

THE YIELD CURVE

Central Bank Patience Rapidly Wearing Thin

HIGHLIGHTS

- ▶ Bond yields generally continued to climb in November, with the Canadian federal 10-year bond yield even temporarily rising above 1.80%. However, significant growth in COVID-19 cases in Europe and the emergence of the Omicron variant hit financial markets hard at the end of the month, triggering a sharp pullback in stock markets and bond yields. However, it soon became apparent that central banks remained very concerned about inflation, particularly when the Federal Reserve (Fed) Chair declared it was time to stop using the term “transitory” to describe the price surge.
- ▶ This statement by Jerome Powell reflected growing discomfort with inflation reaching levels not seen since the 1980s. After months of dithering before finally starting to taper asset purchases in November, the Fed decided at the next meeting to rein in purchases twice as fast. This would see asset purchases ending in March 2022. Fed officials also used the December 15 meeting to signal a much faster rise in key rates, with three 0.25% hikes in 2022, while back in September half of Fed officials still felt maintaining the status quo throughout next year would be appropriate. Three further hikes would then follow in 2023 with two more in 2024. It would seem the Fed’s patience with inflation is a thing of the past, while it appears to be increasingly satisfied with general labour market conditions.
- ▶ At its December meeting, the Bank of Canada (BoC) somewhat calmed expectations of a rate hike as early as January by maintaining its commitment to keep the policy interest rate at the effective lower bound until economic slack is absorbed. However, there is a sense that this time is approaching as the BoC notes the very strong performance of the labour market recently and the prolonged supply issues that could continue to dampen economic growth potential.
- ▶ Proof that the health crisis is not a sufficient reason to justify maintaining ultra-accommodating monetary policies came from the United Kingdom, with the Bank of England raising its key rate in December despite a surge in cases linked to the Omicron variant. However, the European Central Bank and the Bank of Japan remain much less concerned about inflation and have not indicated they will raise key rates next year.

INTEREST RATE FORECASTS

- ▶ The Fed and BoC are clearly signalling their intention to gradually normalize monetary policy to ensure inflation is brought back under control on a sustainable basis. However, given their prior commitments and heightened uncertainty sparked by the emergence of the Omicron variant, they are likely to wait a bit longer, with the first key rate hikes expected in April 2022 in Canada and June in the United States.
- ▶ Our scenarios assume a very gradual rise in key rates, in the range of 0.50% to 0.75% per year. However, this approach will only be possible if supply-constrained inflationary pressures moderate as expected and if the entire yield curve reflects this future normalization of monetary policy. Maintaining strongly negative real yields, particularly at long maturities, seems increasingly at odds with central bank objectives. The U.S. and Canadian 10-year federal bond yields are expected to end 2022 at around 2.40% and 2.30%, respectively.

Jimmy Jean, Vice-President, Chief Economist and Strategist • Mathieu D’Anjou, Director and Deputy Chief Economist
Benoit P. Durocher, Senior Economist • Francis Généreux, Senior Economist • 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 © 2021, Desjardins Group. All rights reserved.

