

The Yield Curve



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UPDATE

HIGHLIGHTS

- Unlike most other asset classes, bonds have done very well over the last few months, with a variety of factors prompting a substantial drop of bond yields. The U.S. 10-year yield, which was above 2.40% at the start of July, recently slid below 2.00%. Yields dropped even more sharply in Canada, where the 10-year yield fell to around 1.25%.
- Tumbling oil prices had a big role in the summer pullback in bond yields. The conclusion of an agreement on Iran's nuclear program at the start of July suggests that output from the Organization of the Petroleum Exporting Countries (OPEC) will continue to surge in the coming quarters, keeping the global oil market in surplus. This, combined with growing concern about Chinese demand, took WTI (West Texas Intermediate) oil prices below US\$40 a barrel, and pulled inflation expectations down sharply.
- Beyond its impact on commodity prices, increasing worry over China also fostered demand for safe-haven securities. Initially, investors did not seem too concerned about the Chinese stock market correction, but strains in the international markets shot up as of mid-August, when the surprise yuan devaluation was construed as a panic gesture from Chinese authorities. Very stable since the start of the year, the VIX index of the S&P 500's implicit volatility recently jumped to its highest level since the 2008 financial crisis, when a wave of panic rolled through the markets. Surging tensions also made spreads between corporate and federal bond yields widen.
- Federal Reserve (Fed) leaders are maintaining the suspense over the September 17 meeting. The July meeting's minutes signalled that the job market had improved nearly enough to justify raising key rates, but leaders would like more evidence that economic growth was sufficiently strong to push inflation up before going into action. The U.S. data released since the July meeting seem strong enough to justify a first rate hike in September, but the surge in financial strains and tumble of oil prices argue for a status quo.
- The Canadian economy's serious problems convinced the Bank of Canada (BoC) to cut its key rates by another 0.25% in July. However, the BoC remains fairly optimistic about the second half of 2015, suggesting it will not further relax its monetary policy in the near future. The election period and better Canadian data for June, especially a major rebound of exports, also argue for a status quo. However, the new tumble taken by oil prices will force the BoC to remain vigilant.

INTEREST RATE FORECASTS

- The extensive market volatility seen recently should not have any lasting consequences for the North American economies. We therefore still expect the Fed to start very gradual monetary firming shortly, which will foster a rise in bond yields. The September meeting decision will be heavily influenced by what the financial markets do over the coming weeks.
- We now expect weak oil prices to persist next year. This will prompt the BoC to wait until 2017 before initiating monetary firming. We could see another rate cut toward the end of 2015 if the problems in Canada's economy persist, but the probability of such a scenario is less than 50%.

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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 %	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
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
Canada												
Overnight funds	1.00	1.00	1.00	1.00	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50
Euro zone												
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
United Kingdom												
Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.25
Japan												
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
June 2015			
2	Reserve Bank of Australia	s.q.	2.00
3	European Central Bank	s.q.	0.05
3	Bank of Brazil	+50 b.p.	13.75
4	Bank of England	s.q.	0.50
4	Bank of Mexico	s.q.	3.00
10	Bank of Korea	-25 b.p.	1.50
10	Reserve Bank of New Zealand	-25 b.p.	3.25
17	Federal Reserve	s.q.	0.00 / 0.25
18	Bank of Norway	-25 b.p.	1.00
18	Swiss National Bank	s.q.	-0.75
18-19	Bank of Japan	---	---
July 2015			
2	Bank of Sweden	-10 b.p.	-0.35
7	Reserve Bank of Australia	s.q.	2.00
8	Bank of Korea	s.q.	1.50
9	Bank of England	s.q.	0.50
14-15	Bank of Japan	---	---
15	Bank of Canada	-25 b.p.	0.50
16	European Central Bank	s.q.	0.05
22	Reserve Bank of New Zealand	-25 b.p.	3.00
29	Bank of Brazil	+50 b.p.	14.25
29	Federal Reserve	s.q.	0.00 / 0.25
30	Bank of Mexico	s.q.	3.00
August 2015			
4	Reserve Bank of Australia	s.q.	2.00
6	Bank of England	s.q.	0.50
6-7	Bank of Japan	---	---
12	Bank of Korea	s.q.	1.50

