Rates Scenario for July 10, 2025

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Forecast Summary

(avg.)	Actual	Forecasts									
	2025	2025						2026			
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Q1	Q2	Q3	Q4
BoC overnight[1]	2.75	2.50	2.50	2.50	2.25	2.25	2.25	2.00	2.00	2.00	2.00
10-yr Canadas	3.31	3.35	3.35	3.35	3.35	3.30	3.30	3.30	3.25	3.20	3.20
Fed funds[1]	4.38	4.38	4.38	4.13	4.13	4.13	3.88	3.63	3.38	3.13	2.88
10-yr Treasuries	4.38	4.35	4.30	4.30	4.25	4.25	4.25	4.20	4.10	4.05	4.00
C$ per US$	1.37	1.36	1.36	1.36	1.36	1.35	1.35	1.35	1.34	1.34	1.33
US$/€	1.15	1.17	1.17	1.18	1.18	1.19	1.19	1.19	1.20	1.20	1.21
US$/£	1.36	1.36	1.36	1.36	1.37	1.37	1.37	1.37	1.38	1.38	1.39
¥/US$	144	145	144	144	143	143	142	142	141	141	140

[1] end of period

Sources: BMO Economics, Haver Analytics

Canada-U.S. Rates Outlook

Michael Gregory, CFA, Deputy Chief Economist

The Bog Days of Summer

Monetary policy is bogged down on both sides of the Canada-U.S. border. After easing policy at the first two confabs of the year, the Bank of Canada has spent the past two meetings on hold. Inflation has proven to be a bit too stubborn for comfort, and the Bank is waiting to see if the stickiness persists amid a slackening labour market and cooling economy. The Fed has been on hold all year, more recently waiting to see how higher tariffs influence inflation, with a lengthier wait time afforded by a still-sturdy labour market and broader economic performance. We reckon both policy holds won't last past the end of the summer and look for rates to start the autumn 25 bps lower. The current season boasts two identically-dated policy announcements: July 30; and September 17. Admittedly, our past conviction about the Bank moving first (July vs. the Fed in September) is wavering, but not about a summer move.

Federal Reserve: As noted above, we look for the FOMC to keep policy rates unchanged on July 30, keeping the fed funds target range at 4.25%-to-4.50% for the fifth consecutive meeting (since December). The seven months' long hold has reflected elevated uncertainty over the Administration's erratically evolving economic policies and their consequences for the economy. June's policy statement acknowledged that *"uncertainty about the economic outlook has diminished"* but it *"remains elevated"*. And we look for this to be repeated this month. Arguably, trade policy has turned murkier with the deadline for deals to avoid reciprocal tariffs extended to August 1 (the day after the Fed's confab), and formal 'letters' sent to many countries stating their tariff rate if a deal isn't reached before then. Meanwhile, President Trump signed the One Big Beautiful Bill Act (OBBBA), with a rough ½ ppt boost to economic growth looming next year, owing to a slew of new temporary tax cuts (which should offset some of the impact of tariffs).

By the September 17 meeting, we anticipate that the evidence of tariffs seeping into broad inflation will (finally) be available but assessed as being sufficiently contained and paling in importance relative to the expected further weakening in the labour market and broader economy. With the policy stance still on the restrictive side (neutral is

closer to 3%), we reckon the Fed is more sensitive to deteriorating labour market conditions and broader economic data. We continue to call for a quarterly cadence of 25 bp rate cuts through the end of next year. Admittedly, our conviction in our current forecast of 100 bps worth of easing next year will be tested by the OBBBA.

Bank of Canada: The July 30 policy announcement could see a resumption of rate reductions after a two-meeting hiatus (and 225 bps worth of rate cuts over seven consecutive confabs). It's still our 'official' call, but as noted above, our conviction in it is wavering. We reckon a cut will require a Labour Force Survey for June (due July 11) that is demonstrably weak and, more importantly, a CPI report for the month (due July 15) that is patently disinflationary. Such a data tandem could be a tall order, making it tempting to wait for another two rounds of labour market and inflation data, along with GDP figures for Q2, that will occur before the next BoC meeting on September 17. Our gut feel tells us they'll take it, short of the above-mentioned pair of data outcomes.

