Rates Scenario for March 25, 2024

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Forecast Summary

(avg.)	Actual 2024 Feb	Forecasts 2024 Mar	Apr	May	Jun	2024 Q3	Q4	2025 Q1	Q2	Q3	Q4
BoC overnight[1]	5.00	5.00[2]	5.00	5.00	4.75	4.50	4.00	3.75	3.50	3.25	3.00
10-yr Canadas	3.50	3.45	3.40	3.35	3.35	3.25	3.15	3.10	3.10	3.05	3.05
Fed funds[1]	5.38	5.38[2]	5.38	5.38	5.38	4.88	4.63	4.38	4.13	3.88	3.63
10-yr Treasuries	4.21	4.20	4.15	4.15	4.10	4.00	3.90	3.85	3.80	3.75	3.75
C$ per US$	1.35	1.35	1.35	1.34	1.34	1.33	1.32	1.31	1.30	1.29	1.28
US$/€	1.08	1.09	1.09	1.09	1.09	1.10	1.10	1.10	1.11	1.11	1.12
US$/£	1.26	1.27	1.27	1.28	1.28	1.29	1.30	1.31	1.31	1.32	1.33
¥/US$	150	150	149	148	147	144	141	139	138	137	135

[1] end of period; [2] actual value

Sources: BMO Economics, Haver Analytics

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Canada-U.S. Rates Outlook

Michael Gregory, CFA, Deputy Chief Economist

- The latest inflation data have given us more confidence in our **Bank of Canada call** and **less so** in our **Federal Reserve forecast** for this year. Both central banks have indicated they won't wait for the yearly change in the targeted inflation metric to hit 2% before beginning rate cuts. They only have to be sufficiently confident that a 2% trajectory is locked in. And critical to the assessment are the yearly and shorter-term changes across the various measures of underlying inflation. The table shows the latest of such readings.
- For a convincing 2% trajectory, **no table node should be above the 3% range**, and most should be below it. And a decelerating trend towards 2% should be evident as you shorten the tenors of the changes. The conclusion: **Canadian inflation performance is strongly convincing**; **the U.S. is downright disturbing**. While the latter could reflect early-in-the-year pressures that aren't being picked up by seasonal adjustment, as Fed Chair Powell said recently, we have *"to be careful about dismissing data that we don't like"*.
- It's too bad the latest CPI data came after this month's Bank of Canada meeting. We suspect the tone of the policy announcement and presser would have been a bit more 'rate-cut friendly' while still being cautious. The latest data were already in the FOMC's hands when it met, with Chair Powell also saying in the presser that this *"certainly hasn't improved our confidence"*.

Underlying Inflation Trends

(% change : a.r.)	3-mo.	6-mo.	12-mo.
Canada — CPI (Feb. 2024)			
CPI-trim	2.3	2.7	3.2
CPI-median	2.1	2.5	3.1
ex. food & energy	1.3	2.3	2.8
CPIX[1]	0.0	1.0	2.1
average	**1.5**	**2.1**	**2.8**
United States			
— CPI (Feb. 2024)			
core[2]	4.2	3.9	3.8
supercore[3]	6.9	5.9	4.3
— PCEPI (Jan. 2024)			
core	2.6	2.5	2.8
supercore	4.1	3.4	3.5
average	**4.5**	**3.9**	**3.6**

[1] ex. eight most volatile components and indirect taxes;
[2] ex. food and energy;
[3] core services ex. housing rents
Sources: BMO Economics, Haver Analytics

