Rates Scenario for June 14, 2024

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

Forecast Summary

(as of June 14, 2024)

(avg.)	Actual	Forecasts									
	2024	2024					2024	2025			
	May	Jun	Jul	Aug	Sep	Oct	Q4	Q1	Q2	Q3	Q4
BoC overnight[1]	5.00	4.75[2]	4.75	4.75	4.50	4.50	4.25	4.00	3.75	3.75	3.50
10-yr Canadas	3.64	3.35	3.35	3.30	3.30	3.25	3.25	3.20	3.20	3.20	3.20
Fed funds[1]	5.38	5.38[2]	5.38	5.38	5.13	5.13	4.88	4.63	4.38	4.38	4.13
10-yr Treasuries	4.48	4.30	4.25	4.25	4.20	4.20	4.15	4.15	4.10	4.10	4.10
C$ per US$	1.37	1.37	1.38	1.38	1.37	1.37	1.36	1.34	1.33	1.32	1.30
US$/€	1.08	1.08	1.08	1.08	1.09	1.09	1.09	1.10	1.10	1.11	1.12
US$/£	1.26	1.27	1.25	1.26	1.27	1.27	1.28	1.29	1.30	1.31	1.32
¥/US$	156	156	155	154	153	152	151	149	148	147	145

[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 Rate Cuts Are Coming

- The G10 central banks have begun cutting policy rates. Earlier this month, the BoC and ECB followed last month's moves by the SNB and Riksbank. And these G10 actions follow recent reductions by other key (emerging market) central banks such as in Brazil and Mexico. All these institutions, and many others, raised rates in response to post-pandemic inflation pressures caused, commonly, by escalating global commodity prices and snarled global supply chains. Time and policy tightening did their collective magic to calm these pressures. Now, rate cuts are being driven, differentially, by domestic considerations such as local economic growth along with inflation and labour market performance. As such, a mishmash of cumulative moves loom in the months ahead. And, yes, the Fed should be jumping on this bandwagon too... soon.
- ***Federal Reserve:*** As expected, the FOMC left policy rates unchanged for the seventh straight meeting on June 12, with the fed funds target range at 5.25%-to-5.50%. In the statement, the inflation assessment shifted slightly from having *"a lack of"* further progress to *"modest"* further progress towards the 2% target. On the same day, the CPI report for May showed better-than-expected results (the core index increased at a 33-month low 0.16%), serving more evidence that Q1's pickup in inflation pressures was more anomaly than trend.
- While these developments are more encouraging for potential rate cuts this year, the Summary of Economic Projections (SEP) and the 'dot plot' showed the median FOMC call now at just one cut for 2024, down from three in March (we were expecting to see two). Note that 8 participants had two cuts for this year (the modal view), but 7 had one and 4 had none. For next year, the cumulative easing action was upped to 100 bps from 75 bps, which was the same for 2026, ending up where we were before. The interim higher policy rate profile mirrored the lifting of the median PCE inflation projection by a couple of tenths for this year (total 2.6%, core 2.8%) and a tenth for next year (2.3% for both). However, "most" participants chose not to change their various projections even after seeing

the terrific CPI figures. If they did, we reckon many projected levels for fed funds and inflation would have been lower at least for this year.

