

Rates Scenario for May 15, 2026

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

Forecast Summary

(avg.)	Actual	Forecasts					2026 2027				
	2026	2026	2026	2026	2026	2026	2027	2027	2027	2027	2027
	Apr	May	Jun	Jul	Aug	Sep	Q4	Q1	Q2	Q3	Q4
BoC overnight ¹	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	3.48	3.55	3.50	3.50	3.45	3.40	3.35	3.25	3.25	3.35	3.45
Fed funds ¹	3.63	3.63	3.63	3.63	3.63	3.63	3.38	3.13	3.13	3.13	3.13
10-yr Treasuries	4.32	4.45	4.40	4.35	4.30	4.25	4.20	4.05	4.05	4.10	4.15
C\$ per US\$	1.38	1.37	1.37	1.36	1.35	1.35	1.34	1.33	1.32	1.31	1.30
US\$/€	1.17	1.17	1.17	1.17	1.17	1.18	1.18	1.19	1.20	1.21	1.22
US\$/£	1.35	1.34	1.34	1.34	1.34	1.35	1.35	1.36	1.36	1.37	1.38
¥/US\$	159	158	158	157	157	156	155	153	151	148	146

¹ end of period

Sources: BMO Economics, Haver Analytics

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Canada-U.S. Rates

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Warsh's Welcome Wagon

May 15 marks the final day with Jay Powell as Fed Chair. **Kevin Warsh's four-year term starts** the next day, when he will take over the Board of Governors seat vacated by Stephen Miran. His first FOMC meeting as Chair will be June 16-17, exactly a month after assuming the role. The market is already speculating about that first meeting, let alone subsequent confabs. Stoking the speculation are: (1) last meeting's more hawkish-leaning dissents and Powell's announcement that he's staying on for a bit; (2) the tone of subsequent data that highlighted both core CPI and PPI inflation heating up more than expected and payrolls growth surprising again to the upside; and, (3) Warsh's reported preference for lower policy rates and his "regime change" agenda.

The FOMC kept rates unchanged last month, with the target range for fed funds at 3.50% to 3.75%. This was the third straight pause after three consecutive 25 bp cuts during the final three meetings of 2025. Governor Miran dissented for the sixth straight time (covering his entire tenure) in favour of a rate cut (or a larger one). The market is questioning **whether Warsh will follow Miran's dovish wing prints**. At this point, we do not think so (at least not at Warsh's first confab as Fed head), given the Chair's traditional role in crafting and communicating the Committee's consensus.

The Fed also kept its forward guidance unchanged with the phrase: "In considering the extent and timing of additional adjustments to the target range for the federal funds rate..." Toggling the phrase "the extent and timing of" in and out, this is the language used since rate cuts began in September 2024. Whenever the modification has been absent, it has signalled a cut next meeting (Sept./Nov. 2024; Sept./Oct. 2025). Otherwise, it has signalled a cut as early as next meeting or after a pause. This 'easing bias' has become problematic for some FOMC participants.

Three voters (and likely other non-voters) favoured altering the language and **dissented** accordingly. Cleveland President Hammack, Minneapolis' Kashkari, and Dallas' Logan supported the pause "but did not support inclusion of an easing bias in the statement at this time". Given the increased risk of faster inflation from the oil shock (with the

labour market stabilizing in the background), they preferred a more neutral statement to convey that rate cuts were no more likely than rate hikes.

There is still a full month of new data to go, but **if the tone of recent reports persists, we reckon the ranks of the ‘neutralists’ will be increasing in June.** There is the chance that at least four more voters (among the remaining nine) will join April’s trio and the easing bias could be dropped. The market is questioning whether Warsh will be onside should the majority favour shifting policy further away from potential easing, at least for a little while, and towards possible tightening.

Elsewhere, **it is going to take time to tick off the assorted items on Warsh’s “regime change” agenda.** In some cases, he will need congressional action. For example, to meaningfully shrink the Fed’s balance sheet, legislation is required to relax bank liquidity rules (the liquidity is often in the form of reserve balances that currently top \$3 trillion, and boost the balance sheet’s size). And, when the Fed does not “*stay in its lane*” (of promoting price stability and maximum employment), it is often because Congress has given the Fed authority over regulatory and supervisory matters.

In other cases, Warsh will need majorities on the Board of Governors or in the FOMC to effect change. Providing less forward guidance (via modifying or dropping the ‘dot plot’ or having fewer pressers) or altering the operational target for inflation (using the trimmed mean and median indices instead of the core) are monetary policy practices that are voted on (just like rate decisions). To walk his nomination hearing talk, Kevin Warsh must convince other Governors and regional Presidents to hop on his bandwagon. This will take time, but at least he has Jay Powell’s counsel for now.

