

THE YIELD CURVE

Are Investors Starting to Worry about the Central Banks' Actions?

HIGHLIGHTS

- ▶ Recent economic figures confirm the scope of the economic contraction stemming from the lockdown measures implemented to curb the spread of COVID-19. In the euro zone, GDP dropped 40% (annualized) in the second quarter, while in the United States, it fell 32.9%. However, the figures also suggest a rapid recovery in economic activity once lockdown measures are lifted, particularly with regard to consumption and the real estate market. Nevertheless, further rises in COVID-19 cases, especially in July in the United States, show that a full return to normal is still a way off and have sparked fears of the return of stricter social distancing measures.
- ▶ North American bond yields are still very low and, generally, have seen a drop of a just few basis points since the end of June. However, it's worth noting that a more significant drop in U.S. real bond yields has been observed in recent weeks. The spread between nominal and real yields thus widened, signalling an increase in inflation compensation paid to investors. This trend, coupled with the surge in gold prices and the decline of the U.S. dollar, could suggest concerns over the extremely aggressive actions taken by the central banks, particularly the Federal Reserve (Fed).
- ▶ The Fed did not announce any changes to its monetary policy at its July 29 meeting. However, it remains very concerned about the economic and public health situation, and it signalled that it will continue to use all the tools at its disposal to support the U.S. economy for a long while. It could soon add forward guidance to its arsenal to further clarify its commitment to maintaining an ultra-accommodative monetary policy for an extended period. A plunge by the U.S. dollar could complicate things, but that scenario remains fairly unlikely.
- ▶ The Bank of Canada (BoC) has also signalled its intention to support the economic recovery for an extended period. The central scenario in *July's Monetary Policy Report* is in the top portion of the estimated range presented in April, particularly with regard to the second quarter GDP drop. After an initial rebound in activity, however, the BoC believes that the recovery will be gradual and uneven, and that it will take a long time to return to pre-pandemic activity levels. To promote this recovery, it has committed to hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2% inflation target is sustainably achieved, and to continuing its massive federal government bond purchases until the recovery is well underway.

INTEREST RATE FORECASTS

- ▶ The Fed and the BoC seem determined to help their economies return to pre-pandemic conditions as quickly as possible. North American key rates are expected to remain at their effective lower bound until 2023.
- ▶ Continued massive bond purchases should keep bond yields close to their current levels in the coming quarters. However, a slight steepening of the curve is expected around mid-2021 as central banks begin to reduce their interventions in the bond market.

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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 %	2019				2020				2021			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	2.50	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Canada												
Overnight funds	1.75	1.75	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
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	0.75	0.75	0.75	0.75	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Japan												
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 %	2019				2020				2021			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
UNITED STATES												
Treasury bills												
3-month	2.40	2.12	1.88	1.55	0.11	0.16	0.10	0.10	0.10	0.10	0.15	0.15
Federal bonds												
2-year	2.29	1.76	1.66	1.58	0.25	0.17	0.10	0.15	0.15	0.20	0.25	0.30
5-year	2.23	1.76	1.54	1.68	0.36	0.28	0.25	0.30	0.30	0.35	0.40	0.45
10-year	2.41	2.00	1.67	1.92	0.67	0.65	0.55	0.60	0.60	0.65	0.70	0.80
30-year	2.82	2.53	2.11	2.39	1.32	1.41	1.25	1.30	1.30	1.35	1.40	1.50
Yield curve slopes												
5-year - 3-month	-0.17	-0.36	-0.34	0.13	0.25	0.12	0.15	0.20	0.20	0.25	0.25	0.30
10-year - 2-year	0.13	0.24	0.01	0.34	0.41	0.49	0.45	0.45	0.45	0.45	0.45	0.50
30-year - 3-month	0.42	0.41	0.23	0.84	1.21	1.25	1.15	1.20	1.20	1.25	1.25	1.35
CANADA												
Treasury bills												
3-month	1.67	1.66	1.65	1.66	0.21	0.20	0.20	0.20	0.20	0.25	0.25	0.25
Federal bonds												
2-year	1.55	1.47	1.58	1.69	0.42	0.28	0.25	0.30	0.30	0.30	0.35	0.40
5-year	1.52	1.39	1.40	1.68	0.60	0.36	0.30	0.35	0.35	0.40	0.45	0.50
10-year	1.62	1.46	1.37	1.70	0.71	0.52	0.45	0.50	0.50	0.55	0.60	0.70
30-year	1.90	1.68	1.53	1.76	1.32	0.99	0.95	1.00	1.00	1.05	1.10	1.20
Yield curve slopes												
5-year - 3-month	-0.15	-0.27	-0.25	0.02	0.39	0.16	0.10	0.15	0.15	0.15	0.20	0.25
10-year - 2-year	0.07	-0.01	-0.21	0.01	0.29	0.24	0.20	0.20	0.20	0.25	0.25	0.30
30-year - 3-month	0.23	0.02	-0.12	0.10	1.11	0.79	0.75	0.80	0.80	0.80	0.85	0.95
Yield spreads (Canada—United States)												
3-month	-0.73	-0.46	-0.23	0.11	0.10	0.04	0.10	0.10	0.10	0.15	0.10	0.10
2-year	-0.74	-0.29	-0.08	0.11	0.17	0.11	0.15	0.15	0.15	0.10	0.10	0.10
5-year	-0.71	-0.37	-0.14	0.00	0.24	0.08	0.05	0.05	0.05	0.05	0.05	0.05
10-year	-0.79	-0.54	-0.30	-0.22	0.04	-0.13	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
30-year	-0.92	-0.85	-0.58	-0.63	0.00	-0.42	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Schedule 2020 of Central Bank Meetings

