

## THE YIELD CURVE

# The Federal Reserve Is Expected to Lower Its Key Rates Soon

### HIGHLIGHTS

- ▶ Renewed trade tensions and mounting fears about the global economy have led to a significant decrease in bond yields in recent weeks. The U.S. and Canadian 10-year yields have dropped to about 2.00% and 1.40% respectively. This steep decline in yields reflects not only increased demand for safe-haven securities, but also expectations of a rapid decrease in U.S. key rates. This investor conviction that monetary easing would soon be announced has greatly limited the adverse effects on credit spreads and stock exchanges of the new uncertainties.
- ▶ The Federal Reserve (Fed) thus finds itself in a difficult position. If it closes the door to monetary easing, it risks causing a major correction in financial markets, amplifying the downside risks on its economic scenarios. This might also increase downward pressures on inflationary expectations, which it already considers too low. Given the disappointing recent jobs and inflation data, it is thus not surprising that the Fed clearly opened the door to monetary easing at its June 19 meeting. The median key rate forecast does not suggest monetary easing before 2020, but Jerome Powell pointed out at the press conference that a number of the leaders who were not signalling cuts this year recognize that the arguments in favour of easing have become stronger in recent weeks. These comments solidified expectations that U.S. key rates would be cut at the meeting in late July.
- ▶ Things are very different in Canada. The most recent labour market and price data would in no way justify lower key rates. The Canadian economy saw weak growth in early 2019, but the strong 3.4% rebound in domestic demand after two quarters of contraction is reassuring. The 0.5% hike in monthly GDP in March and improvement in the trade sector also suggest more robust economic growth as early as Q2. The latest Bank of Canada (BoC) communications thus signal increased confidence in Canada's outlook, while noting higher risks linked to international trade.
- ▶ The President of the European Central Bank also opened the door to further monetary easing if the economic situation does not improve and if inflation's return to around 2% is threatened.

### INTEREST RATE FORECASTS

- ▶ We are now counting on two key rate decreases of 0.25% each in the United States, with one in July and one in September, which would help bond yields maintain their current position near rock-bottom levels. The primary aim of the Fed's gestures would be to respond to market pressure and to reaffirm its determination to hold expected inflation close to the 2% target.
- ▶ It would be surprising for the BoC to follow suit, especially since monetary tightening is not as far along in Canada. Therefore, we continue to count on key rates maintaining the status quo for a long time as the scenario of the Canadian economy's temporary weakness being followed by a rebound appears to be coming true, but international threats have increased.

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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 %	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>United States</b>												
Federal funds	1.75	2.00	2.25	2.50	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
<b>Canada</b>												
Overnight funds	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
<b>Zone euro</b>												
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>United Kingdom</b>												
Base rate	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
<b>Japan</b>												
Main key rate	-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**  
Fixed income market

END OF PERIOD IN %	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
<b>UNITED STATES</b>												
<b>Treasury bills</b>												
3-month	1.73	1.93	2.19	2.45	2.40	2.15	1.80	1.90	1.90	1.90	1.90	1.90
<b>Federal bonds</b>												
2-year	2.27	2.53	2.82	2.51	2.29	1.75	1.65	1.80	1.90	1.95	2.00	2.00
5-year	2.55	2.73	2.95	2.49	2.23	1.75	1.65	1.80	1.95	2.00	2.05	2.05
10-year	2.75	2.86	3.06	2.69	2.41	2.05	1.95	2.05	2.10	2.15	2.20	2.20
30-year	2.97	2.99	3.21	3.02	2.82	2.55	2.45	2.50	2.55	2.60	2.60	2.60
<b>Yield curve slopes</b>												
5-year - 3-month	0.82	0.80	0.76	0.04	-0.17	-0.40	-0.15	-0.10	0.05	0.10	0.15	0.15
10-year - 2-year	0.47	0.33	0.24	0.18	0.13	0.30	0.30	0.25	0.20	0.20	0.20	0.20
30-year - 3-month	1.24	1.06	1.02	0.57	0.42	0.40	0.65	0.60	0.65	0.70	0.70	0.70
<b>CANADA</b>												
<b>Treasury bills</b>												
3-month	1.10	1.26	1.59	1.64	1.67	1.65	1.65	1.65	1.70	1.70	1.70	1.70
<b>Federal bonds</b>												
2-year	1.77	1.91	2.21	1.86	1.55	1.40	1.30	1.45	1.55	1.65	1.70	1.70
5-year	1.96	2.06	2.33	1.88	1.52	1.35	1.30	1.45	1.60	1.70	1.75	1.75
10-year	2.09	2.17	2.42	1.96	1.62	1.50	1.45	1.55	1.65	1.75	1.80	1.80
30-year	2.23	2.20	2.41	2.18	1.90	1.70	1.60	1.70	1.80	1.90	1.95	1.95
<b>Yield curve slopes</b>												
5-year - 3-month	0.86	0.80	0.74	0.24	-0.15	-0.30	-0.35	-0.20	-0.10	0.00	0.05	0.05
10-year - 2-year	0.32	0.26	0.21	0.10	0.07	0.10	0.15	0.10	0.10	0.10	0.10	0.10
30-year - 3-month	1.13	0.94	0.82	0.54	0.23	0.05	-0.05	0.05	0.10	0.20	0.25	0.25
<b>Yield spreads (Canada—United States)</b>												
3-month	-0.63	-0.67	-0.60	-0.81	-0.73	-0.50	-0.15	-0.25	-0.20	-0.20	-0.20	-0.20
2-year	-0.50	-0.62	-0.61	-0.65	-0.74	-0.35	-0.35	-0.35	-0.35	-0.30	-0.30	-0.30
5-year	-0.59	-0.67	-0.62	-0.61	-0.71	-0.40	-0.35	-0.35	-0.35	-0.30	-0.30	-0.30
10-year	-0.66	-0.69	-0.64	-0.73	-0.79	-0.55	-0.50	-0.50	-0.45	-0.40	-0.40	-0.40
30-year	-0.74	-0.79	-0.80	-0.84	-0.92	-0.85	-0.85	-0.80	-0.75	-0.70	-0.65	-0.65