- Given the recent inflation data, **we're sticking with our BoC call for four rate cuts beginning in June** for a total of 100 bps this year. However, despite the stellar inflation performance, we still see **balanced risks** around our forecast. Preventing an otherwise net downside tilt are concerns that more aggressive easing both absolutely and relative to the Fed, could ignite inflation pressures in the housing market and among import prices owing to a likely weaker Canadian dollar.
- But **we're clipping our Fed call to three cuts from four, still beginning in July**, for a total of 75 bps (instead of 100 bps). And, importantly, we see net downside risks surrounding our projection should current inflation performance not turn around. Next year, both central banks are expected to stick to a gradual, quarter-point-per-quarter rate cut cadence.
- ***Federal Reserve:*** The FOMC kept policy rates unchanged on March 20, with the target range for the fed funds rate at 5.25%-to-5.50%. Importantly, the forward guidance was repeated. It said: *"The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."* And as Powell noted, there hasn't been much confidence gained in the interim. Indeed, the latest data likely contributed to the Fed's **waning easing appetite**, which was reflected in the 'dot plot'.
- Although the median projection for the fed funds target range midpoint at 2024-end remained at 4.625%, implying 75 bps of easing as before, the mean projection moved up by more than 10 bps. Seven (of 19) participants lifted their forecast by at least 25 bps. There are now nine participants at the median and another nine projecting a higher rate (less easing), so it would take only one participant shifting from the former to the latter to lift the median. Meanwhile, next year's total easing was reduced to 75 bps from 100 bps with the higher ending level cascading into 2026 (with its 75 bps worth of cuts as before). Interestingly, the longer-run level was also lifted (by a bit above 6 bps) to sit in between 2.50% and 2.625%.
- Elsewhere in the Summary of Economic Projections, the median forecast for real GDP growth (Q4/Q4) was raised across the board, to 2.1% this year (+0.7 ppts), 2.0% next year (+0.2 ppts) and 2.0% in 2026 (+0.1 ppts). Despite stronger growth, inflation is still projected to hit 2.0% by 2026, but it's getting there a bit more stubbornly. For this year and next, PCE inflation is 2.4% (same) and 2.2% (+0.1 ppts) with core inflation at 2.6% (+0.2 ppts) and 2.2% (same). It's this tandem of **economic resiliency** and **inflation stubbornness** that's **undermining the FOMC's quest for confidence in a 2% trajectory**.
- Also in the presser, Powell said the Fed was looking to taper quantitative tightening (QT) *"fairly soon"*. So far, the overnight reverse repo (ON RRP) facility has absorbed the impact of QT and reserves are currently above their pre-QT level (at $3.6 trillion). However, ON RRPs are quickly converging on minimum levels which means that bank reserves will soon begin regularly absorbing the impact. Powell said, *"right now we would characterize them as abundant, and what we're aiming for is ample… which is a little bit less than abundant"*. But given the uncertainty over where *"ample"* lives, and wanting to avoid the money market dislocations that occurred in 2019 during the last QT episode, the Fed wants to be extra cautious as reserves begin absorbing QT.
- ***Bank of Canada:*** On March 6, the BoC kept policy rates unchanged, with the overnight target at 5.00%. The statement's **forward guidance** was a near **carbon copy of the previous one**. It said: *"The Council is still concerned about risks to the outlook for inflation, particularly the persistence in underlying inflation. Governing Council wants to see further and sustained easing in core inflation and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth, and corporate pricing behaviour."* But on the *"balance"*, the Bank concluded the economy was in a state of *"modest excess supply"* (which means it's exerting **net disinflationary pressure**).
- In the press conference, Governor Macklem said: *"It's still too early to consider lowering the policy interest rate. Recent inflation data suggest monetary policy is working largely as expected. But future progress on inflation is*

expected to be gradual and uneven, and upside risks to inflation remain. Governing Council needs to see further and sustained easing in core inflation." As mentioned above, this came before the latest inflation data, which clearly aligned with the *"further"* criterion. There are **two inflation reports before the June 5 meeting**, and we reckon their results will satisfy the *"sustained"* prerequisite.

- Finally, in a March 21 speech, Deputy Governor Gravelle reiterated the Bank's messaging from a year ago that QT would continue until settlement balances (reserves) are in the $20 billion-to-$60 billion range. They are currently around $105 billion and *"based on the maturity profile of our assets, we should get to this range sometime in 2025"*. (They could be nearer the top of the range by this October.) But QT could end earlier if persistent money market pressures emerge in the interim. Interestingly, once it concludes, Gravelle mentioned that the Bank intends to grow the balance sheet via term repos and T-bills, allowing maturing bonds to continue rolling off until holdings are aligned with the level of currency in circulation.

