brazil	+50 b.p.	13.25
29	Federal Reserve	s.q.	0,00 / 0,25
30	Bank of Japan	---	---
30	Bank of Mexico	s.q.	3.00
<b>May 2015</b>			
5	Reserve Bank of Australia	-25 b.p.	2.00
7	Bank of Norway	s.q.	1.25
11	Bank of England	s.q.	0.50
15	Bank of Korea	s.q.	1.75
21-22	Bank of Japan	---	---
27	Bank of Canada	s.q.	0.75

 s.q.: status quo; b.p.: basis points  
 Source: Desjardins, Economic Studies

**Table 3**  
**Coming soon**

Date	Central Bank
<b>June 2015</b>	
2	Reserve Bank of Australia
3	European Central Bank
3	Bank of Brazil
4	Bank of England
4	Bank of Mexico
10	Reserve Bank of New Zealand
11	Bank of Korea
17	Federal Reserve
18	Bank of Norway
18	Swiss National Bank
18-19	Bank of Japan
<b>July 2015</b>	
2	Bank of Sweden
7	Reserve Bank of Australia
9	Bank of England
9	Bank of Korea
14-15	Bank of Japan
15	Bank of Canada
16	European Central Bank
22	Reserve Bank of New Zealand
23	Bank of Mexico
29	Bank of Brazil
29	Federal Reserve
<b>August 2015</b>	
4	Reserve Bank of Australia
6	Bank of England
6-7	Bank of Japan
12	Bank of Korea

Source: Desjardins, Economic Studies

**Table 4**  
**United States: fixed income market**

End of period in %	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>Key rate</b>												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00	1.25	1.50
<b>Treasury bills</b>												
3-month	0.05	0.04	0.02	0.04	0.03	0.05	0.50	0.65	0.70	1.00	1.20	1.50
<b>Federal bonds</b>												
2-year	0.39	0.42	0.56	0.63	0.54	0.70	1.00	1.20	1.30	1.55	1.70	1.80
5-year	1.71	1.60	1.77	1.64	1.37	1.60	1.75	1.90	2.00	2.15	2.30	2.40
10-year	2.73	2.52	2.51	2.17	1.93	2.15	2.30	2.45	2.50	2.65	2.80	3.00
30-year	3.56	3.34	3.21	2.75	2.54	2.85	2.90	2.95	3.00	3.10	3.20	3.35
<b>Yield curve</b>												
5-year - 3-month	1.66	1.56	1.75	1.60	1.34	1.55	1.25	1.25	1.30	1.15	1.10	0.90
10-year - 2-year	2.34	2.09	1.95	1.54	1.39	1.45	1.30	1.25	1.20	1.10	1.10	1.20
30-year - 3-month	3.51	3.30	3.19	2.71	2.51	2.80	2.40	2.30	2.30	2.10	2.00	1.85

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

**Table 5**  
**Canada: fixed income market**

End of period in %	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>Key rate</b>												
Federal funds	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25
<b>Treasury bills</b>												
3-month	0.89	0.94	0.92	0.92	0.56	0.65	0.65	0.65	0.70	1.00	1.10	1.40
<b>Federal bonds</b>												
2-year	1.07	1.10	1.12	1.01	0.50	0.70	0.85	0.95	1.05	1.30	1.45	1.55
5-year	1.71	1.53	1.63	1.34	0.76	1.05	1.20	1.35	1.50	1.70	1.80	1.90
10-year	2.46	2.24	2.15	1.79	1.36	1.70	1.75	1.85	1.95	2.20	2.30	2.40
30-year	2.96	2.78	2.67	2.34	1.98	2.30	2.35	2.40	2.45	2.60	2.65	2.80
<b>Yield curve</b>												
5-year - 3-month	0.82	0.59	0.71	0.42	0.20	0.40	0.55	0.70	0.80	0.70	0.70	0.50
10-year - 2-year	1.39	1.14	1.03	0.78	0.86	1.00	0.90	0.90	0.90	0.90	0.85	0.85
30-year - 3-month	2.07	1.84	1.75	1.42	1.42	1.65	1.70	1.75	1.75	1.60	1.55	1.40
<b>Spreads (Canada - U.S.)</b>												
3-month	0.84	0.90	0.90	0.88	0.53	0.60	0.15	0.00	0.00	0.00	-0.10	-0.10
2-year	0.68	0.68	0.56	0.38	-0.04	0.00	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25
5-year	-0.00	-0.07	-0.14	-0.30	-0.61	-0.55	-0.55	-0.55	-0.50	-0.45	-0.50	-0.50
10-year	-0.27	-0.28	-0.36	-0.38	-0.57	-0.45	-0.55	-0.60	-0.55	-0.45	-0.50	-0.60
30-year	-0.60	-0.56	-0.54	-0.41	-0.56	-0.55	-0.55	-0.55	-0.55	-0.50	-0.55	-0.55

f: forecasts

Sources: Datastream and Desjardins, Economic Studies