

# Rates Scenario for January 15, 2026

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

## Forecast Summary

(avg.)	Actual	Forecasts									
	2025 Dec	2026 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	2026 Q4
BoC overnight <sup>1</sup>	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
10-yr Canadas	3.39	3.40	3.35	3.35	3.35	3.35	3.30	3.30	3.30	3.25	3.25
Fed funds <sup>1</sup>	3.63	3.63	3.63	3.38	3.38	3.38	3.13	3.13	3.13	2.88	2.88
10-yr Treasuries	4.14	4.15	4.15	4.10	4.10	4.10	4.05	4.05	4.00	4.00	4.00
C\$ per US\$	1.38	1.38	1.37	1.37	1.36	1.36	1.36	1.35	1.35	1.35	1.34
US\$/€	1.17	1.17	1.17	1.18	1.18	1.18	1.18	1.19	1.19	1.19	1.20
US\$/£	1.34	1.34	1.34	1.34	1.35	1.35	1.35	1.35	1.35	1.35	1.36
¥/US\$	156	157	157	156	156	155	155	154	154	153	152

<sup>1</sup> end of period

Sources: BMO Economics, Haver Analytics

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## Canada-U.S. Rates

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### Hold in the Cold

After matching rate cuts in September and October that followed multi-month pauses, the Federal Reserve and Bank of Canada moved differently in December. The Fed cut but the BoC held. We expect that pattern to repeat this year, but not this month. Matching holds are expected. Nevertheless, as Canada-U.S. policy rate differentials become less negative, we look for bond yield spreads to do the same and the loonie to gain against the greenback. Once the Fed joins the BoC with policy rates comfortably neutral, they both could remain there a long while; we reckon deep into next year.

**Federal Reserve:** The FOMC is expected to hold policy rates on January 28 after three consecutive rate cuts worth 75 bps. Interestingly, 2025 also began with a hold after three successive rate reductions totalling 100 bps. However, last year's eventual nine-month pause reflected heightened economic policy uncertainty, and the stagflation risk posed by tariffs. Rate cuts resumed as the uncertainty and risk de-escalated and available data emphasized further slowing in the labour market. This month's hold reflects the need to be nimbler with policy rates now *"within a range of plausible estimates of neutral"* and with *"no risk-free path for policy as we navigate this tension between our employment and inflation goals"* (Chair Powell on December 10).

If anything, the latest critical data support holding. Through December (and looking past the huge drop in October payrolls as the federal government's separation program was accounted for), payroll employment has slowed but is no longer knocking on contraction's door (which was happening this summer). Household surveyed employment growth has been steady, running in the 200k-range in each of the past three months (October was cancelled). And the unemployment rate dipped a tenth to 4.4% in December with November's previous 4.6% peak also revised down a tenth. This rolled back the risk of triggering the Sahm Rule again. The labour market seems to be stabilizing, admittedly at a slow pace.

Meanwhile, for December, the yearly total and core CPI inflation rates remained at November's 2.7% and 2.6%, respectively. Although the three-month changes were encouragingly much cooler (at 2.1% annualized and 1.6%

annualized, respectively) there is more uncertainty surrounding the latest trends owing to October's cancelled data and the fact that 40% of December's imputations (for missing figures) involved the less accurate 'different cell' method. This matches the highest on record (back to 2019) along with September when the BLS was scrambling during the shutdown to produce a regulatory required report. And to top it off, the last PCE price index the Fed has seen was for September. Waiting until March 18 to consider another action would provide two additional employment and CPI reports through February along with October and November data on the PCE price index.

As before, we look for the Fed to next cut rates in March (25 bps), on a 'quarter-per-quarter' easing course that should conclude by September with the fed funds target range at 2.75%-to-3.00%. The midpoint (2.875%) is just a bit below the FOMC's median projection of the longer run or neutral level (3.00%). This slight tilt is a nod to the net risk of a more dovish policy push by the new Fed head after May 15, when Chair Powell's tenure (as Chair) ends. (So, too, is the fact that rate cuts will be continuing amid 2%-plus real GDP growth, a jobless rate stabilizing around 4½%, and inflation running above 2%.) Note that 'Governor' Powell's seat on the Fed's Board runs until January 31, 2028, but the tradition has been that the ex-Chair departs. Finally, after the three cuts this year, we see a long pause deep into 2027.

