Rates Scenario for July 9, 2026

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

Forecast Summary

(avg.)	Actual	Forecasts									
	2026	2026						2027			
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	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	3.42	3.55	3.55	3.55	3.55	3.50	3.50	3.50	3.50	3.45	3.50
Fed funds[1]	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.38	3.13
10-yr Treasuries	4.47	4.55	4.55	4.55	4.50	4.50	4.45	4.40	4.35	4.25	4.25
C$ per US$	1.40	1.42	1.42	1.41	1.41	1.40	1.40	1.39	1.37	1.35	1.34
US$/€	1.15	1.14	1.14	1.14	1.15	1.15	1.15	1.16	1.16	1.17	1.18
US$/£	1.33	1.33	1.34	1.34	1.34	1.34	1.34	1.34	1.35	1.35	1.36
¥/US$	161	160	159	158	158	157	156	155	154	153	152

[1] end of period

Sources: BMO Economics, Haver Analytics

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Canada-U.S. Rates

Michael Gregory, CFA, Deputy Chief Economist

Federal Reserve: The FOMC next meets on July 28-29 with no change in policy rates expected for the fifth consecutive confab (fed funds target range at 3.50%-to-3.75%). We believe this stretch could last deep into next year, with inflation and growth dynamics arguing for maintaining current policy.

Following five straight years of topping the 2% target, the PCE price index was up 4.1% y/y in May, pumped by higher oil prices. But excluding energy and food, the core index was still up 3.4% with core services excluding rents up 3.9%. The trimmed mean measure was more benign at 2.6% but is still a bit too high with the median index at 3.1%. And, profoundly, the six-month and three-month annualized changes for all the above-mentioned metrics were running at least a little faster than their yearly moves… the epitome of stickiness.

Note that annual updates to the National Economic Accounts will occur on September 30 which will impact the PCE price index for August with revisions going back to the start of 2021. Methodology changes are looming for the price sub-indices for portfolio management and investment advice services, legal services, along with computer software and accessories. It's argued that these changes could lop 0.2 ppts off the current 3.4% y/y core inflation rate (which is still too high). Meanwhile, a NY Fed survey concluded that *"more tariff pass-through is in the pipeline"* as (separately) new Section 301 duties loom. And the longer oil prices remain high (and the recent ceasefire has effectively ended), the greater the chance they apply upward pressure on other prices and inflation expectations.

Elsewhere, the economy expanded at an above-potential 2.7% y/y pace in Q1 (among policymakers, their central tendency projection for potential growth is 1.8%-to-2.0%). And to confuse the issue, the housing sector and business capex (apart from the trifecta of software, computer equipment and peripherals, and data centres) contracted by 5.5% and 2.0%, respectively, suggesting interest rates are high enough to hurt. But the rest of the economy (including the AI-tinged capex trifecta along with the associated wealth effect that is prodding consumer spending) is expanding 3.6%… roughly double potential and easily taking current interest rates in stride.

Meanwhile, there's a dichotomy in the labour market too. Establishment-surveyed employment expanded in five of the past six months for a cumulative 552k gain. But household-surveyed employment contracted in five of the past six months for a total loss of 1.7 million, the worst half-year result since the aftermath of the pandemic and, before that, the Great Recession. But because the labour force contracted by a larger 2.1 million (the largest half year drop in history apart from 2020), the jobless rate has drifted down 0.2 ppts to 4.2% (in line with the FOMC's median forecast of the natural rate).

There are lots of cross currents here compelling Fed policy caution, including one more. By the end of the year, most of the Fed's five new task forces are expected to have their analyses completed and recommendations made. They are looking into (1) Fed communications; (2) the Fed's balance sheet policy; (3) reliance on existing data sources; (4) productivity and jobs; and (5) the Fed's inflation frameworks. There's a chance that policy decisions deemed appropriate today might not appear that way as much by the turn of the year. Unless data developments (and other events) are unequivocally compelling, we reckon the Fed is standing pat… a position that could persist deep into next year. We have 50 bps worth of rate cuts in the final trimester of 2027, once inflation calms sufficiently and to align policy rates with their neutral range.

Bank of Canada (courtesy of Benjamin Reitzes): The BoC's July 15 policy announcement isn't expected to bring any surprises, with policy rates anticipated to remain steady at 2.25% for the sixth consecutive meeting. The Bank has made it clear that the hurdle for a policy shift, in either direction, is quite high at the moment. There has been more concern about upside inflation risks in recent months due to the war-driven spike in energy prices. However, oil is now well off the highs, even with hostilities ramping up again this week. The economic data have turned up recently following a miserable run. Those factors will keep the BoC comfortable enough to keep from cutting rates again, while the persistent and sizeable output gap, along with relatively tame underlying inflation, limits the appetite for rate hikes.

