

THE YIELD CURVE

The Federal Reserve's More Neutral Stance Is Hurting the Bond Market

HIGHLIGHTS

- ▶ October was a volatile month for U.S. bond yields, which reacted mainly to developments in trade negotiations between the United States and China and to more or less encouraging U.S. economic statistics. A clearer uptrend in yields emerged recently, however, after the Federal Reserve (Fed) took a more neutral stance. The U.S. 10-year yield therefore rose above 1.90% for the first time since July.
- ▶ The Fed proceeded with a third consecutive 25-basis-point key rate cut at its October 30 meeting. As discussed in a recent edition of our [Economic Viewpoint](#), it also announced earlier that it would resume increasing the size of its balance sheet substantially to ensure the smooth operation of the money market. However, what really caught investors' attention was the Fed's message that monetary policy was now in a good place and that further easing would not be necessary unless the economic outlook deteriorates significantly. This message was backed by encouraging economic statistics, particularly a considerable upward revision to job creation numbers from the past few months. The favourable developments in trade negotiations between the United States and China, as it now appears that some tariffs could be removed, also bolstered investor confidence and drove up bond yields.
- ▶ While the Fed's latest rate cut was seen as "hawkish," the Bank of Canada's (BoC) continued status quo had the opposite effect and sent Canadian bond yields tumbling briefly. However, the BoC's message in the October *Monetary Policy Report* was not that different from the one it issued in July. The Canadian economy's current resilience justifies the status quo on key rates, but the BoC will be keeping a close eye on international developments, as Canada's economy is nonetheless influenced negatively by uncertainty. The markets' strong reaction therefore mainly reflected an exaggerated decrease in monetary easing expectations in previous weeks.
- ▶ On the international front, the European Central Bank appears to be running out of ammunition, and we foresee no forthcoming changes to its monetary policy. The Bank of England, however, opened the door to monetary easing a little wider and could well cut its key rate in early 2020.

INTEREST RATE FORECASTS

- ▶ The current stance taken by the Fed and the BoC is in line with our scenarios, which call for North American key rates holding at the current level until the end of 2020. Key rate cuts will, however, remain much more likely than rate increases.
- ▶ We feel that the recent rise in bond yields has been a little too fast. An adjustment in expectations concerning key rate changes was justified in a context of reduced probability of worst-case scenarios for the trade war, Brexit and a global recession. However, we feel it is too early to bank on a lasting resurgence of optimism, as uncertainty should continue to be very present in the coming quarters. Low bond yields will therefore still be needed to prevent economic growth from slowing down too sharply.

François Dupuis, Vice-President and Chief Economist • Mathieu D'Anjou, Deputy Chief Economist

Benoit P. Durocher, Senior Economist • Francis Généreux, Senior Economist • Jimmy Jean, Macro Strategist • Hendrix Vachon, Senior Economist

Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

IMPORTANT: This document is based on public information and may under no circumstances be used or construed as a commitment by Desjardins Group. While the information provided has been determined on the basis of data obtained from sources that are deemed to be reliable, Desjardins Group in no way warrants that the information is accurate or complete. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. Desjardins Group takes no responsibility for the consequences of any decision whatsoever made on the basis of the data contained herein and does not hereby undertake to provide any advice, notably in the area of investment services. The data on prices or margins are provided for information purposes and may be modified at any time, based on such factors as market conditions. The past performances and projections expressed herein are no guarantee of future performance. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the opinions of any other person or the official position of Desjardins Group. Copyright © 2019, Desjardins Group. All rights reserved.