We still look for two 25 bps rate cuts by the end of this year and a final one in 2026 Q1. This will lower the policy rate to 2.00%, just a bit below the Bank's 2.25%-to-3.25% neutral range. How the trade war unfolds after the (current) July 21 deadline for a Canada-U.S. trade deal, and whether Canada gets hit by more sectoral tariffs (copper is looming and lumber is in the wings), are key economic and BoC policy risks over the near term, not to mention how the data behave.

Bond yields: Ten-year Treasury yields averaged 4.38% last month and are a few basis points lower so far this month (4.35% through July 9). We look for yields to average around current levels (within a 10 bp range) until the Fed resumes rate cuts in September (or is widely speculated to do so). Then, we look for them to trend lower, amid 150 bps worth of Fed rate cuts that should unfold gradually (25 bps per quarter). But monthly yields should continue averaging at least 4.00%, short of raging market speculation of much more aggressive Fed easing and/or rocketing risks of a U.S./global recession [1].

Offsetting some of the impact of Fed easing on yields, America's fiscal fundamentals continue to deteriorate. The OBBBA raises the cumulative deficit by $4.1 trillion through 2034 compared to the CBO's baseline projection, according to the Committee for a Responsible Federal Budget (CRFB), or by $5.5 trillion if the slew of temporary tax relief measures is made permanent. The CBO's baseline already projects a 10-year cumulative deficit of $21.9 trillion, hoisting debt held by the public to $50 trillion (>117% of GDP), and this is headed even higher.

It's argued that tariffs could generate offsetting revenue for the OBBBA, but this doesn't consider the negative impact of tariff-induced slower economic growth on other tax revenue and any decline in import volumes. Meanwhile, the legality of tariffs under the International Emergency Economic Powers Act (IEEPA) is being scrutinized. Federal finances were already unsustainable before OBBBA, and tariffs, even under their most lucrative scenario, seem destined to merely slow further fiscal deterioration—not stop it.

Meanwhile, Canada-U.S. 10-year yield spreads averaged -107 bps last month and have moved less negative so far this month (-98 bps through July 9). This continues the pattern of underperformance in place since the record -139 bps in February. Part of the pattern reflects the Bank of Canada pausing after easing more aggressively than the Fed. We reckon spreads will continue to move less negative with future Fed cumulative rate cuts expected to be larger than the BoC's.

Part of the pattern also reflects Canada's own fiscal risks. The picture is getting cloudy given that the current government did not table a post-election budget, and the costed platform has been rearranged by the evolving economic outlook and shifting policy priorities. While the underlying theme of the platform still generally holds, the near-term fiscal projections likely won't. Suffice it to say that both the Parliamentary Budget Officer's March baseline ($46.8 billion deficit) and the Liberal platform ($62.3 billion) are likely underestimating the size of the FY25/26 shortfall. After assessing the current growth outlook, recent policy measures, higher defence-spending targets, and assuming some spending gets deferred or dropped, it wouldn't be surprising to see the federal deficit jump toward $80 billion, or about 2.5% of GDP, versus $48 billion last estimated for FY24/25.

U.S. dollar: The Fed's broad trade-weighted dollar index weakened 1.4% on average last month and has continued to drift lower so far this month (by about 0.9% through July 9). With the sixth consecutive monthly decline unfolding, the greenback is down around 7.1% from January's record high. The initial market narrative was that tariffs would provide a boost to the big dollar, but the net depreciation since their introduction reflects the fact that this driver is being overwhelmed by more hesitant inflows of foreign investment [2]. We suspect that even amid any renewed escalation of the tariff war, this hesitancy will continue to (at least) fully offset any appreciation pressure. Fed rate cuts will only add to the dollar's woes. By this December, we see the index down around 8% from January's record high and see it continuing to depreciate modestly next year.