- ***Bond yields:*** Ten-year Treasury yields are averaging 4.21% so far this month. This will mark the eighth consecutive month running above 4%, the longest stretch at these levels since before the Great Recession (and QE). Meanwhile, 3.75% has held as the lower limit for daily closes for the past nine months. Fed easing should be positive for the bond market, and we look for the monthly figure to drift back below 4% as rate cuts occur. But with only three or potentially fewer Fed actions likely, we reckon the decline will be restrained with the 3.75% mark continuing to be binding for the remainder of the year (we look for December to average around 3.85%). Next year, we see yields drifting lower as Fed rate cuts accumulate, approaching a longer-run level of 3.6% [1].

- Ten-year Government of Canada yields are averaging 3.44% month-to-date, 77 bps below comparable Treasuries. For the past six months the spread has remained in a range from -70 bps to -80 bps, and we look for this to continue well past year-end. Supporting these historically extreme (negative) spread levels, Canada's relatively stronger fiscal situation and relatively weaker economic performance are expected to continue for the foreseeable future.

- ***U.S. dollar:*** For March, the Fed's trade-weighted dollar index is on track to average slightly below February (by about 0.3%), after appreciating modestly to start the year (January 0.3%, February 0.7%). But, it's ending the month with a firmer tone. Recently, as the market has moved away from its most dovish Fed easing expectations for this year (5 to 6 rate cuts were expected at one point), the greenback has been gaining ground. Despite ongoing geopolitical and global economic concerns, we suspect market expectations for, and realized, Fed rate cuts will continue to be the dollar's dominant driver, even amid other major central banks jumping on the rate cut bandwagon. We see the greenback more than 2½% weaker by the end of this year (compared to February's average) with additional depreciation of about 2% next year.

- ***Canadian dollar:*** The loonie is on track to average around US$0.738 in March (C$1.355), down about 0.3% from February's level, despite the slightly weaker greenback overall (and higher oil prices). Amid relatively softer economic readings, the latest profound improvement in Canada's relative inflation performance is reinforcing expectations that not only will the Bank of Canada start cutting rates before the Fed, but overnight interest rate spreads could trend more negative in the months ahead. Although this could weigh on the loonie even as the Fed begins to cut rates, we still judge that a broadly weaker greenback should push the loonie stronger by nearly 2½% by year-end (compared to February's average), to US$0.758 or C$1.32, and by about 3% next year.

[1] This lower bound for the longer-run level of 10-year Treasury yields reflects the combination of neutral policy rates in the 2.75%-to-3.00% range and more normal-looking term premiums. Since the FOMC began targeting the fed funds rate in the 1980s, the spread between 10-year yields and effective fed funds rates has generated a median around 150 bps. Our working assumption has an eventual spread in the range of 75-to-100 bps, resulting in a 3.50%-to-4.00% longer-run range for yields. Meanwhile, the government is sporting large deficits as far as the eye can see, along with more inherent credit risk (according to the three major rating agencies), applying upward pressure within this range.

