Rates Scenario for November 14, 2024

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

Forecast Summary

(avg.)	Actual	Forecasts									
	2024	2024		2025						2025	
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Q3	Q4
BoC overnight[1]	3.75	3.75	3.50	3.25	3.25	3.00	2.75	2.75	2.50	2.50	2.50
10-yr Canadas	3.19	3.30	3.25	3.20	3.15	3.10	3.10	3.05	3.00	2.95	2.85
Fed funds[1]	4.88	4.63[2]	4.38	4.38	4.38	4.13	4.13	4.13	3.88	3.63	3.38
10-yr Treasuries	4.10	4.40	4.35	4.30	4.30	4.25	4.20	4.15	4.10	4.05	3.90
C$ per US$	1.38	1.39	1.40	1.40	1.39	1.39	1.38	1.38	1.38	1.37	1.35
US$/€	1.09	1.06	1.02	1.01	1.01	1.00	1.01	1.02	1.03	1.04	1.05
US$/£	1.30	1.28	1.25	1.25	1.25	1.26	1.26	1.26	1.26	1.26	1.27
¥/US$	150	155	152	152	151	151	151	150	150	148	146

[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

Higher for Longer

- We lifted our forecast for Fed policy rates since our last Rates Scenario (October 11). In the wake of Donald Trump's presidential election victory and the Republicans gaining control of the Senate and keeping control of the House of Representatives, fiscal and trade policies are poised to take turns that should net boost economic growth and lift inflation. This should make the Fed less willing to reduce policy rates as much as before.

- Previously, we reckoned the Fed would cut rates to the 2.75%-to-3.00% range, which is the FOMC's median projection of the longer-run or neutral level—or the level policy rates should gravitate towards in the absence of any shocks to the economy. But there's a huge net positive shock pending (fiscal stimulus), pointing to above-neutral policy rates. **We raised our forecast for the fed funds target range by 50 bps to the 3.25%-to-3.50% range.** And with the higher overnight rate profile, we lifted our forecast for yields along the curve. Upward pressure on yields is also coming from bigger budget deficits and increased bond supply.

- ***Federal Reserve:*** On November 7, the FOMC lowered policy rates by 25 bps after starting rate cuts on September 18 with a 50-bp action. The size of the September move was a surprise and was characterized as a 'catch-up' cut given the deterioration in labour market conditions since the prior confab (in July). Having caught up, and with the interim data since September's meeting not making the case for a follow-up 50-pointer, the Fed shifted into a quarter-point gear for this month. In the presser, Chair Powell said: *"we're trying to steer between the risk of moving too quickly and perhaps undermining our progress on inflation or moving too slowly and allowing the labor market to weaken too much. We're trying to be on a middle path..."* That path should see another 25 bp rate cut next month. Then, as the new year begins, and after already cutting rates by a cumulative 100 bps, we look for another shift into a slower quarter-point-per-quarter gear.

- ***Bank of Canada:*** On October 23, the Bank cut the target for the overnight rate by 50 bps to 3.75%. This was the fourth consecutive action for a total of 125 bps. With the Fed reducing its policy rate by 50 bps the month before, there was lots of market speculation about the BoC following suit. We reckon the Bank's deciding factor was the rapid deceleration in headline CPI inflation—it was 1.6% y/y for September, down more than a percentage point in just two months—and a sharp cut to its Q3 GDP forecast.