Inflation is the Bank of Canada's only mandate, and the acceleration in headline CPI over the past three months to above 3% is a concern. While it's been largely energy driven, policymakers are watching carefully for signs of passthrough to the broader CPI basket. Core inflation metrics have remained subdued through the energy price spike, and the recent retreat in oil (even if reversed somewhat) should ease worries somewhat. However, we could still see some passthrough in the coming months, which will keep policymakers eyeing the data warily. The 2021-2023 inflation surge is still fresh in Governor Macklem's mind, and he'd like to avoid a repeat performance at almost any cost. That fear has driven some seemingly hawkish language from the Bank over the past few months. The counterargument on inflation is centred around the persistent output gap.

Softness in the broader economy through most of the first half of this year helped keep the Bank from becoming too hawkish. GDP contracted in Q4 and Q1, sparking recession chatter, though the BoC (and us) quickly shot that down due to a lack of breadth and depth. Still, the economy has been struggling over the past 18 months as trade uncertainty clouds the outlook. Despite additional uncertainty from the war with Iran, GDP growth is expected to rebound in Q2, likely more than erasing the prior quarters' contraction. Don't be surprised if the BoC's Q2 forecast has a 2-handle (BMO is at 1.8% right now, but we admit there's upside risk). That's probably enough to keep the output gap range steady at -0.5% to -1.5%, where it's been since the July 2025 MPR. The persistent slack in the economy is driving disinflationary pressures, and is a key reason why policymakers aren't keen to hike rates. With no clear near-term catalyst to drive positive economic momentum and the output gap likely to keep underlying inflation contained, policy rates are expected to remain unchanged into next year.

Bond yields: Ten-year Treasury yields averaged 4.47% in June, in line with May's norm (4.48%), and are averaging a hint higher at 4.51%, so far this month. The latter (if sustained) would mark the highest monthly figure since January 2025 (4.63%) when the market was most worried about the inflation, Fed policy, and budget deficit consequences of the incoming Trump Administration's policies. The same worries are drivers again, only this time due to the Iran war and oil prices, which is best seen in the daily closes.

Just before the war began on February 28, yields had closed at 3.97% (a rare sub-4.00% print). They sold off 70 bps to 4.67% by May 19 on higher inflation expectations and risks, fuelled by higher oil prices (WTI >$100), along with a less constructive (and riskier) expected profile for Fed policy rates. As oil prices eventually backed off, particularly in the wake of the June 17 news of a U.S.-Iran deal, yields were down to 4.38% by June 26, with oil probing pre-war (<$70) levels. But both have been on the rise again (yields closed above 4.55% yesterday), as hostilities have returned.

Looking ahead, even if we get the U.S.-Iran deal done and a ceasefire sticks (which is our working assumption), we expect yields to remain range-bound rather than trend materially lower. This reflects deteriorating fiscal fundamentals, partly due to Iran war financing and tariff repayments, and reflecting lingering Fed policy uncertainty, until we get more clarity on how Fed rate prospects will be impacted by the results of the five task forces. Once Fed rate cuts come back into focus (later next year), yields should be averaging closer to around 4¼%.

Elsewhere, 10-year Canada-U.S. bond yield spreads continue to trade in the triple-digit range (-100 bps or more negative). Investors appear comfortable for now with such 'rich' spreads, perhaps eyeing Canada's superior core inflation performance and economic underperformance versus the U.S., along with a fiscal outlook that is not deteriorating as badly as south of the border. However, we expect spreads to narrow gradually again, particularly as next year's Fed rate cuts come into focus with the BoC standing pat.

U.S. dollar: Recently, the greenback has been driven by undulating geopolitical and global economic risks in the wake of the Iran war (the more the perceived risks, the more the big dollar benefits from its safe-haven role, and the opposite), along with oscillating Fed policy prospects (gaining as rate hike expectations mount, and the opposite). According to the Wall Street Journal's index, after bottoming at post-war lows on May 8, the currency has rallied 2.9% (through July 8). This mirrors the Fed's (perceived) more hawkish turn at the June meeting and the Iran conflict continuing to flare despite last month's deal outline. And there is also talk of a 'U.S. exceptionalism' trade as investors take advantage of America's AI boom.