Overseas

Jennifer Lee, Senior Economist

- March saw a lot of firsts, or soon-to-be firsts. Some central banks **tightened** (BoJ, Turkey, Taiwan), some **eased** (SNB, Brazil, Mexico) and some just **stayed put** (Fed, BoC, ECB, RBA, PBoC, Norway, BoE, Indonesia, Russia). Here are some of the big ones:
- The media leaked out most of the moves, but the **BoJ** made it official at its March meeting. It finally ended its negative rate policy (lifted the policy rate from -0.1% to 0%-to-0.1%), got rid of YCC, stopped purchasing ETFs and J-REITs, and eliminated both the easing bias and the commitment to expanding the monetary base. However, it stopped short of being outright hawkish by: 1) stating that it "*anticipates that accommodative financial conditions will be maintained for the time being"*; and 2) pledging to continue buying JGBs, and increasing those purchases in the event of a "*rapid*" rise in bond yields. But, **Governor Ueda** told Parliament that the Bank will reduce how JGBs purchases *"in the future"*. So, this wasn't a pure hawkish change, but it is a start, which is likely why the JPY remains weak at around ¥151, prompting the MoF to threaten intervention. We look for a follow-up move mid-year, with inflation at a 4-month high.
- Meantime, the **BoE** looks ready to pull the trigger on rate cuts. The MPC voted 8-to-1 on March 21 to stay on the sidelines, keeping its Bank Rate at a 16-year high of 5.25%, as the two hawks finally threw in the towel on their quest to tighten policy. The only debate now is: what will it take to prompt a move, or how much more evidence does one need to see that inflation is on a sustained path to 2%? **Governor Bailey** sounds like he is ready to roll. Not only did he call the market's expectation for two to three rate cuts this year "*reasonable*", he said that rate cuts were "*in play*" at future meetings. And, "*I do want to give this message very strongly.... we have had very encouraging and good news, so I think you know we can say... we are on the way.*" In our view, this makes both the May and June meetings live. Although June would allow any skeptics enough time and data to make that decision (three CPI reports would have been released by then), one more good CPI report, supported by Agents' surveys, may be enough for a majority to support a rate cut. We will stay with our June call, but we, too, are data-dependent.
- The **RBA** held its fire in March, keeping its cash rate at a 12-year high of 4.35% for the third meeting in a row. The Bank is likely staying on hold for the time being, with the next move being a cut. However, it is not crystal clear that the hawkish undertones will be tossed aside. The warning that "*the Board is not ruling anything in or out*" was a new twist, as it replaced the line that "*a further increase in interest rates cannot be ruled out*". It is hedging its bets, particularly with employment growth tripling expectations in February, while real GDP rose just 1.5% y/y in Q4, the weakest in four years (ignoring the pandemic period).
- Clearly, there are central bankers that are not going to wait for the Federal Reserve to ease. The **Swiss National Bank** shocked when it cut rates 25 bps to 1.50%, the first in the G10 to do so. Perhaps **Governor Jordan** (who already shocked markets when he announced that he is stepping down in September), wanted to go out with a bang. He cited the "*effective*" fight against inflation, which has brought it down to price stability territory of below 2% for "*some months now*" as the reason behind the move.
- Finally, the **ECB** looks to make its first rate cut in June, with support from almost every member of the Governing Council (even Germany and the Netherlands). **President Lagarde** explained it quite clearly, stating that more evidence on inflation's downtrend is needed, and yes, they will "*know a little bit more in April*" but they will "*know a lot more in June*". That data, "*coming in the next few months*", is needed to be "*sufficiently confident*". Enough said. Message received. Over and out. She did, however, try to dampen expectations of how much easing will be done this year (BMO's view: 75 bps). Repeating the dependency on data, not the calendar, she warned that the central bank cannot "*pre-commit to a particular rate cut path*" after the first move.