s.q.: status quo; b.p.: basis points

Source: Desjardins, Economic Studies

Table 3
Coming soon

Date	Central Bank
September 2015	
1	Reserve Bank of Australia
2	Bank of Brazil
3	European Central Bank
3	Bank of Sweden
9	Reserve Bank of New Zealand
9	Bank of Canada
10	Bank of England
11	Bank of Korea
14-15	Bank of Japan
17	Swiss National Bank
17	Federal Reserve
21	Bank of Mexico
24	Bank of Norway
October 2015	
5	Reserve Bank of Australia
6-7	Bank of Japan
8	Bank of England
14	Bank of Korea
21	Bank of Brazil
21	Bank of Canada
22	European Central Bank
28	Reserve Bank of New Zealand
28	Bank of Sweden
28	Federal Reserve
29	Bank of Mexico
30	Bank of Japan
November 2015	
2	Reserve Bank of Australia
5	Bank of England

Source: Desjardins, Economic Studies

Table 4
United States: fixed income market

End of period in %	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key rate												
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
Treasury bills												
3-month	0.05	0.04	0.02	0.04	0.03	0.01	0.30	0.50	0.65	1.00	1.10	1.50
Federal bonds												
2-year	0.39	0.42	0.56	0.63	0.54	0.58	0.90	1.10	1.30	1.50	1.65	1.80
5-year	1.71	1.60	1.77	1.64	1.37	1.62	1.75	1.90	2.05	2.20	2.30	2.45
10-year	2.73	2.52	2.51	2.17	1.93	2.33	2.35	2.50	2.55	2.65	2.75	2.90
30-year	3.56	3.34	3.21	2.75	2.54	3.10	3.00	3.10	3.10	3.15	3.25	3.35
Yield curve												
5-year - 3-month	1.66	1.56	1.75	1.60	1.34	1.61	1.45	1.40	1.40	1.20	1.20	0.95
10-year - 2-year	2.34	2.09	1.95	1.54	1.39	1.75	1.45	1.40	1.25	1.15	1.10	1.10
30-year - 3-month	3.51	3.30	3.19	2.71	2.51	3.09	2.70	2.60	2.45	2.15	2.15	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	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key rate												
Federal funds	1.00	1.00	1.00	1.00	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50
Treasury bills												
3-month	0.89	0.94	0.92	0.92	0.56	0.58	0.40	0.40	0.40	0.40	0.45	0.50
Federal bonds												
2-year	1.07	1.10	1.12	1.01	0.50	0.48	0.40	0.40	0.50	0.60	0.70	0.85
5-year	1.71	1.53	1.63	1.34	0.76	0.82	0.80	0.90	1.00	1.10	1.20	1.45
10-year	2.46	2.24	2.15	1.79	1.36	1.69	1.50	1.65	1.70	1.75	1.85	2.10
30-year	2.96	2.78	2.67	2.34	1.98	2.31	2.25	2.30	2.30	2.35	2.45	2.60
Yield curve												
5-year - 3-month	0.82	0.59	0.71	0.42	0.20	0.24	0.40	0.50	0.60	0.70	0.75	0.95
10-year - 2-year	1.39	1.14	1.03	0.78	0.86	1.21	1.10	1.25	1.20	1.15	1.15	1.25
30-year - 3-month	2.07	1.84	1.75	1.42	1.42	1.73	1.85	1.90	1.90	1.95	2.00	2.10
Spreads (Canada - U.S.)												
3-month	0.84	0.90	0.90	0.88	0.53	0.57	0.10	-0.10	-0.25	-0.60	-0.65	-1.00
2-year	0.68	0.68	0.56	0.38	-0.04	-0.10	-0.50	-0.70	-0.80	-0.90	-0.95	-0.95
5-year	-0.00	-0.07	-0.14	-0.30	-0.61	-0.80	-0.95	-1.00	-1.05	-1.10	-1.10	-1.00
10-year	-0.27	-0.28	-0.36	-0.38	-0.57	-0.64	-0.85	-0.85	-0.85	-0.90	-0.90	-0.80
30-year	-0.60	-0.56	-0.54	-0.41	-0.56	-0.79	-0.75	-0.80	-0.80	-0.80	-0.80	-0.75

f: forecasts

Sources: Datastream and Desjardins, Economic Studies