Canadian dollar: The loonie averaged C$1.367 last month (US$0.731) and has continued to drift stronger so far this month (C$1.364 or US$0.733 through July 9). When the U.S. dollar was peaking at its record high in January, the Canadian currency had depreciated to its weakest level in nearly 22 years (C$1.439 or US$0.695). The subsequent broad depreciation of the big dollar has been the loonie's main driver, tempered by more aggressive (than the Fed) Bank of Canada easing and heightened concern about Canadian economic exposure to U.S. trade policy. The latter factor is likely to weigh for a while longer. But, as the Fed starts (cumulatively) outpacing BoC rate cuts, we look for the loonie appreciation to better match greenback depreciation. Meanwhile, Canadian economic prospects are getting a big boost from unfolding stimulative fiscal policy. We look for the Canadian dollar to average C$1.350 (US$0.741) by December and appreciate further to $1.333 (US$0.752) by the end of next year.

With files from Robert Kavcic.

[1] Supporting this view, the market has maintained average yields above 4.00% for 21 of the past 23 months (including July-to-date), with only last August and September slipping below. At the time, speculation over the FOMC's inaugural rate cut was running rampant, and then the Fed surprised with a 50 bp action. On a daily basis, yields have closed above the 4.00% mark consistently since October 7. The lowest was 4.01% on April 4, in the wake of reciprocal tariffs being introduced, which fanned fears of U.S. and global recession. [^]

[2] Elevated U.S. economic policy uncertainty, more attractive prospective investment returns elsewhere (think EU ahead of massive infrastructure and military spending), and 'quiet' retaliation against U.S. tariffs could be reasons for the hesitancy. [^]

Overseas

Jennifer Lee, Senior Economist

The "wait and see" mentality continues to hold in the midst of the summer. The U.S. rolled out tariff rates for a number of countries, with a start date of August 1. But, countries can negotiate... and they will. In other words, the listed tariffs (examples: 25% for Japan and South Korea) do not appear to be set in stone. And though flexibility is good, this also makes the job of central bankers more complicated.

The **RBA** was the first central bank with a meeting held immediately after the tariff letters were delivered, and it surprised markets by keeping the cash rate at 3.85%. Thus, it continues the alternating pattern so far this year: February saw the first cut of the cycle (25 bps to 4.10%); then, a hold in April; a cut in May; and now, a hold at 3.85% in July. This, despite slower economic growth, a drop in employment and cooler inflation. The door remained open for a cut, though, as the tone leaned toward being more dovish. Once again, the word "*uncertainty*" prevailed throughout the statement. And, for the first time ever, the RBA released the "*unattributed record of votes*"... there were "*6 in favour, 3 against*". (The BoE suddenly sprang to mind.) So, it was far from unanimous. And, Fed Chair Powell will nod approvingly at the key line in the statement: *"The Board judged that it could wait for a little more information to confirm that inflation remains on track to reach 2.5 per cent on a sustainable basis*." In other words, wait and see, or we need more time. At least Governor Bullock sounded more confident on the trade front in the press conference: "*The likelihood of a severe downside scenario associated with a trade war has abated.*" It might be a little early, but who knows? Australia also needs to work out a trade deal with the U.S. as it, too, has a baseline tariff of 10%. The RBA is likely not finished yet. Just give it time.

The U.K. was the first to secure a deal; and though the country's exporters now face a 10% tariff on nearly all of their goods, at least there is certainty—but the economic effects have yet to be seen. The British economy was particularly weak in April; although a small recovery in May is expected, Q2 real GDP should be flattish vs Q1. The **BoE** voted 6-to-3 to hold at its June meeting, but the broader tone was dovish. There was a broadly held view that wage growth would show a "*significant slowing over the rest of the year*", and that there were "*signs of disinflationary pressures*" coming from the job market. (Let's see if the junior doctors' strike changes anything.) **We look for an August 7 rate cut**, as the BoE may not want to wait until November. A disappointing May GDP result will add to the pressure to cut earlier, as will the next CPI and labour market reports.