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

# Schedule 2019 of Central Bank Meetings

Date	Central banks	Decision	Rate
<b>January</b>			
9	Bank of Canada*	s.q.	1.75
22	Bank of Japan	s.q.	-0.10
23	Bank of Korea	s.q.	1.75
24	European Central Bank	s.q.	0.00
24	Bank of Norway	s.q.	0.75
30	Federal Reserve	s.q.	2.50
<b>February</b>			
4	Reserve Bank of Australia	s.q.	1.50
6	Bank of Brazil	s.q.	6.50
7	Bank of England	s.q.	0.75
7	Bank of Mexico	s.q.	8.25
12	Reserve Bank of New Zealand	s.q.	1.75
13	Bank of Sweden	s.q.	-0.25
27	Bank of Korea	s.q.	1.75
<b>March</b>			
4	Reserve Bank of Australia	s.q.	1.50
6	Bank of Canada	s.q.	1.75
7	European Central Bank	s.q.	0.00
14	Bank of Japan	s.q.	-0.10
20	Bank of Brazil	s.q.	6.50
20	Federal Reserve	s.q.	2.50
21	Bank of England	s.q.	0.75
21	Bank of Norway	+25 b.p.	1.00
21	Swiss National Bank	s.q.	-0.75
26	Reserve Bank of New Zealand	s.q.	1.75
28	Bank of Mexico	s.q.	8.25
<b>April</b>			
1	Reserve Bank of Australia	s.q.	1.50
10	European Central Bank	s.q.	0.00
17	Bank of Korea	s.q.	1.75
24	Bank of Canada*	s.q.	1.75
24	Bank of Japan	s.q.	-0.10
25	Bank of Sweden	s.q.	-0.25
<b>May</b>			
1	Federal Reserve	s.q.	2.50
2	Bank of England	s.q.	0.75
7	Reserve Bank of Australia	s.q.	1.50
7	Reserve Bank of New Zealand	-25 b.p.	1.50
8	Bank of Brazil	s.q.	6.50
16	Bank of Mexico	s.q.	8.25
29	Bank of Canada	s.q.	1.75
30	Bank of Korea	s.q.	1.75
<b>June</b>			
4	Reserve Bank of Australia	-25 b.p.	1.25
6	European Central Bank	s.q.	0.00
13	Swiss National Bank	s.q.	-0.75
19	Bank of Brazil	s.q.	6.50
19	Bank of Japan	s.q.	-0.10
19	Federal Reserve	s.q.	2.50
20	Bank of England	s.q.	0.75
20	Bank of Norway	+25 b.p.	1.25
25	Reserve Bank of New Zealand		
27	Bank of Mexico		

Date	Central banks	Decision	Rate
<b>July</b>			
2	Reserve Bank of Australia		
3	Bank of Sweden		
10	Bank of Canada*		
17	Bank of Korea		
25	European Central Bank		
29	Bank of Japan		
31	Bank of Brazil		
31	Federal Reserve		
<b>August</b>			
1	Bank of England		
6	Reserve Bank of Australia		
6	Reserve Bank of New Zealand		
15	Bank of Mexico		
29	Bank of Korea		
<b>September</b>			
3	Reserve Bank of Australia		
4	Bank of Canada		
5	Bank of Sweden		
12	European Central Bank		
18	Bank of Brazil		
18	Bank of Japan		
18	Federal Reserve		
19	Bank of England		
19	Bank of Norway		
19	Swiss National Bank		
24	Reserve Bank of New Zealand		
26	Bank of Mexico		
<b>October</b>			
1	Reserve Bank of Australia		
16	Bank of Korea		
24	European Central Bank		
24	Bank of Sweden		
30	Bank of Brazil		
30	Bank of Canada*		
30	Bank of Japan		
30	Federal Reserve		
<b>November</b>			
5	Reserve Bank of Australia		
7	Bank of England		
12	Reserve Bank of New Zealand		
14	Bank of Mexico		
28	Bank of Korea		
<b>December</b>			
3	Reserve Bank of Australia		
4	Bank of Canada		
11	Bank of Brazil		
11	Federal Reserve		
12	European Central Bank		
12	Swiss National Bank		
18	Bank of Japan		
19	Bank of England		
19	Bank of Norway		
19	Bank of Sweden		
19	Bank of Mexico		

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively. \* Monetary Policy Report published.