- Looking ahead, the Bank's policy statement said: *"If the economy evolves broadly in line with our latest forecast, we expect to reduce the policy rate further. However, the timing and pace of further reductions in the policy rate will be guided by incoming information and our assessment of its implications for the inflation outlook. We will take decisions one meeting at a time."* We see the BoC shifting back to quarter-point actions in December, presuming no extreme data developments occur in the interim. And the rate cuts should continue until the Bank reaches its 2¼%-to-3¼% estimate of the neutral range (we're thinking the lower half of the range and 2.5%)
- ***Bond yields:*** Ten-year Treasury yields averaged 4.10% in October, up 38 bps from September's 16-month low of 3.72%. And, so far in November, they are averaging above 4.35% (the highest in six months). The selloff reflected the market's focus on the post-election prospects for fiscal policy and the increase in budget deficits and supply of bonds no matter who won the election (and the assessment was that these would be much larger under a Trump-Republican trifecta victory). It also reflected the market's focus on the prospects for associated stronger economic growth and faster inflation along with less-generous Fed rate cuts.
- Although the FOMC is not expected to reduce policy rates as much as before, there are potentially still 125 bps of cumulative rate cuts to come which should help (temporarily) steer bond yields back below 4%. But once the Fed is finished, yields could drift up again. Meanwhile, 10-year Government of Canada bond yields averaged 3.19% in October, up 25 bps from 2.94% in September (which was a 17-month low). This caused Canada-U.S. yield spreads to move more negative from -78 bps in September to -91 bps in October. The latter is close to June's -92 bp spread, a 42-year low.
- So far in November, 10-year Canadas are averaging 3.25%, up a further 6 bps, with Canada-U.S. spreads at -110 bps (setting a new record). Reasons for the outperformance include Canada's fiscal position being in much better shape than its American counterpart and inflation risks being more problematic south of the border.
- ***U.S. dollar:*** The Fed's trade-weighted dollar index averaged 1.4% stronger in October, reversing three consecutive months of depreciation worth 1.5%. So far in November, the greenback is averaging around a 2% gain. Post-election policy prospects, such as less aggressive Fed easing and more tariffs, are helping lift the index. Compared to October, we look for December to average about 3½% stronger, before beginning to reverse course next year.
- ***Canadian dollar:*** The loonie averaged C$1.375 (US$0.727) in October, depreciating 1.5% from September's C$1.355 (US0.738). The latter was the strongest level in six months, with October registering the weakest reading since the onset of the pandemic in March-May 2020. So far this month, the CAD is averaging C$1.392 (US$0.719), with further weakening likely. The currency recently closed at C$1.400 (US$0.714). More aggressive BoC easing (compared to the Fed), and the greenback's election-related revival have helped lead the loonie weaker. We see it averaging a full C$1.400 in December, before beginning an appreciating trend next year with the BoC expected to end easing by around mid-year.

Overseas

Jennifer Lee, Senior Economist

- Be flexible, watch the data as they roll in, and take things meeting by meeting. And don't pre-commit. All rules that should be followed by central bankers, especially now with some still facing sticky inflation and/or wages, and potential trade wars in coming months.
- Take the **Bank of England**. It trimmed its Bank Rate 25 bps to 4.75% on November 7, a move supported by all but one policymaker. With the Autumn Budget now expected to lift GDP growth and inflation—the opposite of what policymakers were expecting—**we now look for only three rate cuts in 2025** (not five). Remember that most central bankers are data-dependent. Indeed, after musing aloud back in October that the Bank could be "*a bit more aggressive*" on rate cuts if inflation comes down faster than expected, **Governor Bailey** now says that the Bank cannot cut rates "*too quickly or by too much*". This is particularly the case with the new fiscal measures that Chancellor Reeves introduced. And with earnings growth, as Chief Economist Huw Pill described it, "*still sticky*", the BoE is likely to pause in December before taking rates lower in the new year.
- The **ECB** will meet on December 12 and is expected to lower the deposit rate for the fourth time this year, by 25 bps to 3.00%. Inflation is currently parked right on the 2% target, while core is steady at 2.7%. Most policymakers are onside with a cut, including the hawks from the Netherlands ("*in the short term…. we may see inflation dropping faster than expected*") and Austria ("*the possibility exists, there's nothing at the moment that would speak against it, but that doesn't mean that it will*"). Vice-President Luis de Guindos also said that "*the disinflationary process is now well on track*". **Germany** is weighing heavily on the region as it deals with the fallout from the auto sector's decline (Schaeffler was the latest name to announce job cuts and plant closures) and now, there will be a confidence vote December 16 and an election February 23. At least the Free Democrats are sounding more flexible with the debt brake. Elsewhere, **Spain** has been slammed by record flooding. And, there is nervousness preparing for Trump 2.0. Indeed, a 25 bp cut should be in the works.
- The **BoJ** unanimously agreed to hold rates at "*around 0.25%*" on October 31. The Statement was short and to the point (likely the shortest one ever, although April's was close). The forecast for real GDP was raised slightly for Fiscal 2025 to 1.1%, supported by stronger consumer spending, and as the "*fog*" over the U.S. economy was "*clearing somewhat*". The forecast for core CPI was cut by two-tenths to 1.9%, thanks to lower energy prices, not wages. In fact, it was noted that more firms were raising wages and prices, and that some of these wage increases were spilling over into services inflation. Governor Ueda even mentioned that Tokyo's latest CPI showed more companies were passing higher costs onto consumers, and that they would take a more "*careful look*" to see if that was also the case nationwide. Finally, exchange rate developments were, "*compared to the past, more likely to affect prices*". And we all know how weak the JPY is these days, particularly post-U.S. election. Finally, there was one line that hammered the case home: "*If the aforementioned outlook for economic activity and prices will be realized, the Bank will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation.*" It is not often that such clear language is used. All the above reasons strengthen the case for a rate hike in December.
- Finally, the **RBA** held the cash rate at a 13-year high of 4.35% on November 5. Governor Bullock continued to sound hawkish, even as Q3 inflation fell within the 1%-to-3% target for the first time in 3½ years. The key was that inflation needs to return "*sustainably*" to the target, a word that was used 6x in the media release. We now look for the RBA to cut rates in February.
- On the **FX** front, we look for the majors to be considerably weaker, at least in the near term. It is all about the greenback: boosted by a stronger U.S. economy and potentially fewer Fed rate cuts. And, a great deal of uncertainty over tariffs and potential trade wars.