- We continue to look for two Fed rate cuts this year (September and December). Between now and the expected inaugural action, there will be three CPI and PCEPI reports along with three employment reports. There is plenty of time, and data, for the FOMC to shift its assessment from *"modest"* further progress to a sufficient degree of 'confidence-building' progress to start cutting policy rates. The FOMC's mantra remains the same: *"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."*
- ***Bank of Canada:*** As expected, the BoC cut its policy rate by 25 bps to 4.75% on June 5, beginning to chip away at the 475 bps in cumulative tightening since March 2022, and after being on hold since last July. Governor Macklem said: *"with further and more sustained evidence underlying inflation is easing, monetary policy no longer needs to be as restrictive"*. More significantly, he added (and a little surprisingly to us): *"If inflation continues to ease, and our confidence that inflation is headed sustainably to the 2% target continues to increase, it is reasonable to expect further cuts to our policy interest rate."*
- The rate cut door was left open; whether the Bank crosses the threshold again on July 24, or among any of the four remaining confabs this year, is data-dependent. Macklem said, *"we are taking our interest rate decisions one meeting at a time"*, so the intra-meeting data flow is now more critical. For example, before the July confab, there are two CPI reports (for May and June) and if they continue to show 'confidence-increasing' results, a follow-up rate cut is likely.
- Our BoC call has been for three rate reductions this year, with the next two separated by a meeting. But it now seems that **easing could occur earlier** and there **could be more of it** (for the time being, we're retaining our forecast). And it's not just the data flow that will influence the timing and cumulative magnitude of Bank easing. Also influential is when and by how much the Fed eases. Macklem mentioned (as he has done before) that there are limits to how far policy can diverge from the U.S. (with an eye on the consequences for the currency), but he added we are *"not close"* to those limits. In the past several decades, policy rates have been as much as 75-to-100 bps from their U.S. counterparts. Currently, compared to the midpoint of the Fed's range, it's 62.5 bps below, suggesting the Bank could easily ease another notch with the Fed expected to remain on hold next month.
- ***Bond yields:*** Ten-year Treasury yields are currently tracking an average around 4.30% for June, marking the 11th consecutive 4%-plus print. Even when the market was its most bullish in terms of Fed rate cuts (around the turn of the year), yields still averaged above 4% (admittedly, barely: at 4.02% and 4.06% in December and January, respectively). Although the daily closes managed to slip slightly below 3.80%, the sub-4% run didn't last long enough to pull the monthly tally into the territory. This suggests 4% should function as a floor for monthly averages going forward, short of a significant cyclical downturn in the economy and/or disinflationary impulse (and nothing untoward transpiring on the global economic growth and risk fronts). In the wake of a couple of Fed rate cuts, we look for 10-year yields to average under 4.15% by year-end, on a gradual decline to 4% as further easing unfolds. Meanwhile, 2-year Treasury yields are averaging under 4.75% this month. Once the market becomes more confident Fed rate cuts are coming and in the wake of their occurrence, we reckon 2-year yields will rally at least enough to end the inversion of the yield curve (2s-10s) by year-end.
- The average of 10-year GoC yields is currently tracking just under 3.40% for June, more than 90 bps below comparable Treasuries. Although spreads averaged consistently in the 70-to-80 bp range through Q4 and Q1, they've recently moved more negative mirroring the divergence between monetary policies. As policies become more aligned, we look for spreads to eventually drift back into the earlier range. Further supporting these historically extreme (negative) spreads (note: the median since 1990 is -6 bps) is Canada's relatively stronger fiscal

situation and relatively weaker economic performance (particularly on a per capita basis). Meanwhile, 2-year yields are currently tracking an average under 3.95%, breaking below the 4%-plus range that has been in place for the past year. With the Bank in easing mode, we look for the downtrend to continue, also ending the inversion of the yield curve (2s-10s) by year-end.

- ***U.S. dollar:*** The Fed's trade-weighted dollar index is on track to average almost 1.5% stronger than in May, taking a run at last October's peak (when fears over Fed policy rates remaining 'higher for longer' were running rampant). The market's ebbing Fed easing expectations are bolstering the greenback, particularly amid other major central banks cutting their policy rates. Despite any geopolitical or global economic issues, we suspect market expectations for, and realized, Fed rate cuts will continue to be the dollar's dominant driver, and more profoundly so after the Fed's inaugural action. We see the greenback down about 1.8% by the end of this year (compared to June's tracking), for a net 1.3% gain on the year. Next year, we see the big dollar depreciating around 3%.
- ***Canadian dollar:*** The loonie is averaging C$1.372 (US$0.729) so far this month, on track to surpass its weakest mark since the immediate months after the onset of the pandemic. In the wake of BoC rate cuts and amid unchanged Fed policy, we look for the currency to continue trending weaker, averaging around C$1.38 (U$0.725). It should rebound to about C$1.35 (topping US$0.74) by year-end, after the Fed enters the easing game. Indeed, despite comparable BoC and Fed expected actions next year, we look for the negative impact of Fed easing on the greenback to dominate, allowing the loonie to appreciate almost 4% to C$1.30 (almost US$0.77) by end-2025.