Despite the arrival of a new Fed head, we are **modifying our forecast** for policy rates. We still see the midpoint of the target range down 50 bps to 3.125% over time so that it aligns with the FOMC’s median projection of the neutral level. However, given last month’s dissents and the tone of subsequent data, **we now judge that the move to neutral will be delayed by three months, to December-March.**

Bank of Canada: The BoC kept its policy rate unchanged on April 29, with the target for the overnight rate at 2.25%. This sits at the bottom of the Bank’s 2.25%-to-3.25% estimate of the neutral range (an estimate that was reconfirmed in the MPR’s annual assessment of the range). This marked the fourth consecutive hold, with the market interpreting this one in the most hawkish light yet.

In the press conference, Governor Macklem said “*a policy rate close to current settings looks appropriate to support adjustment in the economy and return inflation to target*” assuming oil prices drop and U.S. tariffs remain the same. But he acknowledged that “*uncertainty is unusually elevated*” and “*monetary policy may need to be nimble*”. “*We may need to cut the policy rate further*” if U.S. trade restrictions worsen. Or “*there may be a need for consecutive increases in the policy rate*” if oil prices stay high and there are signs that this is fueling “*ongoing generalized inflation increases*”. It was the reference to “**consecutive increases**” that perturbed market participants.

Sitting at the bottom of the neutral range, the policy rate is 25 bps away from moving below it but 100 bps away from moving above it. This means if a shift into either an unequivocally accommodative or restrictive gear is required, there is going to be **asymmetric movements in the policy rate.** However, the market looked past the arithmetic and saw a central bank with serious concerns about inflation persisting, and is pricing in at least a couple of quarter-point rate hikes by year-end. We do not doubt that the Bank could raise rates, but we judge it has a much longer tightening fuse than the market does. The key core inflation metrics are all very well-behaved, and there is so far no evidence of spillovers from energy prices. And the weakened states of the labour market and broader economy should function as inflation pressure sponges. Plus, there is still significant U.S. trade policy (Section 301 and 232 tariffs) and USMCA uncertainty lurking on the horizon. **We reckon the Bank’s current hold is going to last a long while.**

Bond yields: Ten-year Treasury yields closed at 4.59% on May 15, the highest level since last July. Just before the Iran War began on February 28, yields had closed at 3.97% in a rare sub-4.00% print. The subsequent jump in oil prices has pumped inflation expectations (TIPS inflation break-evens are up a net 24 bps), with the remainder of the 62-bp net selloff reflecting the combination of increased inflation risk and a less constructive (and riskier) expected profile for Fed policy rates. The market is currently pricing in more than an 80% chance of a rate hike by year-end.

Also adding some subtle upward pressure on yields are **dimming fiscal prospects** caused by the repayment of IEEPA tariffs (\$166 billion + interest according to CBP) and the cost of the Iran War. Meanwhile, talk of shrinking the Fed's balance sheet—meaning the market must absorb what the Fed rolls off—also is not helping. Although 50 bps worth of rate cuts (by March) should exert some downward pressure on yields, the monthly average will likely remain at least at 4.00%, short of mounting prospects for chunky Fed cuts (>25 bps) or escalating risks of recession. Meanwhile, deteriorating fiscal fundamentals (for which investors are demanding higher yields to compensate) should also act to keep yields north of 4.00%. (Investors are also concerned about the erosion of both Fed independence and U.S. dollar dominance.)

Elsewhere, **10-year Canada-U.S. bond yield spreads** have moved more negative as Treasury yields have moved higher. The spread closed at -91 bps on May 15, the most negative since mid-November, despite the money market pricing in at least a couple of quarter-point BoC rate hikes by the end of the year (compared to less than one for the Fed). Apparently, bond market participants are paying more attention to Canada's superior core inflation performance along with a fiscal picture that is not darkening as badly as south of the border. However, we do expect spreads to start grinding less negative again, particularly as Fed rate cuts resume with the BoC standing pat. The trend to the eventual low -60s range should be a bumpy one, with Canada's own fiscal deterioration on both the federal and provincial fronts prodding some volatility (that is, except for the oil-producing provinces).

U.S. dollar: Assuming its traditional safe-haven role amid escalating geopolitical and global economic risks, the greenback gained ground at the beginning of the Iran War. According to the Wall Street Journal's index, the currency appreciated 2.7% by its peak on March 30 (vs. the February 27 close). However, as a 'shaky' ceasefire emerged in early April and appeared to stick (for the most part), reducing the above-mentioned risks, the dollar depreciated. All the post-war gains were wiped out by the first week of May. This week, the greenback started gaining again, this time due to the rising risk of Fed rate hikes in the wake of worrisome inflation reports.