The **BoJ** is also in an unenviable spot. Japan's trade talks with the U.S. have not gone well; hence, the 25% tariff letter delivered by the Oval Office on July 7. In the weeks leading up to this official letter, President Trump accused Japan of being "*spoiled*" and demanded that the country import more cars and rice from America, though PM Ishiba dug in his heels, saying that Japan won't "*easily compromise*" on its stance. He may have a rethink on that. Normally, one would imagine that the BoJ would stay on the sidelines while cutting back on its monthly JGB purchases at a slower pace. This would be based on overall uncertainty around trade, and the hit to exports and the economy from higher tariffs. There is also the fact that household real cash earnings fell the most in nearly two years in May (-2.9% y/y). However, still-high inflation is a problem and the BoJ's mandate is price stability, which may be challenged as the JPY weakened on trade tensions. Core inflation reached a 28-month high of 3.7% in May, and though it cooled a bit in Tokyo in June, it remains well above the 2% target. (Note that rice prices are still over 100% above year-ago levels.) And, at the ECB Forum in Sintra recently, Governor Ueda did not dismiss rate hikes, citing a number of factors to consider, including wage increases and how demand evolves from those hikes, and domestic supply shocks caused by higher food costs. He also stated that Japan's policy rate is below neutral, and that the Board expects core CPI to "*accelerate thereafter as intensifying labour shortages heighten medium- to long-term inflation expectations.*" **We still look for a September rate hike**, but much will depend on whether the 25% tariff holds.

In Europe, there is hope that the economic lift from upcoming fiscal stimulus, particularly from Germany, will ease some of the burden from the **ECB**. After cutting rates 25 bps in June, the central bank is expected to pause on July 24, then ease again in September. But the June rate cut was not a dovish one. According to the Minutes, "*a few*" members preferred to leave rates unchanged. They felt that rates "*could already be in accommodative territory*" and they wanted "*more time*" to determine the current economic and pricing environment. Indeed, the environment on both counts is in a high state of uncertainty, given the trade negotiations are still in flux and, like Japan, the talks have not gone smoothly. At one point, the U.S. president threatened to slap 50% tariffs on European goods when negotiations appeared stalled, and his patience may be tested once again as the original July 9 deadline which, according to EC President Ursula von der Leyen, was "*impossible*", has come and gone. Whether the two sides come to an agreement or the E.U. will also be issued a 'tariff letter' remains an open question. Aside from trade, it was notable from the Minutes how concerned "*most*" policymakers were about undershooting inflation, which would be another reason to cut rates again in September, then keep policy steady for the rest of the year. That's when fiscal stimulus could step in to support growth. Another wildcard, however, is the currency. The euro has given back some of its recent gains due to the trade tension with the U.S. after it rallied above $1.18 vs the greenback in early July, but the currency's upward trend this year is sure to be a point of discussion at the July meeting.

With files from Erik Johnson.