Overseas

Jennifer Lee, Senior Economist

- Midway through 2024, we're finally seeing some major central banks moving off the sidelines or getting ready to do so. However, some are threatening to head in different directions.
- The **ECB** kept its promise and cut its key lending rates by 25 bps in June, the first such move since 2019. That brought the refi rate down to 4.25%, the marginal lending facility to 4.50%, and the deposit rate to 3.75%. The Press Statement said it was "*now appropriate to moderate the degree of monetary policy restriction*" given cooler headline and core inflation readings and the decline in inflation expectations. But, it was far from dovish as "*wage growth is elevated*"—as if on cue, the compensation per employee data for Q1 was released after the ECB announcement, and it showed an acceleration from a one-year low of 4.9% at the end of 2023 to 5.1% in 2024Q1. Not an encouraging sign. And, broader inflation is expected to "*stay above target well into next year*". The over-arching theme by most Governing Council members echoed what **President Lagarde** said at the Press Conference: they will not pre-commit, every decision will be data-dependent, and be made on a meeting-by-meeting basis. The ECB needs more data to confirm the Euro Area is on this disinflationary path, but fully expects the path to be bumpy. Indeed, BMO continues to expect the ECB to take the summer off before easing again in September.
- The **BoE** is facing a more complicated landscape. First, the labour market is cooling, with the jobless rate reaching a 2½-year high of 4.4% in the three months ending in April. But nominal wage growth has been stuck at 6% y/y for the past three months, while real wages accelerated thanks to slower inflation. Second, the broader economy had a solid start to 2024 (real GDP rose 2.5% annualized in Q1), but it stalled as Q2 began. To make this messier, the large services sector unexpectedly grew 0.2% in April, or 0.9% in the three months to April. So there is no smoking gun, thus far, to convince more policymakers to join the two doves (Dave Ramsden and Swati Dhingra) in voting for a rate cut. Third, the day that the MPC actually votes (Wednesday), it will have the benefit of the May CPI report. April was an encouraging month for inflation, except that services CPI has been hovering around 6% for nearly two years and is very slowly coming down. A more significant move may coax more into the easing camp. And finally, if the polls are correct, there could be a new government following the July 4 election, and the incoming Chancellor

may have fiscal plans that help, or hinder, the BoE's job to cool inflation further. Complicated, indeed. BMO expects the BoE to wait until August before easing policy.

- The **BoJ** kept policy unchanged at its June meeting, leaving the target rate at a still, very low "*around 0%-to-0.1%*" range, where it has been since March. And it will continue buying JGBs at around ¥6 trln per month. However, there is a **plan to continue normalizing**. The Bank will "*reduce its purchase amount of JGBs thereafter to ensure that long-term interest rates would be formed more freely in financial markets.*" By how much? According to Governor Ueda, "*the size will be significant*". When? The Bank will poll market participants at the July meeting, and come up with "*a detailed plan for the reduction of its purchase amount during the next one to two years or so*." But the BoJ "*wants to proceed carefully*". BMO has long been expecting another rate hike, or at least further tweaks to its policy, before year-end, as the current target rate is still too low and there is plenty of room to move higher. In fact, the Governor said during his press conference that it is "*possible to raise rates in July, depending on the data*". So we shall continue watching the data.
- The **RBA** has been quietly watching developments carefully and considered both hiking and not hiking at its prior meeting in May. **Governor Bullock** warned recently that the Bank will "*have to take action*" if it doesn't look like inflation is getting back to the 2%-to-3% target. The latest reading showed a pickup in April to a 5-month high of 3.6%. But given weaker economic activity (real GDP growing at the slowest rate since the days of 2020), particularly household spending, the bar for the RBA to actually hike is likely very high. The RBA was not alone in debating raising rates. According to **RBNZ Governor Orr**, "*there was a real consideration on raising rates*" at its May meeting, given the persistence of services CPI.