We still expect the next move by the Fed will be a rate cut, not a hike; and when the market starts feeling the wind of easing, the currency should re-weaken. In the interim, there could be additional dollar appreciation, but we reckon this would fall well short of the post-war peak (unless the bombing resumes). Comparing December averages, we see the greenback down close to 2% this year (against the major currencies).

Canadian dollar: Higher oil prices in the wake of the Iran War initially provided some support for the loonie, but it lasted only for a week or two. The factors boosting the greenback ended up dominating, even with the market pricing in Bank of Canada rate hikes and, until recently, not for the Fed. By March-end, the currency had lost 2.2% against the big dollar only to gain it all back, and then some, by the end of April (+2.6%) as the U.S. dollar weakened. The Bank's hawkish talk also helped, but this too has not provided lasting support with mounting market speculation about Fed rate hikes now dominating.

Once Fed rate cuts are back on the market's mind and being realized, we look for the Canadian dollar to follow an appreciating trend, getting to C\$1.33 (US\$0.752) and registering a 3½% y/y gain by 2026-end. This is better than the pack of majors, as the Canadian economy rebounds after being hit disproportionately by U.S. trade policy. But the latter remains a major risk facing the loonie and there is still significant uncertainty lurking on the horizon with respect to Section 301 and 232 tariffs along with the USMCA review.

Overseas

Jennifer Lee, Senior Economist

We are all some form of hawks now... some have been around for a while (those in Japan), and there are others that are just entering the vicinity. In any event, throughout April and early May, financial markets have witnessed **varying degrees of hawkishness**, particularly in terms of how policymakers voted.

The **BoJ** has been at the forefront, and started tightening in 2024, in a slow but measured manner. It held off due to the election of PM Takaichi, then again with the uncertainty created by the war in Iran. However, with inflation remaining above target, energy prices rising, and a still-weak JPY despite intervention efforts by the MoF, the time to resume rate hikes is coming. After one-third (three members) of the Policy Board dissented in favour of a hike at its most recent meeting on April 28, we look for the Bank to raise rates 25 bps to 1.00% on June 16.

The **RBA**, meantime, joined the parade earlier this year and has raised the cash rate three times, most recently by 25 bps to a 16-month high of 4.35% in May. It was all about inflation, with the latest reports in the week before the policy announcement showing prices heating up well above target. The Statement still sounded hawkish, noting *"early signs that many firms experiencing cost pressures are looking to increase prices of their goods and services"*, short-term inflation expectations are climbing, and that *"inflation is likely to remain above target for some time"*, with risks tilted to the upside. However, a pause was signalled as this latest hike leaves monetary policy *"well-placed to respond to developments"*. And, **Governor Bullock** stated during the press conference that with this hike, the RBA is *"now in a position where we've got space, to be alert now to both sides of the risks to inflation — upside and downside."* In other words, the Board will take a breather. The next meeting is June 16, at which we had already expected policy to stay unchanged. Meantime, we will stick with our call for an August rate hike, but this is all data-dependent.

The **BoE** is in a tough spot. The last two meetings saw the Bank remain on hold, but the tone was hawkish. In fact, the most recent meeting in April had Chief Economist Huw Pill as the sole dissenter, voting in favour of a rate hike, while even the ultra dovish Swati Dhingra said that the balance of risks for inflation *"has shifted to the upside"*. But there is a new uber-dove in town, and his name is Alan Taylor. He supported staying on the sidelines *"for some time, then... move to a neutral or accommodative stance."* Markets interpreted the overall announcement hawkishly, so **Governor Bailey**, in a repeat of what happened in March, quickly stepped in and threw cold water on such rate hike expectations. *"I would very much give the message: no, it is not the case that we're sort of giving some sort of slightly clandestine message, that interest rates are going to go up notwithstanding what we've decided today... today is an active hold."* Our **Laurence Mutkin, Director & Head, EMEA Rates Strategy**, sees it this way: *"The MPC acknowledged that monetary conditions have been market—not policy-driven—and that policy choices themselves will be reactive not proactive. In other words, state-dependent. So everything in U.K. rates depends, for now, on energy prices and political events, and economic agents' responses to them."* The political turmoil surrounding PM Starmer (how long will he stay at 10 Downing Street?) would also suggest that the Bank may need to hold off on any moves in the near term. We continue to see the Bank on hold this year.