The greenback is likely to at least hold on to recent gains (if not grind stronger) until the Iran conflict calms down again (with an effective peace deal and lasting ceasefire), or Fed rate hikes are no longer on the market's mind (or more global central banks join the policy tightening parade). Or, once investors start becoming less optimistic about the AI narrative, specifically, or U.S. economic and fiscal prospects, generally.

Canadian dollar: The loonie remains under pressure, averaging C$1.40 (US$0.71) in June, the weakest level in seven months. And, so far in July, it's averaging around C$1.42 (US$0.70). A stronger greenback is the key culprit, but Canada's mix of sluggish economic data and benign core inflation readings hasn't helped. Accordingly, the BoC is less likely to keep its hawkish-tilt, in contrast to potential Fed policy. Although the July 1 outcome on the USMCA was as expected, it kicks off an annual series of potentially difficult negotiations, and that uncertainty will weigh on Canada's economy for the foreseeable future. Indeed, reflecting this along with our recent forecast change pushing Fed rate cuts deep into 2027, we have adjusted our projection for the Canadian dollar. We now see it averaging C$1.40 by yearend (vs. C$1.35 before) and improving to C$1.33 by end-2027 (vs. $1.30 before).

Overseas

Jennifer Lee, Senior Economist

When one thinks about Hormuz or Malacca, the Suez or Panama Canals, or the Turkish or Danish Straits.... the vulnerability of global trade comes to mind. Not just from a geopolitical perspective. If you're off by a mere few seconds when maneuvering a tanker around these narrow waterways, it could cause a massive traffic jam, with global implications. Recall the Ever Given ship. Same concept applies to central bankers. In a time of surging inflation, caused by the surge in energy prices during the war in Iran... not knowing how long the conflict would last or the spillover effects from these higher prices, central bankers had to decide between hiking or looking through the conflict. Reacting too quickly could cause significant negative reverberations throughout the economy.

Hindsight is always 20-20. Take the **ECB**, for instance. It started the year off in a 'good place', with headline inflation below target, core inflation just above. Then, the world changed on February 28th and the ECB became the first central bank in the G7 to tighten in response (+25 bps to 2.25%), although seemingly every Governing Council member had been warning about tightening for weeks. On June 11th, the same day as the rate hike, Brent closed at $90.38, and since then, tumbled to ~$70, a level not seen since before the war began, as the June 17th memorandum of understanding had, more or less, held up. Then, as the NATO Summit concluded, President Trump declared that the ceasefire was "*over*" after new attacks were carried out on U.S. bases. This keeps the ECB's cautious stance intact. Yes, energy prices are far from their peaks after the war began, but with the prospect of fighting resuming, the central bank remains on alert. The **Minutes** from that June meeting revealed how concerned the central bank was about inflation: that the **energy shock** was "*proving more persistent*"; the **direct effects** had "*occurred rapidly*"; the **indirect effects** were becoming "*increasingly visible and broad-based*", and though the **second-round effects** weren't seen yet in the data, the "*risks of such effects were rising as the duration of the shock increased*". Of course, it was reassuring that June inflation tumbled to a 3-month low of 2.8%, from May's 32-month high of 3.2%, but one should never take a single month's figure as a trend. Besides, there could be some stickiness to come, as the Euro region's jobless rate remained at a record-low 6.2% in May (we will take that as a good thing for the economy), and for now, the ceasefire is "*over*". Wait for the July inflation rate, and if the talks with Iran continue, to judge if the 'one and done' scenario plays out. For now, a **September hike is very much in play**, although the uncertainty will weigh on the **EUR**, which could very well flatline in the second half of the year.

The **BoE** has a bit more of a challenge on its hands, with so many divergent views within the MPC. At its first meeting a few weeks after the war in Iran began, it had its first unanimous vote since September 2021 (to hold). Since then, the number of those in favour of hiking has inched higher, from one to two, although Governor Bailey said that he is willing to temporarily tolerate above-target inflation and that "*cutting rates is off the table at the moment"*. Still, to call the BoE hawkish would be a stretch, despite what we hear from Chief Economist Huw Pill and Megan Greene, both of whom wanted to raise rates in June. The country is facing slower economic growth (Q2 started on a weak footing) but at least purchasing managers reported more moderate price pressures in June. Then there is the political uncertainty swirling around 10 Downing Street… and who will be the next Chancellor and will they remain within the fiscal guardrails? Our **Laurence Mutkin**, Director & Head, EMEA Rates Strategy, is sticking to his view that the BoE will be on hold this year.