Foreign Exchange Forecasts

(local currency per US$: avg.)		Actual 2025 Jun	Forecasts 2025 Jul	Aug	Sep	Oct	Nov	Dec	2026 Q1	Q2	Q3	Q4
Canadian Dollar												
C$ per US$		1.37	1.36	1.36	1.36	1.36	1.35	1.35	1.35	1.34	1.34	1.33
US$ per C$[1]		0.732	0.733	0.735	0.736	0.738	0.739	0.741	0.743	0.745	0.748	0.750
Trade-weighted		115.6	115.5	115.6	115.6	115.7	115.8	115.9	116.0	116.2	116.5	116.6
U.S. Dollar												
Trade-weighted[2]		121.0	120.3	120.0	119.7	119.4	119.1	118.8	118.6	118.2	117.7	117.4
European Currencies												
Euro[1]		1.15	1.17	1.17	1.18	1.18	1.19	1.19	1.19	1.20	1.20	1.21
Danish Krone		6.47	6.45	6.45	6.40	6.40	6.40	6.40	6.35	6.35	6.30	6.30
Norwegian Krone		10.05	10.00	9.90	9.85	9.80	9.75	9.65	9.65	9.60	9.55	9.50
Swedish Krone		9.55	9.50	9.45	9.35	9.30	9.25	9.20	9.15	9.10	9.10	9.05
Swiss Franc		0.81	0.81	0.81	0.80	0.80	0.79	0.79	0.79	0.79	0.78	0.78
U.K. Pound[1]		1.36	1.36	1.36	1.36	1.37	1.37	1.37	1.37	1.38	1.38	1.39
Asian Currencies												
Chinese Yuan		7.18	7.18	7.17	7.17	7.16	7.16	7.15	7.14	7.13	7.12	7.10
Japanese Yen		144	145	144	144	143	143	142	142	141	141	140
Korean Won		1,365	1,360	1,360	1,360	1,355	1,355	1,350	1,350	1,345	1,345	1,345
Indian Rupee		85.9	85.8	85.7	85.6	85.5	85.4	85.3	85.2	85.1	84.9	84.8
Singapore Dollar		1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.27	1.27	1.27	1.27
Malaysian Ringgit		4.24	4.25	4.25	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20
Thai Baht		32.6	32.5	32.5	32.4	32.4	32.3	32.2	32.2	32.2	32.1	32.0
Philippine Peso		56.4	56.2	56.1	55.9	55.8	55.6	55.5	55.4	55.3	55.2	55.1
Taiwan Dollar		29.6	29.6	29.6	29.5	29.5	29.5	29.5	29.4	29.4	29.3	29.3
Indonesian Rupiah		16,295	16,275	16,255	16,235	16,215	16,195	16,175	16,155	16,130	16,100	16,070
Other Currencies												
Australian Dollar[1]		0.651	0.652	0.654	0.655	0.657	0.658	0.660	0.662	0.664	0.667	0.669
New Zealand Dollar[1]		0.604	0.606	0.607	0.609	0.611	0.613	0.615	0.617	0.619	0.622	0.624
Mexican Peso		19.02	18.75	18.70	18.65	18.60	18.55	18.50	18.45	18.35	18.30	18.25
Brazilian Real		5.55	5.50	5.45	5.40	5.35	5.30	5.25	5.20	5.15	5.10	5.00
South African Rand		17.8	17.8	17.8	17.8	17.8	17.8	17.8	17.7	17.6	17.6	17.5
Cross Rates												
Versus Canadian Dollar												
Euro	(C$/€)	1.58	1.60	1.60	1.60	1.60	1.60	1.61	1.61	1.61	1.61	1.61
U.K. Pound	(C$/£)	1.86	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85
Japanese Yen	(¥/C$)	106	106	106	106	106	105	105	105	105	105	105
Australian Dollar	(C$/A$)	0.89	0.89	0.89	0.89	0.89	0.89	0.89	0.89	0.89	0.89	0.89
Versus Euro												
U.K. Pound	(£/€)	0.85	0.86	0.86	0.86	0.87	0.87	0.87	0.87	0.87	0.87	0.87
Japanese Yen	(¥/€)	167	170	170	169	169	169	169	169	169	169	169