Foreign Exchange Forecasts

(local currency per US$: avg.)	Actual 2024 Feb	Forecasts 2024 Mar	Apr	May	Jun	2024 Q3	Q4	2025 Q1	Q2	Q3	Q4
Canadian Dollar											
C$ per US$	1.35	1.35	1.35	1.34	1.34	1.33	1.32	1.31	1.30	1.29	1.28
US$ per C$[1]	0.741	0.741	0.743	0.744	0.746	0.750	0.756	0.761	0.767	0.773	0.779
Trade-weighted	117.6	117.3	117.4	117.5	117.7	117.9	118.3	118.8	119.4	120.0	120.6
U.S. Dollar											
Trade-weighted[2]	121.4	121.0	120.6	120.3	120.0	119.4	118.5	117.7	117.1	116.5	115.9
European Currencies											
Euro[1]	1.08	1.09	1.09	1.09	1.09	1.10	1.10	1.10	1.11	1.11	1.12
Danish Krone	6.91	6.85	6.85	6.85	6.80	6.80	6.80	6.75	6.70	6.70	6.65
Norwegian Krone	10.56	10.60	10.60	10.60	10.60	10.55	10.55	10.50	10.50	10.45	10.40
Swedish Krone	10.43	10.40	10.40	10.40	10.40	10.35	10.35	10.30	10.30	10.25	10.20
Swiss Franc	0.88	0.89	0.88	0.88	0.88	0.87	0.86	0.86	0.86	0.85	0.85
U.K. Pound[1]	1.26	1.27	1.27	1.28	1.28	1.29	1.30	1.31	1.31	1.32	1.33
Asian Currencies											
Chinese Yuan	7.19	7.20	7.17	7.14	7.12	7.06	6.98	6.93	6.89	6.85	6.81
Japanese Yen	150	150	149	148	147	144	141	139	138	137	135
Korean Won	1,331	1,330	1,325	1,320	1,315	1,305	1,290	1,280	1,275	1,265	1,260
Indian Rupee	82.9	83.1	82.7	82.4	82.1	81.5	80.6	80.0	79.6	79.1	78.7
Singapore Dollar	1.34	1.34	1.34	1.33	1.33	1.32	1.30	1.29	1.28	1.28	1.27
Malaysian Ringgit	4.77	4.70	4.70	4.70	4.65	4.65	4.55	4.55	4.50	4.50	4.45
Thai Baht	35.8	36.0	35.8	35.7	35.6	35.3	34.9	34.6	34.4	34.3	34.1
Philippine Peso	56.0	55.8	55.6	55.5	55.3	54.9	54.3	53.9	53.6	53.3	53.0
Taiwan Dollar	31.4	31.7	31.6	31.5	31.4	31.2	30.9	30.7	30.5	30.3	30.2
Indonesian Rupiah	15,657	15,690	15,630	15,570	15,515	15,395	15,225	15,110	15,030	14,945	14,865
Other Currencies											
Australian Dollar[1]	0.652	0.656	0.657	0.659	0.661	0.664	0.668	0.673	0.676	0.680	0.684
New Zealand Dollar[1]	0.612	0.609	0.610	0.611	0.612	0.615	0.619	0.623	0.626	0.630	0.634
Mexican Peso	17.09	16.80	16.80	16.80	16.80	16.75	16.75	16.70	16.65	16.60	16.50
Brazilian Real	4.96	5.00	4.95	4.95	4.95	4.90	4.90	4.85	4.80	4.80	4.75
South African Rand	19.0	18.9	18.8	18.8	18.8	18.8	18.7	18.7	18.6	18.6	18.5
Cross Rates											
Versus Canadian Dollar											
Euro (C$/€)	1.46	1.47	1.47	1.47	1.47	1.46	1.45	1.45	1.44	1.44	1.44
U.K. Pound (C$/£)	1.71	1.71	1.71	1.71	1.72	1.72	1.72	1.71	1.71	1.71	1.70
Japanese Yen (¥/C$)	111	111	111	110	109	108	107	106	106	106	106
Australian Dollar (C$/A$)	0.88	0.89	0.89	0.89	0.89	0.88	0.88	0.88	0.88	0.88	0.88
Versus Euro											
U.K. Pound (£/€)	0.85	0.86	0.86	0.86	0.85	0.85	0.85	0.85	0.84	0.84	0.84
Japanese Yen (¥/€)	161	164	162	161	160	158	155	154	153	152	151

[1] (US$ per local currency); [2] Federal Reserve Broad Index
Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