The **RBA** began raising rates in early February, given that inflation had risen "*materially*" in the second half of 2025 and was expected to stay above target "*for some time*". That was before the war in Iran began. Domestic inflation, along with higher energy prices, prompted two more rate hikes, which left the central bank "*well-placed to respond to developments*" and allowed it "*space to sit and see what happens*". If the June and Q2 CPI reports, due out July 29, continue to show inflation pressures, expect a 25 bp rate hike in August to 4.60%. The **RBNZ** also hiked rates for the first time in three years and warned that more tightening is "*likely*", though the "*timing is highly uncertain*".

The **BoJ** has been, unequivocally, the one central bank that had been tightening slowly but steadily since 2024. It paused in early 2026, held back by politics (the landslide election victory of PM Takaichi and the expectation of lots of fiscal spending) and then, by the war in Iran. But the Board (minus Governor Ueda in his hospital bed), resumed the rate hike campaign in June, lifting the overnight call rate 25 bps to a 31-year high of "*around 1.00%*". It also warned that it would "*continue to raise*" rates, given the risk that core CPI will stay above target. There were also plans to reduce monthly JGB purchases, from ~¥2.7 trln/mth in the current quarter, to ~¥2 trln/mth in April 2027, while warning that if there is a "*rapid rise in long term interest rates*", it will be "*nimble*" and adjust its stance, perhaps by buying more JGBs. It does not want to be seen as 'falling behind the curve', but still wants to ensure the bond market is stable. Despite this hawkish bent, and warnings from the MoF that it will take "*bold actions*" with the currency hitting 40-year lows, the JPY is struggling to rally. Expect one more rate hike, possibly in September, with a risk of an earlier move. We expect the **JPY** to strengthen a bit to ¥156 by year-end given tighter monetary policy on the back of higher wage growth, and the prospect of FX intervention given the unjustified weakness in the JPY and its impact on the energy import bill. However, our patience is running thin.

Foreign Exchange Forecasts

(local currency per US$: avg.)	Actual 2026 Jun	Forecasts 2026 Jul	Aug	Sep	Oct	Nov	Dec	2027 Q1	Q2	Q3	Q4
Canadian Dollar											
C$ per US$	1.40	1.42	1.42	1.41	1.41	1.40	1.40	1.39	1.37	1.35	1.34
US$ per C$[1]	0.713	0.704	0.706	0.708	0.710	0.712	0.714	0.720	0.729	0.739	0.749
Trade-weighted	111.5	110.4	110.6	110.8	111.0	111.2	111.4	112.1	113.2	114.4	115.6
U.S. Dollar											
Trade-weighted[2]	120.1	120.8	120.5	120.3	120.0	119.8	119.5	119.0	118.3	117.5	116.8
European Currencies											
Euro[1]	1.15	1.14	1.14	1.14	1.15	1.15	1.15	1.16	1.16	1.17	1.18
Danish Krone	6.49	6.55	6.55	6.55	6.50	6.50	6.50	6.45	6.45	6.40	6.35
Norwegian Krone	9.58	9.80	9.80	9.75	9.75	9.75	9.75	9.70	9.65	9.55	9.50
Swedish Krona	9.52	9.65	9.65	9.65	9.60	9.60	9.60	9.55	9.50	9.45	9.40
Swiss Franc	0.80	0.81	0.80	0.80	0.80	0.80	0.80	0.80	0.79	0.78	0.78
U.K. Pound[1]	1.33	1.33	1.34	1.34	1.34	1.34	1.34	1.34	1.35	1.35	1.36
Asian Currencies											
Chinese Yuan	6.78	6.79	6.78	6.77	6.77	6.76	6.75	6.75	6.74	6.73	6.72
Japanese Yen	161	160	159	158	158	157	156	155	154	153	152
Korean Won	1,529	1,520	1,515	1,510	1,510	1,505	1,505	1,500	1,500	1,500	1,495
Indian Rupee	95.0	95.0	94.9	94.7	94.6	94.4	94.3	94.2	94.1	94.0	93.9
Singapore Dollar	1.29	1.29	1.29	1.29	1.29	1.28	1.28	1.28	1.28	1.28	1.28
Malaysian Ringgit	4.06	4.05	4.05	4.05	4.05	4.05	4.05	4.05	4.05	4.05	4.05
Thai Baht	32.9	33.3	33.2	33.2	33.1	33.1	33.0	33.0	33.0	32.9	32.9
Philippine Peso	61.2	61.4	61.3	61.2	61.1	61.1	61.0	60.9	60.9	60.8	60.7
Taiwan Dollar	31.6	32.1	32.0	32.0	32.0	31.9	31.9	31.9	31.8	31.8	31.8
Indonesian Rupiah	17,890	17,970	17,950	17,925	17,900	17,875	17,850	17,840	17,820	17,800	17,780
Other Currencies											
Australian Dollar[1]	0.703	0.695	0.696	0.697	0.698	0.699	0.700	0.703	0.708	0.713	0.718
New Zealand Dollar[1]	0.578	0.570	0.571	0.572	0.573	0.574	0.575	0.578	0.581	0.585	0.589
Mexican Peso	17.38	17.50	17.45	17.40	17.35	17.30	17.25	17.15	16.95	16.75	16.55
Brazilian Real	5.12	5.15	5.10	5.10	5.05	5.05	5.00	4.95	4.90	4.85	4.75
South African Rand	16.4	16.3	16.2	16.2	16.1	16.1	16.0	16.0	15.9	15.8	15.8
Cross Rates											
Versus Canadian Dollar											
Euro (C$/€)	1.62	1.62	1.62	1.62	1.61	1.61	1.61	1.60	1.59	1.58	1.57
U.K. Pound (C$/£)	1.87	1.90	1.89	1.89	1.88	1.88	1.88	1.86	1.85	1.83	1.81
Japanese Yen (¥/C$)	115	113	112	112	112	112	111	112	113	113	114
Australian Dollar (C$/A$)	0.99	0.99	0.99	0.98	0.98	0.98	0.98	0.98	0.97	0.97	0.96
Versus Euro											
U.K. Pound (£/€)	0.86	0.85	0.85	0.86	0.86	0.86	0.86	0.86	0.86	0.86	0.87
Japanese Yen (¥/€)	185	182	182	181	181	180	179	179	179	179	179