Finally, there is the **ECB**. The central bank has not changed rates at all since mid-2025, although a number of members have been sounding increasingly hawkish. At the most recent meeting on April 30, **President Lagarde** revealed that a **rate hike was discussed**, *"at length and in depth"*, although the Governing Council unanimously decided to leave things the way they were. Obviously, they are not pre-committing to anything as they have yet to see second-round effects of higher energy and food prices. Plus, corporate heads told them that they had *"no intention"* of raising wages *"significantly"*. President Lagarde also pointed out that there was still time before the June 11 decision, during which there will be plenty of data to review and new baseline scenarios. Also interesting was when she said **"Directionally, I think I know where we're heading."** Following the meeting, the usual sources stepped out of the shadows and spilled the beans that a June rate hike was *"very likely"* and that there was a broad agreement that the ECB needed to move. But sure, let's hold... *"we can live with June"*. Also, *"several"* felt that at least two hikes were

needed unless the war ends and Brent drops. Central bank heads including those from Germany, Austria and Estonia have spoken out hawkishly since then, suggesting that they are among those moving toward a June 11th hike. We will hold our ground for steady policy until the data prove otherwise.

Bottom Line: It is all about duration... how long the war in Iran lasts and following that, how long until the damaged infrastructure is fixed. Watch inflation expectations, wage growth, and plain old CPI. Meantime, we continue to look for the BoJ and RBA to hike, but the ECB and the BoE to stay cautiously on the sidelines, ready to act. They just need a really good reason to back it up.

Foreign Exchange Forecasts

(local currency per US\$: avg.)	Actual 2026	Forecasts 2026					2026	2027			
	Apr	May	Jun	Jul	Aug	Sep	Q4	Q1	Q2	Q3	Q4
Canadian Dollar											
C\$ per US\$	1.38	1.37	1.37	1.36	1.35	1.35	1.34	1.33	1.32	1.31	1.30
US\$ per C\$ ¹	0.727	0.730	0.733	0.736	0.738	0.741	0.747	0.753	0.758	0.763	0.768
Trade-weighted	113.3	113.6	113.9	114.3	114.7	115.0	115.8	116.4	116.8	117.2	117.5
U.S. Dollar											
Trade-weighted ²	119.0	118.7	118.5	118.3	118.1	117.9	117.5	116.9	116.2	115.6	114.9
European Currencies											
Euro ¹	1.17	1.17	1.17	1.17	1.17	1.18	1.18	1.19	1.20	1.21	1.22
Danish Krone	6.39	6.40	6.40	6.40	6.35	6.35	6.35	6.30	6.25	6.20	6.15
Norwegian Krone	9.45	9.30	9.30	9.25	9.25	9.25	9.20	9.15	9.05	9.00	8.90
Swedish Krona	9.27	9.35	9.35	9.35	9.35	9.30	9.30	9.25	9.15	9.10	9.00
Swiss Franc	0.79	0.78	0.78	0.78	0.78	0.78	0.77	0.77	0.76	0.76	0.75
U.K. Pound ¹	1.35	1.34	1.34	1.34	1.34	1.35	1.35	1.36	1.36	1.37	1.38
Asian Currencies											
Chinese Yuan	6.84	6.80	6.80	6.79	6.79	6.79	6.78	6.78	6.77	6.76	6.75
Japanese Yen	159	158	158	157	157	156	155	153	151	148	146
Korean Won	1,484	1,485	1,485	1,490	1,490	1,490	1,490	1,490	1,490	1,485	1,485
Indian Rupee	93.5	95.5	95.5	95.5	95.5	95.5	95.5	95.4	95.3	95.2	95.1
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	3.97	3.95	3.95	3.95	3.95	3.95	3.95	3.95	3.95	3.95	3.90
Thai Baht	32.3	32.5	32.5	32.5	32.5	32.5	32.5	32.4	32.4	32.4	32.3
Philippine Peso	60.3	61.4	61.4	61.4	61.4	61.4	61.3	61.3	61.2	61.2	61.1
Taiwan Dollar	31.7	31.5	31.5	31.5	31.5	31.4	31.4	31.4	31.3	31.3	31.3
Indonesian Rupiah	17,139	17,435	17,430	17,420	17,415	17,405	17,390	17,370	17,350	17,330	17,310
Other Currencies											
Australian Dollar ¹	0.709	0.720	0.721	0.721	0.722	0.723	0.724	0.726	0.727	0.728	0.730
New Zealand Dollar ¹	0.585	0.590	0.591	0.593	0.594	0.596	0.599	0.603	0.606	0.610	0.614
Mexican Peso	17.45	17.30	17.25	17.20	17.15	17.15	17.05	16.90	16.80	16.65	16.55
Brazilian Real	5.03	5.00	5.00	4.95	4.90	4.90	4.85	4.80	4.75	4.75	4.70
South African Rand	16.6	16.6	16.6	16.5	16.5	16.4	16.3	16.2	16.0	15.9	15.8
Cross Rates											
Versus Canadian Dollar											
Euro (C\$/€)	1.61	1.60	1.60	1.60	1.59	1.59	1.58	1.58	1.58	1.58	1.59
U.K. Pound (C\$/£)	1.85	1.84	1.83	1.83	1.82	1.82	1.80	1.80	1.80	1.80	1.79
Japanese Yen (¥/C\$)	116	115	115	116	116	116	116	116	114	113	112
Australian Dollar (C\$/A\$)	0.98	0.99	0.98	0.98	0.98	0.98	0.97	0.96	0.96	0.95	0.95
Versus Euro											
U.K. Pound (£/€)	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.88	0.88	0.88	0.88
Japanese Yen (¥/€)	186	185	185	184	184	184	183	182	180	179	177