(% : avg.)	Actual 2024 Feb	Forecasts 2024 Mar	Apr	May	Jun	2024 Q3	Q4	2025 Q1	Q2	Q3	Q4
Canada											
Overnight target (period end)	5.00	5.00[6]	5.00	5.00	4.75	4.50	4.00	3.75	3.50	3.25	3.00
Overnight target	5.00	5.00[6]	5.00	5.00	4.79	4.57	4.26	3.93	3.55	3.29	3.08
CORRA[2]	5.03	5.01	5.01	5.00	4.79	4.57	4.26	3.93	3.55	3.29	3.08
3-month bills	4.93	4.90	4.95	4.95	4.75	4.50	4.20	3.85	3.50	3.25	3.00
6-month	4.90	4.90	4.90	4.90	4.70	4.50	4.20	3.90	3.55	3.30	3.10
1-year	4.76	4.65	4.60	4.50	4.30	4.15	3.90	3.65	3.40	3.20	3.00
2-year bonds	4.18	4.10	3.95	3.75	3.55	3.50	3.35	3.25	3.15	3.00	2.90
3-year	3.95	3.85	3.75	3.65	3.50	3.45	3.30	3.20	3.10	3.05	2.95
5-year	3.60	3.50	3.50	3.45	3.45	3.35	3.25	3.15	3.10	3.05	2.95
7-year	3.50	3.40	3.40	3.40	3.40	3.30	3.20	3.15	3.10	3.05	3.00
10-year	3.50	3.45	3.40	3.35	3.35	3.25	3.15	3.10	3.10	3.05	3.05
30-year	3.38	3.35	3.35	3.35	3.30	3.30	3.25	3.25	3.20	3.20	3.15
1m BA	5.36	5.30	5.40	5.40	5.15	4.95	4.60	4.25	3.85	3.55	3.30
3m BA	5.36	5.30	5.35	5.35	5.15	4.90	4.60	4.25	3.85	3.60	3.35
Prime rate	7.20	7.20[6]	7.20	7.20	6.99	6.77	6.46	6.13	5.75	5.49	5.28
United States											
Fed funds target (period end)	5.38	5.38[6]	5.38	5.38	5.38	4.88	4.63	4.38	4.13	3.88	3.63
Fed funds target	5.38	5.38[6]	5.38	5.38	5.38	5.18	4.84	4.59	4.32	4.09	3.84
EFFR[3]	5.33	5.33	5.33	5.33	5.33	5.14	4.81	4.56	4.30	4.07	3.82
SOFR[4]	5.31	5.31	5.31	5.31	5.31	5.12	4.79	4.55	4.28	4.05	3.81
3-month bills	5.44	5.45	5.45	5.45	5.45	5.25	4.90	4.65	4.35	4.10	3.85
6-month	5.28	5.35	5.35	5.35	5.35	5.15	4.80	4.55	4.30	4.10	3.85
1-year	4.92	5.00	4.95	4.85	4.80	4.65	4.40	4.25	4.05	3.85	3.65
2-year notes	4.54	4.60	4.50	4.40	4.25	4.10	4.00	3.85	3.75	3.60	3.50
3-year	4.33	4.35	4.30	4.25	4.20	4.10	3.95	3.85	3.75	3.65	3.55
5-year	4.19	4.20	4.20	4.15	4.15	4.05	3.95	3.85	3.75	3.70	3.60
7-year	4.21	4.20	4.20	4.15	4.10	4.05	3.90	3.85	3.80	3.75	3.65
10-year	4.21	4.20	4.15	4.15	4.10	4.00	3.90	3.85	3.80	3.75	3.75
30-year bonds	4.38	4.35	4.35	4.35	4.30	4.30	4.25	4.20	4.15	4.10	4.05
Prime rate	8.50	8.50[6]	8.50	8.50	8.50	8.30	7.97	7.72	7.45	7.22	6.96
Other G7											
ECB Refi[1]	4.50	4.50[6]	4.50	4.50	4.25	4.00	3.75	3.50	3.25	3.00	2.75
10yr Bund	2.37	2.35	2.40	2.40	2.40	2.40	2.40	2.35	2.30	2.20	2.10
BoE Repo[1]	5.25	5.25[6]	5.25	5.25	5.00	4.75	4.50	4.25	4.00	3.75	3.50
SONIA[5]	5.19	5.19	5.19	5.19	5.10	4.77	4.54	4.29	4.04	3.79	3.54
10yr Gilt	4.06	4.05	4.00	4.00	4.00	3.95	3.85	3.85	3.80	3.75	3.75
BoJ O/N[1]	-0.10	0.05[6]	0.07	0.08	0.10	0.13	0.15	0.15	0.15	0.15	0.15
10yr JGB	0.71	0.74	0.77	0.80	0.83	0.89	0.97	0.97	0.92	0.87	0.82

[1] end of period; [2] Canadian Overnight Repo Rate Average; [3] Effective Fed Funds Rate; [4] Secured Overnight Financing Rate; [5] Sterling Overnight Index Average; [6] actual value

Sources: BMO Economics, Haver Analytics

General Disclosures

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