**Bank of Canada:** The BoC is also expected to hold policy rates on January 28 after holding last month. Before December, the Bank had cut a total of 275 bps starting in June 2024 and over consecutive confabs apart from a six-month pause (last March-September). We reckon the current pause is going to last a lot longer. The September-October easing couplet left the policy rate at 2.25%, at the bottom of the Bank's 2.25%-to-3.25% estimated range for neutral. After last month's hold, Governor Macklem asserted that *"a policy rate at the lower end of the neutral range was appropriate to provide some support for the economy as it works through this structural transition [owing to U.S. trade policy] while keeping inflationary pressures contained."*

This is 'long pause' talk. We reckon this balancing between providing the most economic support possible without prodding inflation could last all year (and deep into next year). Macklem said: *"We will be assessing incoming data relative to our outlook. If a new shock or an accumulation of evidence materially change the outlook, we are prepared to respond."* How the USMCA review unfolds poses a potential massive shock, which we judge will tilt the net odds in favour of another rate cut (vs. a hike). Note that in the meeting (according to the Summary of Deliberations), Governing Council also discussed the direction of the next move. *"Given the high level of uncertainty, members agreed that while the current policy rate was at about the right level in the current situation, it was difficult to predict when and in which direction the next change in the policy rate would be."* Indeed.

**Bond yields:** Ten-year U.S. Treasury yields averaged 4.14% in December and are slightly higher so far this month. A 4.00% average floor has held for 16 consecutive months. Indeed, starting from early October 2024, even among the daily closes, the 4.00% line has held except for four readings during October 2025. We consider the line an effective floor for yields, shored up by deteriorating fiscal fundamentals for which investors are demanding higher yields to compensate. Deficits, debt, and interest payments were already on unsustainable paths before the One Big Beautiful Bill Act pushed them on even worse paths. Tariff revenue could cushion some, but not all, of the OBBBA's blow. Also, investors are concerned about the erosion of Fed independence and U.S. dollar dominance. The former was stoked further by the latest news of the Justice Department's investigation into a past Powell congressional testimony (that included grand jury subpoenas).

Looking ahead, additional Fed rate cuts could exert some downward pressure on yields. And, as we have seen already, the odd daily close can easily slip under 4.00% (for the record, the low during October was 3.97%). However, our fundamental view is that a 4.00% monthly floor should hold indefinitely, short of mounting prospects for chunky Fed cuts (>25 bps) or escalating risks of recession.

Meanwhile, Canada-U.S. 10-year yield spreads averaged -75 bps in December, the least negative in 22 months and in stark contrast to the record -139 bps in January 2025. Interestingly, the latter extreme marked when the Bank of Canada continued easing as the Fed held (which happened again in March). And the former extreme marked when

the Fed continued easing while the BoC held; a pattern that should persist as 2026 unfolds (a cumulative -75 bps for the Fed, nothing for the Bank). Although yield spreads have averaged a slightly more negative -77 bps so far this month, we expect the unfolding policy asymmetry will impart net pressure for less negative spreads. The move to the eventual -60s range will be drawn out and a bit choppy, abetted by Canada's own fiscal deterioration on both the federal and provincial fronts.

**U.S. dollar:** The Fed's broad trade-weighted dollar index weakened an average 1% in December as the FOMC cut rates again, with the greenback slipping 1.3% against the advanced foreign economies (AFE). But since September, when the Fed resumed rate cuts, which was supposed to be 'bad' for the big dollar, the net changes are -0.3% for the broad index and +0.3% for AFE. During the period, the dollar-friendly, mounting data emphasizing U.S. economic resiliency seems to have effectively countered dollar-unfriendly Fed easing. But December's price action alone hints that the latter could weigh heavier as 2026 unfolds.

The dollar is unchanged so far this month against the AFE (per the Wall Street Journal's Dollar Index). As 75 bps worth of Fed easing occurs, we look for the greenback to follow a modest depreciating trend assisted by investor concerns about fiscal profligacy and Fed independence. (The risk that the Supreme Court rules against IEEPA-justified tariffs also appears to be weighing.) We see the broad index down around 2% y/y by 2026-end, or about 2½% against the majors.