TABLE 1
Key interest rates

END OF PERIOD IN %	2021				2022				2023			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.00	1.25	1.50	1.75
Canada												
Overnight funds	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00	1.25	1.50	1.50
Zone euro												
Refinancing rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25
United Kingdom												
Base rate	0.10	0.10	0.10	0.25	0.50	0.75	0.75	0.75	1.00	1.00	1.25	1.25
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 %	2021				2022				2023			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
UNITED STATES												
Treasury bills												
3-month	0.03	0.05	0.04	0.05	0.20	0.45	0.70	0.90	0.95	1.20	1.45	1.65
Federal bonds												
2-year	0.16	0.24	0.26	0.70	0.90	1.10	1.30	1.45	1.65	1.85	2.05	2.20
5-year	0.92	0.86	0.98	1.20	1.45	1.65	1.80	1.90	2.00	2.15	2.30	2.40
10-year	1.75	1.44	1.53	1.45	1.85	2.15	2.30	2.40	2.50	2.60	2.70	2.80
30-year	2.42	2.07	2.09	1.90	2.20	2.50	2.70	2.80	2.90	3.00	3.10	3.20
Yield curve slopes												
5-year - 3-month	0.89	0.81	0.94	1.15	1.25	1.20	1.10	1.00	1.05	0.95	0.85	0.75
10-year - 2-year	1.59	1.20	1.26	0.75	0.95	1.05	1.00	0.95	0.85	0.75	0.65	0.60
30-year - 3-month	2.39	2.02	2.05	1.85	2.00	2.05	2.00	1.90	1.95	1.80	1.65	1.55
CANADA												
Treasury bills												
3-month	0.09	0.15	0.12	0.05	0.35	0.60	0.75	0.85	1.10	1.35	1.50	1.60
Federal bonds												
2-year	0.22	0.45	0.53	1.00	1.20	1.30	1.40	1.50	1.65	1.85	2.05	2.15
5-year	0.99	0.97	1.11	1.25	1.55	1.75	1.90	1.95	2.05	2.15	2.25	2.25
10-year	1.55	1.39	1.51	1.40	1.85	2.15	2.25	2.30	2.40	2.45	2.50	2.50
30-year	1.97	1.84	1.98	1.75	2.05	2.35	2.50	2.55	2.65	2.70	2.75	2.80
Yield curve slopes												
5-year - 3-month	0.90	0.82	0.99	1.20	1.20	1.15	1.15	1.10	0.95	0.80	0.75	0.65
10-year - 2-year	1.33	0.94	0.98	0.40	0.65	0.85	0.85	0.80	0.75	0.60	0.45	0.35
30-year - 3-month	1.88	1.69	1.86	1.70	1.70	1.75	1.75	1.70	1.55	1.35	1.25	1.20
Yield spreads (Canada—United States)												
3-month	0.06	0.10	0.08	0.00	0.15	0.15	0.05	-0.05	0.15	0.15	0.05	-0.05
2-year	0.06	0.21	0.27	0.30	0.30	0.20	0.10	0.05	0.00	0.00	0.00	-0.05
5-year	0.07	0.11	0.13	0.05	0.10	0.10	0.10	0.05	0.05	0.00	-0.05	-0.15
10-year	-0.20	-0.05	-0.02	-0.05	0.00	0.00	-0.05	-0.10	-0.10	-0.15	-0.20	-0.30
30-year	-0.45	-0.23	-0.11	-0.15	-0.15	-0.15	-0.20	-0.25	-0.25	-0.30	-0.35	-0.40

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Schedule 2021 of Central Bank Meetings

Date	Central banks	Decision	Rate
January			
14	Bank of Korea	s.q.	0.50
20	Bank of Brazil	s.q.	2.00
20	Bank of Canada*	s.q.	0.25
20	Bank of Japan	s.q.	-0.10
21	European Central Bank	s.q.	0.00
21	Bank of Norway	s.q.	0.00
27	Federal Reserve	s.q.	0.25
February			
1	Reserve Bank of Australia	s.q.	0.10
4	Bank of England	s.q.	0.10
10	Bank of Sweden	s.q.	0.00
11	Bank of Mexico	-25 b.p.	4.00
23	Reserve Bank of New Zealand	s.q.	0.25
24	Bank of Korea	s.q.	0.50
March			
1	Reserve Bank of Australia	s.q.	0.10
10	Bank of Canada	s.q.	0.25
11	European Central Bank	s.q.	0.00
17	Bank of Brazil	+75 b.p.	2.75
17	Federal Reserve	s.q.	0.25
18	Bank of England	s.q.	0.10
18	Bank of Norway	s.q.	0.00
18	Bank of Japan	s.q.	-0.10
25	Bank of Mexico	s.q.	4.00
25	Swiss National Bank	s.q.	-0.75
April			
6	Reserve Bank of Australia	s.q.	0.10
13	Reserve Bank of New Zealand	s.q.	0.25
14	Bank of Korea	s.q.	0.50
21	Bank of Canada*	s.q.	0.25
22	European Central Bank	s.q.	0.00
26	Bank of Japan	s.q.	-0.10
27	Bank of Sweden	s.q.	0.00
28	Federal Reserve	s.q.	0.25
May			
4	Reserve Bank of Australia	s.q.	0.10
5	Bank of Brazil	+75 b.p.	3.50
6	Bank of England	s.q.	0.10
6	Bank of Norway	s.q.	0.00
13	Bank of Mexico	s.q.	4.00
25	Reserve Bank of New Zealand	s.q.	0.25
26	Bank of Korea	s.q.	0.50
June			
1	Reserve Bank of Australia	s.q.	0.10
9	Bank of Canada	s.q.	0.25
10	European Central Bank	s.q.	0.00
16	Bank of Brazil	+75 b.p.	4.25
16	Federal Reserve	s.q.	0.25
17	Bank of Norway	s.q.	0.00
17	Bank of Japan	s.q.	-0.10
17	Swiss National Bank	s.q.	-0.75
24	Bank of England	s.q.	0.10
24	Bank of Mexico	+25 b.p.	4.25