TABLE 1
Key interest rates

END OF PERIOD IN %	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75
Canada												
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
Zone euro												
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
United Kingdom												
Base rate	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.50	0.50	0.50	0.50
Japan												
Main key rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.20	-0.20	-0.20	-0.20

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	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
UNITED STATES												
Treasury bills												
3-month	1.73	1.93	2.19	2.45	2.40	2.12	1.88	1.60	1.60	1.65	1.65	1.60
Federal bonds												
2-year	2.27	2.53	2.82	2.51	2.29	1.76	1.66	1.60	1.55	1.60	1.65	1.55
5-year	2.55	2.73	2.95	2.49	2.23	1.76	1.54	1.60	1.55	1.55	1.65	1.50
10-year	2.75	2.86	3.06	2.69	2.41	2.00	1.67	1.80	1.70	1.70	1.75	1.60
30-year	2.97	2.99	3.21	3.02	2.82	2.53	2.11	2.25	2.15	2.20	2.25	2.10
Yield curve slopes												
5-year - 3-month	0.82	0.80	0.76	0.04	-0.17	-0.36	-0.34	0.00	-0.05	-0.10	0.00	-0.10
10-year - 2-year	0.47	0.33	0.24	0.18	0.13	0.24	0.01	0.20	0.15	0.10	0.10	0.05
30-year - 3-month	1.24	1.06	1.02	0.57	0.42	0.41	0.23	0.65	0.55	0.55	0.60	0.50
CANADA												
Treasury bills												
3-month	1.10	1.26	1.59	1.64	1.67	1.66	1.65	1.65	1.70	1.70	1.70	1.65
Federal bonds												
2-year	1.77	1.91	2.21	1.86	1.55	1.47	1.58	1.55	1.55	1.60	1.65	1.55
5-year	1.96	2.06	2.33	1.88	1.52	1.39	1.40	1.45	1.45	1.50	1.60	1.50
10-year	2.09	2.17	2.42	1.96	1.62	1.46	1.37	1.50	1.50	1.55	1.65	1.50
30-year	2.23	2.20	2.41	2.18	1.90	1.68	1.53	1.65	1.60	1.70	1.80	1.65
Yield curve slopes												
5-year - 3-month	0.86	0.80	0.74	0.24	-0.15	-0.27	-0.25	-0.20	-0.25	-0.20	-0.10	-0.15
10-year - 2-year	0.32	0.26	0.21	0.10	0.07	-0.01	-0.21	-0.05	-0.05	-0.05	0.00	-0.05
30-year - 3-month	1.13	0.94	0.82	0.54	0.23	0.02	-0.12	0.00	-0.10	0.00	0.10	0.00
Yield spreads (Canada—United States)												
3-month	-0.63	-0.67	-0.60	-0.81	-0.73	-0.46	-0.23	0.05	0.10	0.05	0.05	0.05
2-year	-0.50	-0.62	-0.61	-0.65	-0.74	-0.29	-0.08	-0.05	0.00	0.00	0.00	0.00
5-year	-0.59	-0.67	-0.62	-0.61	-0.71	-0.37	-0.14	-0.15	-0.10	-0.05	-0.05	0.00
10-year	-0.66	-0.69	-0.64	-0.73	-0.79	-0.54	-0.30	-0.30	-0.20	-0.15	-0.10	-0.10
30-year	-0.74	-0.79	-0.80	-0.84	-0.92	-0.85	-0.58	-0.60	-0.55	-0.50	-0.45	-0.45

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Schedule 2019 of Central Bank Meetings