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

Interest Rate Forecasts

(% : avg.)	Actual	Forecasts									
	2025	2025						2026			
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Q1	Q2	Q3	Q4
Canada											
Overnight target (period end)	2.75	2.50	2.50	2.50	2.25	2.25	2.25	2.00	2.00	2.00	2.00
Overnight target	2.75	2.74	2.50	2.50	2.48	2.25	2.25	2.08	2.00	2.00	2.00
CORRA[2]	2.75	2.74	2.50	2.50	2.48	2.25	2.25	2.08	2.00	2.00	2.00
3-month bills	2.66	2.65	2.40	2.40	2.40	2.15	2.15	2.00	1.95	1.95	1.95
6-month	2.65	2.65	2.45	2.45	2.40	2.25	2.25	2.10	2.05	2.05	2.05
1-year	2.64	2.65	2.50	2.45	2.35	2.25	2.15	2.05	2.05	2.10	2.15
2-year bonds	2.65	2.65	2.55	2.45	2.35	2.20	2.10	2.05	2.10	2.20	2.25
3-year	2.68	2.70	2.60	2.55	2.50	2.45	2.40	2.35	2.40	2.45	2.50
5-year	2.90	2.90	2.90	2.85	2.80	2.75	2.70	2.65	2.70	2.70	2.70
7-year	3.08	3.10	3.10	3.05	3.05	3.00	3.00	2.95	2.95	2.95	2.95
10-year	3.31	3.35	3.35	3.35	3.35	3.30	3.30	3.30	3.25	3.20	3.20
30-year	3.60	3.70	3.65	3.65	3.65	3.65	3.60	3.60	3.55	3.50	3.50
Prime rate	4.95	4.94	4.70	4.70	4.68	4.45	4.45	4.28	4.20	4.20	4.20
United States											
Fed funds target (period end)	4.38	4.38	4.38	4.13	4.13	4.13	3.88	3.63	3.38	3.13	2.88
Fed funds target	4.38	4.38	4.38	4.27	4.13	4.13	3.96	3.84	3.59	3.34	3.07
EFFR[3]	4.33	4.33	4.33	4.23	4.09	4.09	3.93	3.81	3.57	3.32	3.06
SOFR[4]	4.31	4.33	4.32	4.22	4.08	4.08	3.92	3.80	3.56	3.31	3.05
3-month bills	4.42	4.40	4.40	4.30	4.15	4.15	4.00	3.85	3.60	3.30	3.00
6-month	4.30	4.30	4.30	4.20	4.05	4.05	3.90	3.80	3.55	3.30	3.05
1-year	4.06	4.05	4.05	3.95	3.85	3.85	3.75	3.60	3.40	3.20	3.00
2-year notes	3.89	3.85	3.80	3.75	3.70	3.65	3.55	3.45	3.30	3.10	2.95
3-year	3.86	3.80	3.75	3.75	3.70	3.65	3.60	3.55	3.40	3.30	3.20
5-year	3.96	3.90	3.90	3.85	3.85	3.80	3.80	3.70	3.65	3.55	3.45
7-year	4.16	4.10	4.10	4.05	4.05	4.00	4.00	3.95	3.90	3.80	3.75
10-year	4.38	4.35	4.30	4.30	4.25	4.25	4.25	4.20	4.10	4.05	4.00
30-year bonds	4.89	4.85	4.85	4.80	4.80	4.80	4.75	4.70	4.65	4.55	4.55
Prime rate	7.50	1.96	0.00	-0.10	-0.25	-0.25	-0.41	-0.53	-0.78	-1.04	-1.31
Other G7											
ECB Deposit Rate[1]	2.00	2.00	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
10yr Bund	2.54	2.65	2.65	2.60	2.60	2.55	2.55	2.50	2.40	2.35	2.25
BoE Repo[1]	4.25	4.25	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
SONIA[5]	4.21	4.22	4.01	3.97	3.97	3.97	3.97	3.97	3.97	3.97	3.97
10yr Gilt	4.54	4.55	4.55	4.50	4.50	4.50	4.50	4.45	4.40	4.35	4.25
BoJ O/N[1]	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
10yr JGB	1.45	1.43	1.42	1.40	1.38	1.37	1.35	1.33	1.29	1.25	1.21

[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

Sources: BMO Economics, Haver Analytics

General Disclosures

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