

# The Yield Curve

November 3, 2015

## All eyes are on the Federal Reserve

### HIGHLIGHTS

- North American bond yields were fairly stable during the first weeks of October, contrary to the stock markets, which recorded a strong rally. But by signalling on October 28 that monetary firming was still possible in December, the Federal Reserve (Fed) drove bond yields up.
- The Fed's decision to maintain the status quo in September raised many doubts about its intention to start monetary firming soon. The release of some disappointing economic data, including a sharp slowdown in job creation, bolstered the perception that key interest rates will end the year at floor level. Some Fed leaders promoted that impression by emphasizing that they would prefer to wait for clearer signs of inflation heading up, before taking action.
- In its October press release, the Fed seemed to want to set the record straight. It pointed out the recent deceleration in job creation, but maintained a positive tone about the U.S. economy, mentioning that household consumption and business investment have been increasing at solid rates. Moreover, in that press release, it explicitly raised the possibility of a rate hike in December.
- After strong annualized growth of 3.9% in the second quarter, U.S. real GDP grew by a mere 1.5% during the summer. But that slower pace is mainly attributable to a sharp slowdown in inventory growth, while U.S. domestic demand remained robust, with growth of 2.9%.
- The European Central Bank (ECB) surprised market watchers in October by clearly signalling that it might further ease its monetary policy in December. President Mario Draghi said that all options were on the table. The securities purchase program could be expanded, in size or in duration, or the types of assets could be changed. He also opened the door to the possibility of lowering interest rates deeper into negative territory. New action by the ECB would probably force other European central banks to react, to avoid letting their currencies appreciate too much against the euro. Already, the Bank of Sweden (Riksbank) has announced that it will expand its purchases of financial assets.
- For the second time in a row, the Bank of Canada (BoC) decided on the status quo at its October meeting. The BoC has somewhat downgraded its growth forecasts for 2016; this reflects lower oil prices, among other things. But it stresses that the economy has rebounded after the pullback in the first half of 2015. It predicts that the U.S. economy will keep growing at a solid pace, especially domestic demand, which is important for Canadian exports.

### INTEREST RATE FORECASTS

- We predict that the Fed will start very gradual monetary firming at its March 2016 meeting. Strong economic data, especially a rally in job creation, could however convince it to take action as of its next meeting. Any decisive action by the ECB in early December that would put upward pressure on the U.S. dollar would constitute another argument in favour of the status quo. All indications are that Canadian key interest rates will remain unchanged for several quarters to come.
- In the short term, all of the bond market's attention will be focused on the Fed's December decision. U.S. economic statistics and comments by Fed leaders are thus likely to generate significant moves in bond yields. Apart from that decision, everything suggests that the central banks will maintain very accommodative monetary policies for a long while yet; this will limit upturns in bond yields.

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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	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
<b>United States</b>												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00
<b>Canada</b>												
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
<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>September 2015</b>			
1	Reserve Bank of Australia	s.q.	2.00
2	Bank of Brazil	s.q.	14.25
3	European Central Bank	s.q.	0.05
3	Bank of Sweden	s.q.	-0.35
9	Reserve Bank of New Zealand	-25 b.p.	2.75
9	Bank of Canada	s.q.	0.50
10	Bank of England	s.q.	0.50
10	Bank of Korea	s.q.	1.50
14-15	Bank of Japan	---	---
17	Swiss National Bank	s.q.	-0.75
17	Federal Reserve	s.q.	0.00 / 0.25
21	Bank of Mexico	s.q.	3.00
24	Bank of Norway	-25 b.p.	0.75
<b>October 2015</b>			
5	Reserve Bank of Australia	s.q.	2.00
6-7	Bank of Japan	---	---
8	Bank of England	s.q.	0.50
14	Bank of Korea	s.q.	1.50
21	Bank of Brazil	s.q.	14.25
21	Bank of Canada	s.q.	0.50
22	European Central Bank	s.q.	0.05
28	Reserve Bank of New Zealand	s.q.	2.75
28	Bank of Sweden	s.q.	-0.35
28	Federal Reserve	s.q.	0.00 / 0.25
29	Bank of Mexico	s.q.	3.00
30	Bank of Japan	---	---
<b>November 2015</b>			
2	Reserve Bank of Australia	s.q.	2.00