¹ (US\$ per local currency); ² Federal Reserve Broad Index

Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

(% : avg.)	Actual	Forecasts					2026	2027			
	2026	2026									
	Apr	May	Jun	Jul	Aug	Sep	Q4	Q1	Q2	Q3	Q4
Canada											
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 ²	2.29	2.26	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
3-month bills	2.27	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
6-month	2.36	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
1-year	2.56	2.65	2.60	2.60	2.55	2.55	2.50	2.45	2.45	2.45	2.45
2-year bonds	2.83	2.95	2.90	2.85	2.75	2.70	2.55	2.50	2.50	2.50	2.50
3-year	2.93	3.05	3.00	2.95	2.90	2.85	2.75	2.70	2.70	2.75	2.75
5-year	3.10	3.20	3.15	3.15	3.10	3.05	2.95	2.90	2.95	2.95	2.95
7-year	3.26	3.35	3.30	3.30	3.25	3.20	3.15	3.15	3.15	3.20	3.20
10-year	3.48	3.55	3.50	3.50	3.45	3.40	3.35	3.25	3.25	3.35	3.45
30-year	3.90	3.90	3.90	3.85	3.80	3.75	3.70	3.60	3.60	3.70	3.80
Prime rate	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45	4.45
United States											
Fed funds target (period end)	3.63	3.63	3.63	3.63	3.63	3.63	3.38	3.13	3.13	3.13	3.13
Fed funds target	3.63	3.63	3.63	3.63	3.63	3.63	3.57	3.34	3.13	3.13	3.13
EFFR ³	3.64	3.63	3.63	3.63	3.63	3.63	3.57	3.34	3.13	3.13	3.13
SOFR ⁴	3.64	3.59	3.60	3.60	3.60	3.60	3.54	3.32	3.12	3.12	3.12
3-month bills	3.70	3.70	3.70	3.70	3.70	3.70	3.60	3.35	3.05	3.05	3.05
6-month	3.72	3.75	3.75	3.75	3.75	3.75	3.70	3.40	3.15	3.15	3.15
1-year	3.69	3.80	3.75	3.70	3.70	3.65	3.55	3.30	3.15	3.15	3.20
2-year notes	3.80	3.95	3.90	3.80	3.70	3.65	3.45	3.20	3.15	3.20	3.25
3-year	3.82	4.00	3.95	3.85	3.80	3.75	3.60	3.40	3.35	3.40	3.45
5-year	3.94	4.10	4.05	4.00	3.95	3.90	3.80	3.60	3.60	3.65	3.70
7-year	4.12	4.25	4.20	4.15	4.10	4.05	4.00	3.85	3.80	3.85	3.90
10-year	4.32	4.45	4.40	4.35	4.30	4.25	4.20	4.05	4.05	4.10	4.15
30-year bonds	4.91	5.00	4.95	4.90	4.85	4.85	4.75	4.60	4.60	4.65	4.70
Prime rate	6.75	6.75	6.75	6.75	6.75	6.75	6.69	6.46	6.25	6.25	6.25
Other G7											
ECB Deposit Rate ¹	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
10yr Bund	3.02	3.05	3.05	3.05	3.10	3.10	3.10	3.10	3.00	2.90	2.80
BoE Bank Rate ¹	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
SONIA ⁵	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73	3.73
10yr Gilt	4.87	5.00	5.00	4.95	4.95	4.90	4.85	4.80	4.70	4.60	4.50
BoJ O/N ¹	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25
10yr JGB	2.42	2.50	2.49	2.47	2.46	2.44	2.41	2.40	2.40	2.40	2.40

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

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