**Canadian dollar:** The loonie averaged C\$1.380 in December (US\$0.726), strengthening 1.8% against the greenback. It did better than the AFE pack as the Bank of Canada kept policy rates unchanged. So far this month, the Canadian dollar has moved mostly sideways. With another 75 bps of Fed rate cuts coming this year, and with the BoC on a long pause, we look for the loonie to continue appreciating to C\$1.333 (US\$0.752) by 2026-end, gaining almost 3½%. However, the key risk for the C\$ remains U.S. trade policy, with the review of the USMCA scheduled for mid-year (and formal talks are beginning). Our working assumption is that the USMCA will still be around by the start of 2027, perhaps not yet having been renegotiated, with America's Section 232 'national security' sectoral duties addressed via tariff-rate quotas. If the outcome is brighter, so too should be the loonie's prospects.

## Overseas

Jennifer Lee, Senior Economist

One is still the loneliest number. The BoJ was pretty lonely throughout 2025 (it hiked twice) but now, it has some company.

It looks like the **RBA**, after trimming rates a whopping 75 bps in 2025 over a 7-month span, is ready to raise rates for the first time since November 2023. For this central bank, which has shown it can shift its stance quickly, it is all about inflation being sticky. Take the latest monthly CPI report, which was rejigged to be less volatile, although the Board seems to look at the series with a wary eye. In any event, the November inflation rate came in below expected at 3.4% y/y, down from 3.8% in October, with most of the increases coming from housing and food. The trimmed mean rate eased a tad to 3.2% from 3.3% in the prior month. For both ... right direction, but the headline is still too high, and the trimmed mean is still too sticky. Other measures tell a similar story: goods and services CPI each cooled but remain above the 2%-to-3% target as well. All of this is concerning. The Minutes from the RBA's December meeting showed that policymakers had a chat about what conditions would warrant a rate hike, and that would be if inflation risks shift to the upside. Although the latest inflation report cools any urgency to raise rates in February, **a March RBA rate hike is still our base case scenario.**

So the RBA will be joining the **Bank of Japan**, a central bank that has put an end to the "will they or won't they" guessing games. After raising rates in January 2025, it finally followed up with another hike in December, and firmly signalled that more moves are coming in 2026. Inflation has cooled but, again, is still above the 2% target. And the wage data have been supportive. Although high inflation caused real cash earnings to take a 2.8% y/y fall in November, base pay for full-timers grew 2% y/y in the same month, which keeps a source of support beneath the

consumer. The weak JPY alone, despite a "hawkish" central bank and warnings from the MoF that it is watching it closely, pushes for tighter monetary policy. We continue to believe that **the BoJ will raise rates a couple of times this year** (to around 1.25%).

And that is about it for those who are tightening. The others are staying put, for the most part.

The **ECB** is likely staying on the sidelines this year. It has sounded increasingly confident over the past few months, having brought inflation down to the 2% target by December. The comment most frequently used by many members of the Governing Council has been that policy is in "*a good place*" but, as President Lagarde warned at the most recent meeting in December, "*it does not mean we are static*". At the same meeting, the staff forecasts for growth were lifted, prompted by stronger domestic demand (specifically, AI investment and exports). Headline and core inflation forecasts were raised as well; and services inflation, due to wages, is expected to decline "*more slowly*". The Governing Council is, as it stands, comfortable with inflation, but there are some who are a little concerned about growth, citing some downside risks. As always, the ECB will be data-dependent and take things on a meeting-by-meeting basis. But it will get some help from governments across Europe, as defence spending ramps up and other fiscal measures are introduced. We remain of the view that **the central bank will be patient and stay on hold this year**.

The **BoE** is also likely to remain on the sidelines in 2026, although one should not completely rule out a move in the spring. But the December rate cut was the result of a tight 5-to-4 vote (with Governor Bailey providing the swing vote), and it sounds like the bar is higher for further cuts. **BMO's Laurence Mutkin, Director & Head of EMEA Rates Strategy**, noted that the MPC minutes revealed a large majority (7-to-2) were in favour of a slower pace of rate cuts (or no further cut), while a smaller majority was in favour of the December cut. In any event, yes, rates are likely to continue on a "*gradual*" downward path, the risk of inflation persistence is "*somewhat less pronounced*", Governor Bailey sees scope for "*some additional policy easing*", and the hawkish Catherine Mann and Huw Pill admit that the decision was "*finely balanced*". But Governor Bailey also said that "*with every cut we make, how much further we go becomes a closer call*" and that the "*room for cuts is more limited*" as they approach neutral. At the end of the day, "*the extent of further easing in monetary policy will depend on the evolution of the outlook for inflation.*" Indeed, **the BoE will likely be on hold for 2026**.