Foreign Exchange Forecasts

(local currency per US$: avg.)	Actual 2024 Oct	Forecasts 2024 Nov	Dec	2025 Jan	Feb	Mar	Apr	May	Jun	2025 Q3	Q4
Canadian Dollar											
C$ per US$	1.38	1.39	1.40	1.40	1.39	1.39	1.38	1.38	1.38	1.37	1.35
US$ per C$[1]	0.727	0.719	0.714	0.716	0.719	0.721	0.723	0.725	0.727	0.732	0.738
Trade-weighted	116.3	116.7	116.7	117.1	117.5	117.8	118.0	118.1	118.2	118.6	119.3
U.S. Dollar											
Trade-weighted[2]	123.8	126.6	128.3	128.3	128.3	128.2	127.8	127.4	126.9	126.3	125.5
European Currencies											
Euro[1]	1.09	1.06	1.02	1.01	1.01	1.00	1.01	1.02	1.03	1.04	1.05
Danish Krone	6.85	7.00	7.30	7.30	7.30	7.25	7.25	7.20	7.20	7.15	7.10
Norwegian Krone	10.84	11.10	11.55	11.50	11.45	11.45	11.40	11.40	11.35	11.30	11.25
Swedish Krone	10.48	10.90	11.40	11.35	11.30	11.30	11.25	11.25	11.20	11.15	11.10
Swiss Franc	0.86	0.88	0.87	0.87	0.87	0.87	0.86	0.86	0.86	0.86	0.85
U.K. Pound[1]	1.30	1.28	1.25	1.25	1.25	1.26	1.26	1.26	1.26	1.26	1.27
Asian Currencies											
Chinese Yuan	7.09	7.20	7.20	7.20	7.20	7.20	7.19	7.19	7.19	7.19	7.18
Japanese Yen	150	155	152	152	151	151	151	150	150	148	146
Korean Won	1,362	1,400	1,395	1,395	1,395	1,390	1,390	1,390	1,390	1,390	1,390
Indian Rupee	84.0	84.4	84.2	84.2	84.1	84.1	84.1	84.0	84.0	83.9	83.8
Singapore Dollar	1.31	1.34	1.34	1.34	1.34	1.34	1.34	1.34	1.34	1.34	1.33
Malaysian Ringgit	4.30	4.40	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45
Thai Baht	33.4	34.6	34.7	34.7	34.7	34.7	34.7	34.7	34.6	34.6	34.6
Philippine Peso	57.5	58.6	58.5	58.5	58.5	58.5	58.4	58.4	58.4	58.4	58.4
Taiwan Dollar	32.1	32.4	32.4	32.3	32.3	32.3	32.3	32.3	32.3	32.3	32.3
Indonesian Rupiah	15,592	15,760	15,710	15,710	15,705	15,700	15,695	15,695	15,690	15,685	15,670
Other Currencies											
Australian Dollar[1]	0.670	0.650	0.640	0.641	0.642	0.643	0.643	0.644	0.645	0.647	0.649
New Zealand Dollar[1]	0.608	0.590	0.580	0.581	0.582	0.583	0.583	0.584	0.585	0.587	0.589
Mexican Peso	19.72	20.50	21.00	20.90	20.85	20.75	20.65	20.60	20.50	20.35	20.10
Brazilian Real	5.63	5.80	5.85	5.80	5.80	5.75	5.70	5.65	5.65	5.55	5.45
South African Rand	17.6	18.0	18.5	18.4	18.3	18.3	18.2	18.1	18.0	17.8	17.6
Cross Rates											
Versus Canadian Dollar											
Euro (C$/€)	1.50	1.47	1.43	1.41	1.40	1.39	1.40	1.41	1.42	1.42	1.42
U.K. Pound (C$/£)	1.79	1.78	1.75	1.75	1.74	1.74	1.74	1.74	1.73	1.73	1.72
Japanese Yen (¥/C$)	109	112	109	109	109	109	109	109	109	109	108
Australian Dollar (C$/A$)	0.92	0.90	0.90	0.89	0.89	0.89	0.89	0.89	0.89	0.88	0.88
Versus Euro											
U.K. Pound (£/€)	0.84	0.83	0.82	0.81	0.80	0.80	0.80	0.81	0.82	0.82	0.83
Japanese Yen (¥/€)	163	164	155	154	152	151	152	153	155	154	153