Date	Central banks	Decision	Rate
July			
1	Bank of Sweden	s.q.	0.00
6	Reserve Bank of Australia	s.q.	0.10
13	Reserve Bank of New Zealand	s.q.	0.25
14	Bank of Canada*	s.q.	0.25
14	Bank of Korea	s.q.	0.50
15	Bank of Japan	s.q.	-0.10
22	European Central Bank	s.q.	0.00
28	Federal Reserve	s.q.	0.25
August			
3	Reserve Bank of Australia	s.q.	0.10
4	Bank of Brazil	+100 b.p.	5.25
5	Bank of England	s.q.	0.10
12	Bank of Mexico	+25 b.p.	4.50
17	Reserve Bank of New Zealand	s.q.	0.25
19	Bank of Norway	s.q.	0.00
25	Bank of Korea	+25 b.p.	0.75
September			
7	Reserve Bank of Australia	s.q.	0.10
8	Bank of Canada	s.q.	0.25
9	European Central Bank	s.q.	0.00
21	Bank of Sweden	s.q.	0.00
21	Bank of Japan	s.q.	-0.10
22	Bank of Brazil	+100 b.p.	6.25
22	Federal Reserve	s.q.	0.25
23	Bank of England	s.q.	0.10
23	Bank of Norway	+25 b.p.	0.25
23	Swiss National Bank	s.q.	-0.75
30	Bank of Mexico	+25 b.p.	4.75
October			
4	Reserve Bank of Australia	s.q.	0.10
5	Reserve Bank of New Zealand	+25 b.p.	0.50
11	Bank of Korea	s.q.	0.75
27	Bank of Brazil	+150 b.p.	7.75
27	Bank of Japan	s.q.	-0.10
27	Bank of Canada*	s.q.	0.25
28	European Central Bank	s.q.	0.00
November			
1	Reserve Bank of Australia	s.q.	0.10
3	Federal Reserve	s.q.	0.25
4	Bank of England	s.q.	0.10
4	Bank of Norway	s.q.	0.25
11	Bank of Mexico	+25 b.p.	5.00
23	Reserve Bank of New Zealand	+25 b.p.	0.75
24	Bank of Korea	+25 b.p.	1.00
25	Bank of Sweden	s.q.	0.00
December			
6	Reserve Bank of Australia	s.q.	0.10
8	Bank of Brazil	+150 b.p.	9.25
8	Bank of Canada	s.q.	0.25
15	Federal Reserve	s.q.	0.25
16	European Central Bank	s.q.	0.00
16	Bank of England	+15 b.p.	0.25
16	Bank of Norway	+25 b.p.	0.25
16	Bank of Mexico	+50 b.p.	5.50
16	Bank of Japan	s.q.	-0.10
16	Swiss National Bank	s.q.	-0.75

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.