Date	Central banks	Decision	Rate	Date	Central banks	Decision	Rate
January				July			
9	Bank of Canada*	s.q.	1.75	2	Reserve Bank of Australia	-25 b.p.	1.00
22	Bank of Japan	s.q.	-0.10	3	Bank of Sweden	s.q.	-0.25
23	Bank of Korea	s.q.	1.75	10	Bank of Canada*	s.q.	1.75
24	European Central Bank	s.q.	0.00	17	Bank of Korea	-25 b.p.	1.50
24	Bank of Norway	s.q.	0.75	25	European Central Bank	s.q.	0.00
30	Federal Reserve	s.q.	2.50	29	Bank of Japan	s.q.	-0.10
February				31	Bank of Brazil	-50 b.p.	6.00
4	Reserve Bank of Australia	s.q.	1.50	31	Federal Reserve	-25 b.p.	2.25
6	Bank of Brazil	s.q.	6.50	August			
7	Bank of England	s.q.	0.75	1	Bank of England	s.q.	0.75
7	Bank of Mexico	s.q.	8.25	6	Reserve Bank of Australia	s.q.	1.00
12	Reserve Bank of New Zealand	s.q.	1.75	6	Reserve Bank of New Zealand	-50 b.p.	1.00
13	Bank of Sweden	s.q.	-0.25	15	Bank of Norway	s.q.	1.25
27	Bank of Korea	s.q.	1.75	15	Bank of Mexico	-25 b.p.	8.00
March				29	Bank of Korea	s.q.	1.50
4	Reserve Bank of Australia	s.q.	1.50	September			
6	Bank of Canada	s.q.	1.75	3	Reserve Bank of Australia	s.q.	1.00
7	European Central Bank	s.q.	0.00	4	Bank of Canada	s.q.	1.75
14	Bank of Japan	s.q.	-0.10	5	Bank of Sweden	s.q.	-0.25
20	Bank of Brazil	s.q.	6.50	12	European Central Bank	s.q.	0.00
20	Federal Reserve	s.q.	2.50	18	Bank of Brazil	-50 b.p.	5.50
21	Bank of England	s.q.	0.75	18	Bank of Japan	s.q.	-0.10
21	Bank of Norway	+25 b.p.	1.00	18	Federal Reserve	-25 b.p.	2.00
21	Swiss National Bank	s.q.	-0.75	19	Bank of England	s.q.	0.75
26	Reserve Bank of New Zealand	s.q.	1.75	19	Bank of Norway	+25 b.p.	1.50
28	Bank of Mexico	s.q.	8.25	19	Swiss National Bank	s.q.	-0.75
April				24	Reserve Bank of New Zealand	s.q.	1.00
1	Reserve Bank of Australia	s.q.	1.50	26	Bank of Mexico	-25 b.p.	7.75
10	European Central Bank	s.q.	0.00	October			
17	Bank of Korea	s.q.	1.75	1	Reserve Bank of Australia	-25 b.p.	0.75
24	Bank of Canada*	s.q.	1.75	15	Bank of Korea	-25 b.p.	1.25
24	Bank of Japan	s.q.	-0.10	24	European Central Bank	s.q.	0.00
25	Bank of Sweden	s.q.	-0.25	24	Bank of Norway	s.q.	1.50
May				24	Bank of Sweden	s.q.	-0.25
1	Federal Reserve	s.q.	2.50	30	Bank of Brazil	-50 b.p.	5.00
2	Bank of England	s.q.	0.75	30	Bank of Canada*	s.q.	1.75
7	Reserve Bank of Australia	s.q.	1.50	30	Bank of Japan	s.q.	-0.10
7	Reserve Bank of New Zealand	-25 b.p.	1.50	30	Federal Reserve	-25 b.p.	1.75
8	Bank of Brazil	s.q.	6.50	November			
16	Bank of Mexico	s.q.	8.25	4	Reserve Bank of Australia	s.q.	0.75
29	Bank of Canada	s.q.	1.75	7	Bank of England	s.q.	0.75
30	Bank of Korea	s.q.	1.75	12	Reserve Bank of New Zealand	s.q.	1.00
June				14	Bank of Mexico		
4	Reserve Bank of Australia	-25 b.p.	1.25	28	Bank of Korea		
6	European Central Bank	s.q.	0.00	December			
13	Swiss National Bank	s.q.	-0.75	3	Reserve Bank of Australia		
19	Bank of Brazil	s.q.	6.50	4	Bank of Canada		
19	Bank of Japan	s.q.	-0.10	11	Bank of Brazil		
19	Federal Reserve	s.q.	2.50	11	Federal Reserve		
20	Bank of England	s.q.	0.75	12	European Central Bank		
20	Bank of Norway	+25 b.p.	1.25	12	Swiss National Bank		
25	Reserve Bank of New Zealand	s.q.	1.50	18	Bank of Japan		
27	Bank of Mexico	s.q.	8.25	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.