## Foreign Exchange Forecasts

(local currency per US\$ : avg.)	Actual 2025 Dec	Forecasts 2026									2026 Q4
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep		
<b>Canadian Dollar</b>											
C\$ per US\$	1.38	1.38	1.37	1.37	1.36	1.36	1.36	1.35	1.35	1.35	1.34
US\$ per C\$ <sup>1</sup>	0.725	0.727	0.729	0.731	0.733	0.735	0.737	0.739	0.742	0.744	0.748
Trade-weighted	113.8	113.9	114.1	114.3	114.6	114.8	115.0	115.3	115.5	115.8	116.3
<b>U.S. Dollar</b>											
Trade-weighted <sup>2</sup>	120.6	120.1	119.9	119.7	119.5	119.4	119.2	119.0	118.8	118.6	118.2
<b>European Currencies</b>											
Euro <sup>1</sup>	1.17	1.17	1.17	1.18	1.18	1.18	1.18	1.19	1.19	1.19	1.20
Danish Krone	6.38	6.40	6.40	6.40	6.35	6.35	6.35	6.30	6.30	6.30	6.25
Norwegian Krone	10.11	10.10	10.05	10.00	10.00	9.95	9.95	9.90	9.90	9.85	9.80
Swedish Krona	9.29	9.20	9.20	9.15	9.15	9.10	9.10	9.05	9.05	9.00	8.95
Swiss Franc	0.80	0.80	0.80	0.80	0.80	0.79	0.79	0.79	0.79	0.79	0.78
U.K. Pound <sup>1</sup>	1.34	1.34	1.34	1.34	1.35	1.35	1.35	1.35	1.35	1.35	1.36
<b>Asian Currencies</b>											
Chinese Yuan	7.04	7.00	7.00	7.00	7.00	7.00	7.00	6.99	6.99	6.99	6.99
Japanese Yen	156	157	157	156	156	155	155	154	154	153	152
Korean Won	1,465	1,460	1,460	1,465	1,465	1,465	1,465	1,470	1,470	1,470	1,475
Indian Rupee	90.0	90.2	90.2	90.3	90.3	90.3	90.4	90.4	90.5	90.5	90.6
Singapore Dollar	1.29	1.29	1.29	1.29	1.29	1.29	1.29	1.29	1.29	1.29	1.29
Malaysian Ringgit	4.09	4.05	4.05	4.05	4.05	4.05	4.05	4.05	4.05	4.05	4.05
Thai Baht	31.6	31.4	31.4	31.4	31.4	31.4	31.4	31.5	31.5	31.5	31.5
Philippine Peso	58.9	59.3	59.3	59.4	59.4	59.4	59.5	59.5	59.5	59.5	59.6
Taiwan Dollar	31.4	31.5	31.5	31.5	31.5	31.6	31.6	31.6	31.6	31.6	31.6
Indonesian Rupiah	16,688	16,835	16,845	16,855	16,865	16,870	16,880	16,890	16,900	16,910	16,925
<b>Other Currencies</b>											
Australian Dollar <sup>1</sup>	0.664	0.670	0.671	0.672	0.673	0.674	0.675	0.675	0.676	0.677	0.679
New Zealand Dollar <sup>1</sup>	0.579	0.580	0.581	0.583	0.584	0.585	0.587	0.588	0.590	0.591	0.594
Mexican Peso	18.07	17.75	17.75	17.70	17.70	17.65	17.65	17.60	17.60	17.55	17.50
Brazilian Real	5.46	5.40	5.35	5.30	5.30	5.25	5.20	5.15	5.15	5.10	5.05
South African Rand	16.8	16.4	16.4	16.3	16.3	16.3	16.2	16.2	16.1	16.1	16.0
<b>Cross Rates</b>											
<b>Versus Canadian Dollar</b>											
Euro (C\$/€)	1.62	1.61	1.61	1.61	1.61	1.61	1.61	1.60	1.60	1.60	1.60
U.K. Pound (C\$/£)	1.85	1.84	1.84	1.84	1.84	1.83	1.83	1.83	1.82	1.82	1.82
Japanese Yen (¥/C\$)	113	114	114	114	114	114	114	114	114	114	114
Australian Dollar (C\$/A\$)	0.92	0.92	0.92	0.92	0.92	0.92	0.91	0.91	0.91	0.91	0.91
<b>Versus Euro</b>											
U.K. Pound (£/€)	0.87	0.87	0.87	0.87	0.88	0.88	0.88	0.88	0.88	0.88	0.88
Japanese Yen (¥/€)	183	184	184	183	183	183	183	183	183	183	183