Foreign Exchange Forecasts

(as of June 14, 2024)

(local currency per US$: avg.)	Actual 2024 May	Forecasts 2024 Jun	Jul	Aug	Sep	Oct	2024 Q4	2025 Q1	Q2	Q3	Q4
Canadian Dollar											
C$ per US$	1.37	1.37	1.38	1.38	1.37	1.37	1.36	1.34	1.33	1.32	1.30
US$ per C$[1]	0.732	0.728	0.725	0.725	0.729	0.733	0.737	0.745	0.752	0.759	0.767
Trade-weighted	116.3	116.6	116.0	115.9	116.3	116.7	117.1	117.9	118.6	119.3	120.0
U.S. Dollar											
Trade-weighted[2]	122.2	123.8	123.8	123.7	123.2	122.7	122.2	121.1	120.2	119.4	118.5
European Currencies											
Euro[1]	1.08	1.08	1.08	1.08	1.09	1.09	1.09	1.10	1.10	1.11	1.12
Danish Krone	6.90	6.90	6.90	6.85	6.85	6.85	6.85	6.80	6.75	6.70	6.65
Norwegian Krone	10.74	10.70	10.70	10.65	10.60	10.60	10.55	10.45	10.40	10.30	10.25
Swedish Krone	10.75	10.70	10.65	10.60	10.50	10.45	10.40	10.30	10.25	10.15	10.10
Swiss Franc	0.91	0.89	0.89	0.89	0.89	0.88	0.88	0.87	0.87	0.86	0.85
U.K. Pound[1]	1.26	1.27	1.25	1.26	1.27	1.27	1.28	1.29	1.30	1.31	1.32
Asian Currencies											
Chinese Yuan	7.23	7.25	7.23	7.20	7.18	7.15	7.13	7.07	7.02	6.97	6.92
Japanese Yen	156	156	155	154	153	152	151	149	148	147	145
Korean Won	1,365	1,360	1,360	1,355	1,355	1,355	1,350	1,340	1,330	1,320	1,315
Indian Rupee	83.4	83.2	82.9	82.7	82.5	82.2	82.0	81.4	80.8	80.2	79.7
Singapore Dollar	1.35	1.35	1.34	1.34	1.33	1.33	1.33	1.32	1.31	1.30	1.29
Malaysian Ringgit	4.72	4.70	4.70	4.65	4.65	4.65	4.65	4.60	4.55	4.50	4.50
Thai Baht	36.6	36.5	36.4	36.3	36.2	36.1	36.0	35.7	35.5	35.2	35.0
Philippine Peso	57.8	57.7	57.7	57.6	57.5	57.5	57.4	57.1	56.7	56.3	55.9
Taiwan Dollar	32.3	32.2	32.1	32.0	31.9	31.9	31.8	31.5	31.3	31.1	30.8
Indonesian Rupiah	16,083	16,060	16,040	16,015	15,990	15,970	15,945	15,850	15,735	15,625	15,515
Other Currencies											
Australian Dollar[1]	0.663	0.664	0.666	0.668	0.670	0.671	0.673	0.676	0.677	0.678	0.680
New Zealand Dollar[1]	0.607	0.617	0.618	0.620	0.621	0.622	0.624	0.626	0.627	0.628	0.630
Mexican Peso	16.80	18.30	18.40	18.50	18.40	18.25	18.15	17.90	17.80	17.65	17.55
Brazilian Real	5.14	5.30	5.35	5.40	5.35	5.25	5.20	5.05	5.00	4.95	4.90
South African Rand	18.4	18.5	18.6	18.6	18.5	18.4	18.3	18.2	18.1	18.1	18.0
Cross Rates											
Versus Canadian Dollar											
Euro (C$/€)	1.48	1.49	1.50	1.50	1.49	1.48	1.48	1.47	1.47	1.46	1.46
U.K. Pound (C$/£)	1.73	1.74	1.73	1.74	1.74	1.74	1.73	1.73	1.72	1.72	1.72
Japanese Yen (¥/C$)	114	114	112	112	111	111	111	111	111	111	112
Australian Dollar (C$/A$)	0.91	0.91	0.92	0.92	0.92	0.92	0.91	0.91	0.90	0.89	0.89
Versus Euro											
U.K. Pound (£/€)	0.86	0.85	0.87	0.86	0.86	0.85	0.85	0.85	0.85	0.85	0.85
Japanese Yen (¥/€)	168	169	168	167	166	165	164	163	163	163	163

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

Interest Rate Forecasts

(as of June 14, 2024)

