

THE YIELD CURVE

Pandemic Developments Will Be Critical for the Bond Market

HIGHLIGHTS

- ▶ Given the worrisome spike in COVID-19 cases, uncertainty remained high on financial markets in October. This didn't benefit the bond market, and upward pressure continued to be felt on longer-term yields, particularly in the United States. The possibility of a blue wave, which would open the door to significant public spending, seemed to worry investors, and just before the U.S. presidential election, the U.S. 10-year yield hit a several months high. Like the equity market, the bond market reacted positively to the tight election results. The likely combination of a Biden presidency and a Republican Senate led to a 10-point drop in U.S. 10-year and 30-year yields. However, encouraging news regarding the development of a COVID-19 vaccine sent bond yields back up at the start of the following week.
- ▶ The Federal Reserve (Fed) was discreet at its last meeting. However, monetary authorities remain extremely concerned about the economic and public health situation and are determined to use all the tools at their disposal to promote as strong an economic recovery as possible. The Fed seems to think that its current level of support is optimal, but we sense that they're willing to bolster it if necessary.
- ▶ The Bank of Canada (BoC) also seems determined to support the economic recovery for a long time. At its meeting on October 28, it said that its new scenario suggested that key rates would stay at their effective lower bound until 2023. The BoC has also decided to gradually reduce the weekly minimum for bond purchases from \$5B to \$4B, but will target longer maturities to provide at least the same level of monetary easing. Lastly, the BoC has significantly reduced its growth estimates for potential output and cut its neutral interest rate assessment by 50 basis points.
- ▶ As the spike in COVID-19 cases has forced many European governments to reinstate lockdown measures, monetary authorities are under significant pressure to take further action. The Bank of England thus announced in early November that it would significantly increase its quantitative purchases, and the European Central Bank is expected to follow suit in December.

INTEREST RATE FORECASTS

- ▶ The major rise in COVID-19 cases in many countries has reinforced the determination of central banks to do everything in their power to support economic activity. Key rates will remain at their effective lower bound for a long time, and central banks will ensure that fears concerning public debt don't lead to a major hike in bond yields as long as public health risks remain.
- ▶ Nevertheless, recent developments regarding a COVID-19 vaccine should be watched closely. If an effective vaccine is quickly made available on a large scale, the economic outlook would improve markedly and upward pressure on interest rates would increase. Even in such a scenario, the Fed and the BoC would likely keep their key rates unchanged for several more quarters. However, they could reduce their asset purchases and tolerate a steepening of the yield curve to reflect a more positive economic and inflation outlook.

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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	Q3	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	Q3	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	0.13	0.15	0.15	0.20	0.25	0.35
5-year	2.23	1.76	1.54	1.68	0.36	0.28	0.27	0.40	0.40	0.45	0.50	0.55
10-year	2.41	2.00	1.67	1.92	0.67	0.65	0.68	0.90	0.90	0.95	1.00	1.05
30-year	2.82	2.53	2.11	2.39	1.32	1.41	1.45	1.70	1.70	1.75	1.80	1.85
Yield curve slopes												
5-year - 3-month	-0.17	-0.36	-0.34	0.13	0.25	0.12	0.17	0.30	0.30	0.35	0.35	0.40
10-year - 2-year	0.13	0.24	0.01	0.34	0.41	0.49	0.55	0.75	0.75	0.75	0.75	0.70
30-year - 3-month	0.42	0.41	0.23	0.84	1.21	1.25	1.35	1.60	1.60	1.65	1.65	1.70
CANADA												
Treasury bills												
3-month	1.67	1.66	1.65	1.66	0.21	0.20	0.12	0.10	0.10	0.15	0.20	0.20
Federal bonds												
2-year	1.55	1.47	1.58	1.69	0.42	0.28	0.25	0.25	0.25	0.30	0.35	0.40
5-year	1.52	1.39	1.40	1.68	0.60	0.36	0.36	0.45	0.45	0.50	0.55	0.55
10-year	1.62	1.46	1.37	1.70	0.71	0.52	0.57	0.70	0.70	0.75	0.80	0.85
30-year	1.90	1.68	1.53	1.76	1.32	0.99	1.11	1.25	1.25	1.30	1.35	1.40
Yield curve slopes												
5-year - 3-month	-0.15	-0.27	-0.25	0.02	0.39	0.16	0.24	0.35	0.35	0.35	0.35	0.35
10-year - 2-year	0.07	-0.01	-0.21	0.01	0.29	0.24	0.32	0.45	0.45	0.45	0.45	0.45
30-year - 3-month	0.23	0.02	-0.12	0.10	1.11	0.79	0.99	1.15	1.15	1.15	1.15	1.20
Yield spreads (Canada—United States)												
3-month	-0.73	-0.46	-0.23	0.11	0.10	0.04	0.02	0.00	0.00	0.05	0.05	0.05
2-year	-0.74	-0.29	-0.08	0.11	0.17	0.11	0.12	0.10	0.10	0.10	0.10	0.05
5-year	-0.71	-0.37	-0.14	0.00	0.24	0.08	0.09	0.05	0.05	0.05	0.05	0.00
10-year	-0.79	-0.54	-0.30	-0.22	0.04	-0.13	-0.11	-0.20	-0.20	-0.20	-0.20	-0.20
30-year	-0.92	-0.85	-0.58	-0.63	0.00	-0.42	-0.34	-0.45	-0.45	-0.45	-0.45	-0.45

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.	0.00
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	-50 b.p.	4.50
20	Bank of Norway	s.q.	0.00
26	Bank of Korea	s.q.	0.50
September			
1	Reserve Bank of Australia	s.q.	0.25
9	Bank of Canada	s.q.	0.25
10	European Central Bank	s.q.	0.00
16	Bank of Brazil	s.q.	2.00
16	Bank of Japan	s.q.	-0.10
16	Federal Reserve	s.q.	0.25
17	Bank of England	s.q.	0.10
22	Reserve Bank of New Zealand	s.q.	0.25
22	Bank of Sweden	s.q.	0.00
24	Bank of Norway	s.q.	0.00
24	Bank of Mexico	-25 b.p.	4.25
24	Swiss National Bank	s.q.	-0.75
October			
5	Reserve Bank of Australia	s.q.	0.25
13	Bank of Korea	s.q.	0.50
28	Bank of Brazil	s.q.	2.00
28	Bank of Canada*	s.q.	0.25
28	Bank of Japan	s.q.	-0.10
29	European Central Bank	s.q.	0.00
November			
2	Reserve Bank of Australia	-15 b.p.	0.10
5	Bank of England	s.q.	0.10
5	Bank of Norway	s.q.	0.00
5	Federal Reserve	s.q.	0.25
10	Reserve Bank of New Zealand	s.q.	0.25
12	Bank of Mexico		
25	Bank of Korea		
26	Bank of Sweden		
30	Reserve Bank of Australia		
December			
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.