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

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

Date	Central Bank
<b>November 2015</b>	
5	Bank of England
5	Bank of Norway
11	Bank of Korea
18-19	Bank of Japan
25	Bank of Brazil
30	Reserve Bank of Australia
<b>December 2015</b>	
2	Bank of Canada
3	European Central Bank
9	Bank of Korea
9	Reserve Bank of New Zealand
10	Bank of England
10	Swiss National Bank
15	Bank of Sweden
16	Federal Reserve
17	Bank of Norway
17	Bank of Mexico
17-18	Bank of Japan
<b>January 2016</b>	
14	Bank of England
20	Bank of Brazil
20	Bank of Canada
21	European Central Bank
27	Federal Reserve
28	Reserve Bank of New Zealand
28-29	Bank of Japan
<b>February 2016</b>	
1	Reserve Bank of Australia
2	Bank of Sweden

Source: Desjardins, Economic Studies

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

End of period in %	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
<b>Key rate</b>												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00
<b>Treasury bills</b>												
3-month	0.05	0.04	0.02	0.04	0.03	0.01	0.00	0.10	0.35	0.55	0.60	0.85
<b>Federal bonds</b>												
2-year	0.39	0.42	0.56	0.63	0.54	0.58	0.60	0.75	0.95	1.10	1.25	1.40
5-year	1.71	1.60	1.77	1.64	1.37	1.62	1.35	1.50	1.75	1.90	2.00	2.15
10-year	2.73	2.52	2.51	2.17	1.93	2.33	2.06	2.15	2.35	2.45	2.50	2.65
30-year	3.56	3.34	3.21	2.75	2.54	3.10	2.88	2.95	3.05	3.10	3.15	3.20
<b>Yield curve</b>												
5-year - 3-month	1.66	1.56	1.75	1.60	1.34	1.61	1.35	1.40	1.40	1.35	1.40	1.30
10-year - 2-year	2.34	2.09	1.95	1.54	1.39	1.75	1.46	1.40	1.40	1.35	1.25	1.25
30-year - 3-month	3.51	3.30	3.19	2.71	2.51	3.09	2.88	2.85	2.70	2.55	2.55	2.35

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	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
<b>Key rate</b>												
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
<b>Treasury bills</b>												
3-month	0.89	0.94	0.92	0.92	0.56	0.58	0.44	0.45	0.45	0.45	0.50	0.50
<b>Federal bonds</b>												
2-year	1.07	1.10	1.12	1.01	0.50	0.48	0.52	0.55	0.60	0.65	0.70	0.80
5-year	1.71	1.53	1.63	1.34	0.76	0.82	0.80	0.85	0.95	1.05	1.15	1.30
10-year	2.46	2.24	2.15	1.79	1.36	1.69	1.43	1.55	1.65	1.65	1.70	1.85
30-year	2.96	2.78	2.67	2.34	1.98	2.31	2.20	2.30	2.35	2.35	2.40	2.45
<b>Yield curve</b>												
5-year - 3-month	0.82	0.59	0.71	0.42	0.20	0.24	0.36	0.40	0.50	0.60	0.65	0.80
10-year - 2-year	1.39	1.14	1.03	0.78	0.86	1.21	0.91	1.00	1.05	1.00	1.00	1.05
30-year - 3-month	2.07	1.84	1.75	1.42	1.42	1.73	1.76	1.85	1.90	1.90	1.90	1.95
<b>Spreads (Canada - U.S.)</b>												
3-month	0.84	0.90	0.90	0.88	0.53	0.57	0.44	0.35	0.10	-0.10	-0.10	-0.35
2-year	0.68	0.68	0.56	0.38	-0.04	-0.10	-0.08	-0.20	-0.35	-0.45	-0.55	-0.60
5-year	-0.00	-0.07	-0.14	-0.30	-0.61	-0.80	-0.55	-0.65	-0.80	-0.85	-0.85	-0.85
10-year	-0.27	-0.28	-0.36	-0.38	-0.57	-0.64	-0.63	-0.60	-0.70	-0.80	-0.80	-0.80
30-year	-0.60	-0.56	-0.54	-0.41	-0.56	-0.79	-0.68	-0.65	-0.70	-0.75	-0.75	-0.75

f: forecasts

Sources: Datastream and Desjardins, Economic Studies