(% : avg.)	Actual	Forecasts									
	2024	2024					2024	2025			
	May	Jun	Jul	Aug	Sep	Oct	Q4	Q1	Q2	Q3	Q4
Canada											
Overnight target (period end)	5.00	4.75[6]	4.75	4.75	4.50	4.50	4.25	4.00	3.75	3.75	3.50
Overnight target	5.00	4.78[6]	4.75	4.75	4.54	4.50	4.45	4.18	3.93	3.75	3.58
CORRA[2]	5.01	4.82	4.78	4.78	4.55	4.52	4.46	4.18	3.93	3.75	3.58
3-month bills	4.86	4.65	4.65	4.65	4.45	4.40	4.35	4.10	3.85	3.65	3.50
6-month	4.79	4.60	4.55	4.55	4.35	4.35	4.30	4.05	3.85	3.70	3.55
1-year	4.67	4.45	4.35	4.30	4.15	4.05	3.95	3.75	3.60	3.50	3.40
2-year bonds	4.22	3.90	3.80	3.70	3.55	3.45	3.35	3.20	3.20	3.15	3.10
3-year	4.09	3.75	3.60	3.55	3.50	3.40	3.30	3.20	3.20	3.15	3.15
5-year	3.70	3.40	3.40	3.40	3.40	3.35	3.30	3.20	3.20	3.20	3.15
7-year	3.65	3.35	3.35	3.35	3.35	3.30	3.25	3.20	3.20	3.20	3.20
10-year	3.64	3.35	3.35	3.30	3.30	3.25	3.25	3.20	3.20	3.20	3.20
30-year	3.51	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30
Prime rate	7.20	6.99[6]	6.95	6.95	6.74	6.70	6.65	6.38	6.13	5.95	5.78
United States											
Fed funds target (period end)	5.38	5.38[6]	5.38	5.38	5.13	5.13	4.88	4.63	4.38	4.38	4.13
Fed funds target	5.38	5.38[6]	5.38	5.38	5.28	5.13	5.09	4.84	4.57	4.38	4.22
EFFR[3]	5.33	2.13	0.00	0.00	0.13	0.35	0.39	0.74	1.11	1.39	1.60
SOFR[4]	5.31	5.32	5.31	5.31	5.22	5.07	5.03	4.79	4.53	4.33	4.18
3-month bills	5.46	5.50	5.50	5.50	5.40	5.25	5.20	4.95	4.65	4.40	4.25
6-month	5.42	5.35	5.35	5.35	5.25	5.10	5.10	4.85	4.55	4.35	4.20
1-year	5.16	5.10	5.05	5.00	4.90	4.75	4.70	4.50	4.35	4.20	4.05
2-year notes	4.86	4.70	4.65	4.55	4.45	4.35	4.25	4.10	4.00	3.95	3.85
3-year	4.66	4.50	4.40	4.35	4.30	4.25	4.20	4.10	4.05	4.00	3.90
5-year	4.50	4.30	4.25	4.25	4.20	4.20	4.15	4.10	4.05	4.00	3.95
7-year	4.49	4.30	4.25	4.25	4.20	4.20	4.15	4.10	4.10	4.05	4.05
10-year	4.48	4.30	4.25	4.25	4.20	4.20	4.15	4.15	4.10	4.10	4.10
30-year bonds	4.62	4.45	4.40	4.40	4.35	4.35	4.30	4.30	4.25	4.25	4.25
Prime rate	8.50	8.50[6]	8.50	8.50	8.40	8.25	8.22	7.97	7.70	7.50	7.35
Other G7											
ECB Refi[1]	4.50	4.25[6]	4.25	4.25	4.00	4.00	4.00	3.75	3.50	3.25	3.00
10yr Bund	2.54	2.50	2.50	2.50	2.50	2.45	2.45	2.40	2.40	2.35	2.30
BoE Repo[1]	5.25	5.25	5.25	5.00	5.00	5.00	5.00	4.75	4.50	4.25	4.00
SONIA[5]	5.20	5.20	5.20	4.95	4.95	4.95	4.95	4.80	4.55	4.30	4.05
10yr Gilt	4.21	4.20	4.15	4.15	4.10	4.10	4.05	4.00	4.00	3.95	3.90
BoJ O/N[1]	0.05	0.06[6]	0.08	0.09	0.11	0.12	0.15	0.15	0.15	0.15	0.15
10yr JGB	0.96	0.97	0.97	0.98	0.98	0.99	0.99	1.03	1.08	1.13	1.18

[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

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