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

Interest Rate Forecasts

(% : avg.)	Actual	Forecasts									
	2026	2026						2027			
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	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	2.28	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
3-month bills	2.27	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
6-month	2.34	2.35	2.35	2.35	2.35	2.35	2.35	2.35	2.35	2.35	2.35
1-year	2.54	2.55	2.55	2.50	2.50	2.45	2.45	2.45	2.45	2.45	2.45
2-year bonds	2.79	2.85	2.75	2.70	2.65	2.55	2.50	2.50	2.50	2.50	2.50
3-year	2.89	2.95	2.90	2.85	2.85	2.80	2.75	2.75	2.75	2.75	2.75
5-year	3.06	3.15	3.10	3.10	3.05	3.05	3.00	3.00	3.00	3.00	3.00
7-year	3.20	3.30	3.30	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
10-year	3.42	3.55	3.55	3.55	3.55	3.50	3.50	3.50	3.50	3.45	3.50
30-year	3.82	3.95	3.95	3.95	3.90	3.90	3.90	3.90	3.85	3.85	3.90
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	3.63	3.63	3.63	3.38	3.13
Fed funds target	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.60	3.33
EFFR[3]	3.63	3.62	3.62	3.62	3.62	3.62	3.62	3.62	3.62	3.60	3.33
SOFR[4]	3.63	3.60	3.59	3.60	3.61	3.61	3.61	3.61	3.61	3.59	3.32
3-month bills	3.81	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.45
6-month	3.87	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	3.95	3.55
1-year	3.91	4.05	4.05	4.05	4.00	4.00	3.95	3.90	3.80	3.70	3.45
2-year notes	4.11	4.20	4.20	4.20	4.15	4.05	4.00	3.85	3.65	3.45	3.30
3-year	4.15	4.20	4.20	4.20	4.15	4.10	4.05	3.95	3.80	3.65	3.55
5-year	4.21	4.30	4.30	4.30	4.25	4.20	4.15	4.10	3.95	3.85	3.75
7-year	4.33	4.40	4.40	4.40	4.40	4.35	4.30	4.25	4.15	4.05	4.00
10-year	4.47	4.55	4.55	4.55	4.50	4.50	4.45	4.40	4.35	4.25	4.25
30-year bonds	4.95	5.05	5.05	5.05	5.00	5.00	4.95	4.90	4.85	4.75	4.75
Prime rate	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.73	6.46
Other G7											
ECB Deposit Rate[1]	2.25	2.25	2.25	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
10yr Bund	2.97	2.95	3.05	3.15	3.25	3.35	3.45	3.35	3.25	3.10	2.95
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	4.82	4.80	4.85	4.95	5.00	5.10	5.15	5.05	4.95	4.80	4.65
BoJ O/N[1]	1.00	1.00	1.00	1.25	1.25	1.25	1.25	1.50	1.50	1.75	1.75
10yr JGB	2.65	2.77	2.74	2.70	2.67	2.63	2.60	2.58	2.56	2.53	2.51

[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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