Date	Central banks	Decision	Rate
January			
16	Bank of Korea	s.q.	1.25
20	Bank of Japan	s.q.	-0.10
22	Bank of Canada*	s.q.	1.75
23	European Central Bank	s.q.	0.00
23	Bank of Norway	s.q.	1.50
29	Federal Reserve	s.q.	1.75
30	Bank of England	s.q.	0.75
February			
3	Reserve Bank of Australia	s.q.	0.75
5	Bank of Brazil	-25 b.p.	4.25
11	Reserve Bank of New Zealand	s.q.	1.00
12	Bank of Sweden	s.q.	0.00
13	Bank of Mexico	-25 b.p.	7.00
26	Bank of Korea	s.q.	1.25
March			
2	Reserve Bank of Australia	-25 b.p.	0.50
3	Federal Reserve	-50 b.p.	1.25
4	Bank of Canada	-50 b.p.	1.25
11	Bank of England	-50 b.p.	0.25
12	European Central Bank	s.q.	0.00
13	Bank of Norway	-50 b.p.	1.00
13	Bank of Canada	-50 b.p.	0.75
15	Reserve Bank of New Zealand	-75 b.p.	0.25
15	Federal Reserve	-100 b.p.	0.25
16	Bank of Korea	-50 b.p.	0.75
16	Bank of Japan	s.q.	-0.10
18	Reserve Bank of Australia	-25 b.p.	0.25
18	Bank of Brazil	-50 b.p.	3.75
19	Bank of England	-15 b.p.	0.10
19	Swiss National Bank	s.q.	-0.75
20	Bank of Norway	-75 b.p.	0.25
20	Bank of Mexico	-50 b.p.	6.50
26	Bank of England	s.q.	0.10
27	Bank of Canada	-50 b.p.	0.25
April			
7	Reserve Bank of Australia	s.q.	0.25
8	Bank of Korea	s.q.	0.75
15	Bank of Canada*	s.q.	0.25
21	Bank of Mexico	-50 b.p.	6.00
28	Bank of Sweden	s.q.	0.00
28	Bank of Japan	s.q.	-0.10
29	Federal Reserve	s.q.	0.25
30	European Central Bank	s.q.	0.00
May			
5	Reserve Bank of Australia	s.q.	0.25
6	Bank of Brazil	-75 b.p.	3.00
7	Bank of England	s.q.	0.10
7	Bank of Norway	-25 b.p.	0.00
12	Reserve Bank of New Zealand	s.q.	0.25
14	Bank of Mexico	-50 b.p.	5.50
27	Bank of Korea	-25 b.p.	0.50
June			
2	Reserve Bank of Australia	s.q.	0.25
3	Bank of Canada	s.q.	0.25
4	European Central Bank	s.q.	0.00
10	Federal Reserve	s.q.	0.25
15	Bank of Japan	s.q.	-0.10
17	Bank of Brazil	-75 b.p.	2.25
18	Bank of England	s.q.	0.10
18	Bank of Norway	s.q.	0.00
18	Swiss National Bank	s.q.	-0.75
23	Reserve Bank of New Zealand	s.q.	0.25
25	Bank of Mexico	-50 b.p.	5.00

Date	Central banks	Decision	Rate
July			
1	Bank of Sweden	s.q.	0.00
7	Reserve Bank of Australia	s.q.	0.25
14	Bank of Japan	s.q.	-0.10
15	Bank of Korea	s.q.	0.50
15	Bank of Canada*	s.q.	0.25
16	European Central Bank	s.q.	0.10
29	Federal Reserve	s.q.	0.25
August			
4	Reserve Bank of Australia	s.q.	0.25
5	Bank of Brazil	-25 b.p.	2.00
6	Bank of England	s.q.	0.10
11	Reserve Bank of New Zealand	s.q.	0.25
13	Bank of Mexico		
20	Bank of Norway		
26	Bank of Korea		
September			
1	Reserve Bank of Australia		
9	Bank of Canada		
10	European Central Bank		
16	Bank of Brazil		
16	Bank of Japan		
16	Federal Reserve		
17	Bank of England		
22	Reserve Bank of New Zealand		
22	Bank of Sweden		
24	Bank of Norway		
24	Bank of Mexico		
24	Swiss National Bank		
October			
6	Reserve Bank of Australia		
13	Bank of Korea		
28	Bank of Brazil		
28	Bank of Canada*		
28	Bank of Japan		
29	European Central Bank		
November			
3	Reserve Bank of Australia		
5	Bank of England		
5	Bank of Norway		
5	Federal Reserve		
10	Reserve Bank of New Zealand		
12	Bank of Mexico		
25	Bank of Korea		
26	Bank of Sweden		
December			
1	Reserve Bank of Australia		
9	Bank of Brazil		
9	Bank of Canada		
10	European Central Bank		
16	Federal Reserve		
17	Bank of England		
17	Bank of Norway		
17	Bank of Japan		
17	Bank of Mexico		
17	Swiss National Bank		

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.