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

Interest Rate Forecasts

(% : avg.)	Actual 2024 Oct	Forecasts 2024 Nov	Dec	2025 Jan	Feb	Mar	Apr	May	Jun	2025 Q3	Q4
Canada											
Overnight target (period end)	3.75	3.75	3.50	3.25	3.25	3.00	2.75	2.75	2.50	2.50	2.50
Overnight target	4.12	3.75	3.59	3.48	3.25	3.10	2.89	2.75	2.54	2.50	2.50
CORRA[2]	4.17	3.80	3.63	3.52	3.28	3.12	2.90	2.76	2.54	2.50	2.50
3-month bills	3.71	3.50	3.35	3.25	3.05	2.95	2.75	2.65	2.45	2.45	2.45
6-month	3.58	3.40	3.25	3.20	3.05	2.95	2.80	2.70	2.55	2.55	2.55
1-year	3.35	3.30	3.15	3.05	2.95	2.80	2.70	2.60	2.45	2.45	2.45
2-year bonds	3.08	3.15	3.05	2.95	2.80	2.70	2.60	2.50	2.40	2.40	2.40
3-year	3.04	3.10	3.05	2.95	2.85	2.80	2.70	2.60	2.55	2.50	2.50
5-year	2.97	3.10	3.05	3.00	2.95	2.85	2.80	2.75	2.70	2.65	2.60
7-year	3.07	3.20	3.15	3.10	3.05	3.00	2.95	2.90	2.85	2.80	2.75
10-year	3.19	3.30	3.25	3.20	3.15	3.10	3.10	3.05	3.00	2.95	2.85
30-year	3.32	3.30	3.25	3.20	3.20	3.15	3.10	3.05	3.00	2.95	2.85
Prime rate	6.32	5.95	5.79	5.68	5.45	5.30	5.09	4.95	4.74	4.70	4.70
United States											
Fed funds target (period end)	4.88	4.63[6]	4.38	4.38	4.38	4.13	4.13	4.13	3.88	3.63	3.38
Fed funds target	4.88	4.68[6]	4.52	4.38	4.38	4.28	4.13	4.13	4.03	3.84	3.57
EFFR[3]	4.83	4.64	4.48	4.34	4.34	4.25	4.10	4.10	4.01	3.82	3.56
SOFR[4]	4.85	4.65	4.50	4.35	4.35	4.26	4.11	4.11	4.01	3.83	3.56
3-month bills	4.72	4.60	4.50	4.35	4.35	4.25	4.10	4.10	4.00	3.80	3.50
6-month	4.44	4.40	4.30	4.20	4.20	4.10	4.00	4.00	3.90	3.75	3.55
1-year	4.20	4.30	4.25	4.15	4.10	4.05	3.95	3.95	3.90	3.75	3.55
2-year notes	3.97	4.25	4.20	4.15	4.10	4.05	3.95	3.90	3.85	3.75	3.55
3-year	3.90	4.20	4.15	4.15	4.10	4.05	4.00	3.95	3.90	3.80	3.65
5-year	3.91	4.25	4.25	4.20	4.15	4.10	4.05	4.00	3.95	3.85	3.75
7-year	3.99	4.35	4.30	4.25	4.20	4.15	4.15	4.10	4.05	3.95	3.80
10-year	4.10	4.40	4.35	4.30	4.30	4.25	4.20	4.15	4.10	4.05	3.90
30-year bonds	4.38	4.60	4.55	4.50	4.45	4.45	4.40	4.35	4.30	4.20	4.10
Prime rate	8.00	7.81[6]	7.65	7.50	7.50	7.40	7.25	7.25	7.15	6.97	6.70
Other G7											
ECB Deposit Rate[1]	3.25	3.25	3.00	3.00	3.00	2.75	2.75	2.75	2.50	2.25	2.00
10yr Bund	2.25	2.30	2.35	2.35	2.30	2.30	2.30	2.25	2.25	2.20	2.15
BoE Repo[1]	5.00	4.75[6]	4.75	4.75	4.50	4.50	4.50	4.25	4.25	4.00	4.00
SONIA[5]	4.95	4.75	4.70	4.70	4.49	4.45	4.45	4.26	4.20	4.05	3.95
10yr Gilt	4.18	4.50	4.45	4.45	4.40	4.40	4.35	4.35	4.30	4.30	4.20
BoJ O/N[1]	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.25
10yr JGB	0.94	0.99	1.05	1.06	1.07	1.08	1.08	1.09	1.10	1.12	1.14

[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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