<sup>1</sup> (US\$ per local currency); <sup>2</sup> Federal Reserve Broad Index

Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

(% : avg.)	Actual 2025 Dec	Forecasts 2026									2026 Q4
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	
<b>Canada</b>											
Overnight target (period end)	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
Overnight target	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
CORRA <sup>2</sup>	2.27	2.26	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
3-month bills	2.17	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
6-month	2.24	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
1-year	2.36	2.40	2.40	2.35	2.35	2.35	2.35	2.35	2.35	2.35	2.30
2-year bonds	2.58	2.55	2.55	2.50	2.50	2.50	2.45	2.45	2.45	2.40	2.40
3-year	2.57	2.50	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.60	2.60
5-year	2.95	2.90	2.90	2.90	2.90	2.90	2.85	2.85	2.85	2.85	2.85
7-year	3.09	3.05	3.05	3.05	3.05	3.05	3.05	3.05	3.05	3.05	3.05
10-year	3.39	3.40	3.35	3.35	3.35	3.35	3.30	3.30	3.30	3.25	3.25
30-year	3.82	3.85	3.80	3.80	3.80	3.80	3.75	3.75	3.75	3.70	3.70
Prime rate	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45
<b>United States</b>											
Fed funds target (period end)	3.63	3.63	3.63	3.38	3.38	3.38	3.13	3.13	3.13	2.88	2.88
Fed funds target	3.71	3.63	3.63	3.52	3.38	3.38	3.27	3.13	3.13	3.01	2.88
EFFR <sup>3</sup>	3.72	3.64	3.64	3.54	3.39	3.39	3.28	3.13	3.13	3.01	2.88
SOFR <sup>4</sup>	3.79	3.66	3.64	3.53	3.38	3.38	3.28	3.12	3.12	3.01	2.87
3-month bills	3.68	3.65	3.65	3.55	3.40	3.40	3.25	3.10	3.10	2.95	2.80
6-month	3.63	3.60	3.60	3.50	3.35	3.35	3.25	3.10	3.10	3.00	2.90
1-year	3.54	3.50	3.45	3.40	3.30	3.25	3.15	3.05	3.05	2.95	2.90
2-year notes	3.50	3.50	3.40	3.35	3.25	3.20	3.10	3.05	2.95	2.90	2.90
3-year	3.55	3.55	3.50	3.45	3.40	3.35	3.30	3.25	3.20	3.15	3.15
5-year	3.70	3.75	3.70	3.65	3.60	3.60	3.55	3.50	3.45	3.45	3.45
7-year	3.90	3.95	3.90	3.90	3.85	3.80	3.80	3.75	3.75	3.70	3.70
10-year	4.14	4.15	4.15	4.10	4.10	4.10	4.05	4.05	4.00	4.00	4.00
30-year bonds	4.80	4.80	4.80	4.75	4.75	4.75	4.70	4.70	4.65	4.65	4.65
Prime rate	6.84	6.75	6.75	6.65	6.50	6.50	6.40	6.25	6.25	6.14	6.00
<b>Other G7</b>											
ECB Deposit Rate <sup>1</sup>	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
10yr Bund	2.84	2.80	2.80	2.75	2.75	2.70	2.65	2.65	2.60	2.60	2.55
BoE Bank Rate <sup>1</sup>	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
SONIA <sup>5</sup>	3.88	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73
10yr Gilt	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
BoJ O/N <sup>1</sup>	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
10yr JGB	1.98	2.01	2.04	2.06	2.09	2.11	2.14	2.17	2.19	2.22	2.27

<sup>1</sup> end of period; <sup>2</sup> Canadian Overnight Repo Rate Average; <sup>3</sup> Effective Fed Funds Rate; <sup>4</sup> Secured Overnight Financing Rate;

<sup>5</sup> Sterling Overnight Index Average

Sources: BMO Economics, Haver Analytics

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