

Rates Scenario for August 7, 2025

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

Forecast Summary

(avg.)	Actual 2025 Jul	Forecasts 2025						2026			
		Aug	Sep	Oct	Nov	Dec	Jan	Q1	Q2	Q3	Q4
BoC overnight ¹	2.75	2.75	2.50	2.50	2.50	2.25	2.25	2.00	2.00	2.00	2.00
10-yr Canadas	3.48	3.40	3.40	3.35	3.35	3.35	3.35	3.35	3.30	3.30	3.25
Fed funds ¹	4.38	4.38	4.13	4.13	4.13	3.88	3.88	3.63	3.38	3.13	2.88
10-yr Treasuries	4.39	4.20	4.20	4.20	4.15	4.15	4.15	4.15	4.10	4.05	4.00
C\$ per US\$	1.37	1.37	1.36	1.36	1.35	1.35	1.35	1.35	1.34	1.34	1.33
US\$/€	1.17	1.16	1.17	1.17	1.18	1.18	1.18	1.18	1.19	1.19	1.20
US\$/£	1.35	1.34	1.35	1.35	1.36	1.36	1.36	1.36	1.37	1.37	1.38
¥/US\$	147	147	146	145	144	143	143	143	142	142	141

¹ end of period

Sources: BMO Economics, Haver Analytics

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Canada-U.S. Rates: A Rate Cut Herald for Autumn

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We continue to look for both the Federal Reserve and the Bank of Canada to **resume reducing policy rates in the months ahead**, with the former eventually easing more than the latter into next year. The midpoint of the current range for the fed funds rate is 4.375%, 125-to-150 bps above the FOMC's 3.00% median projection of the neutral level. The BoC's current target for the overnight rate is 2.75%, smack dab in the middle of the Bank's 2.25%-to-3.25% estimated range for the neutral level. To end a bit below neutral (as is our current call), Fed rate cuts are poised to more than double up on those of the BoC. This should prod less negative Canada-U.S. bond yield spreads and a stronger Canadian dollar (vs. the greenback) into next year. However, these forecast themes could easily become buried amid the central bank and market reactions to the U.S. Administration's erratically evolving trade and other policies.

Federal Reserve: The FOMC left policy rates **unchanged** on July 30 for the fifth consecutive confab over the past seven months. The statement's economic assessment was slightly more downbeat, referring to recent activity as having "moderated" as opposed to still being "solid", in line with the data flow. The risk assessment didn't refer to uncertainty as having "diminished", with the August 1 tariff announcements looming. And, as advertised, Governors Bowman and Waller dissented in favour of a quarter-point rate cut. The vote was 9-to-2, with Governor Kugler absent and not voting. (Two days later, Kugler announced her resignation.)

In the press conference, Chair Powell said: "We see our current policy stance as appropriate to guard against inflation risks. We are also attentive to risks on the employment side of our mandate. In coming months, we will receive a good amount of data that will help inform our assessment of the balance of risks and the appropriate setting of the federal funds rate." For Bowman and Waller, they perceived the data as having already tipped the balance of risks to the slower growth side. For the remaining members, they wanted to wait for more data "to learn more about the likely course of the economy and the evolving balance of risks before adjusting our policy stance". Out of the gate, the post-meeting data flow has probably convinced more members that the evidence of **weaker growth is starting to weigh heavier**, even as tariffs become more evident in the price level.

Nonfarm payrolls rose by 73k in July with gains averaging just 35k over the past three months. Apart from the initial pandemic months, this is the weakest trend in 15 years, and it was topping 200k as recently as the turn of the year. The unemployment rate rose a tenth to 4.2%, marking the seventh time in the past 13 months that it has been at the FOMC's longer-run level. Only this time, unrounded at 4.248%, it's the highest since late 2021. Elsewhere, the ISM Services PMI dropped to 50.1 in July, averaging 50.3 in the past three months, which again is the lowest level in 15 years apart from a couple of pandemic months. Meanwhile, the PCE price index increased 0.3% in June with the (tariff-emphasizing) core goods component at 0.4%. The latter is up 3.7% annualized over the past three months, the fastest clip since the summer of 2022.

Previously, a sturdy labour market and broader economic performance afforded the Fed time to wait and see whether tariffs' influence on inflation was temporary, and it being temporary was a "*reasonable base case*" (according to Powell). But the past sturdiness is buckling, making the case that current "*modestly restrictive*" policy should be at least a little less restrictive. With 125-to-150 bps to go before neutral, even a gradual approach to rate cuts would keep policy on the restrictive side for a while longer. The risk management case for an autumn-heralding rate cut is becoming compelling if the interim data don't shout otherwise. We're sticking to our call for **a September 17 start to a quarterly campaign of 25 bp rate cuts** through the end of next year (to a range of 2.75%-to-3.00% which is just a hint below neutral), with hefty risks that this pattern could be either expedited or delayed.

Bank of Canada: The BoC also left policy rates **unchanged** on July 30. This was the third hold since March. In the previous Rates Scenario (July 10), we noted that although our 'official' call was still for a rate cut at the end of the month, our conviction was wavering. A cut would require a weak Labour Force Survey (LFS) and benign CPI report (both for June). Instead, jobs jumped by 83k, and the unemployment rate dipped a tenth to 6.9%. The core CPI metrics (trim, median) along with the 'old' cores (CPIX, ex. food & energy) showed mostly 0.3% monthly moves and three-month annualized changes that were all accelerating and sporting '3 handles'. In the wake of these data (as of July 15) we no longer had a month-ending rate cut on the books.

The policy statement said: "*With still high uncertainty [owing to U.S. trade policy], the Canadian economy showing some resilience [as in the latest LFS], and ongoing pressures on underlying inflation [as in the latest CPI], Governing Council decided to hold the policy interest rate unchanged.*" The Bank left the door open for further cuts, saying: "*If a weakening economy puts further downward pressure on inflation and the upward price pressures from the trade disruptions are contained, there may be a need for a reduction in the policy interest rate.*" But it appears to be in no hurry to cross the threshold, unless the data change meaningfully, amid the heightened "*risks and uncertainties facing the Canadian economy*".

To underscore the latter, the Monetary Policy Report had three economic and inflation projections, a "*current tariff scenario*", which assumes no further changes in the trade war, along with a "*de-escalation scenario*" and an "*escalation scenario*". In the presser, Governor Macklem asserted: "*I want to underline that the lack of a conventional forecast does not impede our ability to take monetary policy decisions. But the unusual degree of uncertainty does mean we have to put more weight on the risks, look over a shorter horizon than usual, and be ready to respond to new information.*"

Bank of Canada policy is becoming nimbler and so is our call for **two 25 bp rate cuts by the end of this year and a final one in 2026 Q1** (to a notch below the neutral range at 2.00%). A rate cut on September 17 (which is what we've pencilled in) will require very favourable inflation reports on August 19 and September 16 and, to lesser extent, generally weak Labour Force Surveys on August 8 and September 5. This could be a tall order, with the net risk of a later rate cut.

Bond yields: Ten-year Treasury yields averaged 4.39% last month and have begun this month lower, averaging under 4.25% (through August 6). The weak employment report was the key catalyst by stoking Fed rate cut expectations. The OIS market now has two-to-three quarter-point rate reductions priced in by the end of this year with a total of five-to-six by the end of next year. Recall, we're at two and six respectively, with the **market a bit more aggressive**

near-term. As these rate cuts unfold, we look for bond yields to trend moderately lower. 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.

Offsetting some of the impact of Fed easing on yields, **America's fiscal fundamentals continue to deteriorate.** The One Big Beautiful Bill Act (OBBBA) raised the cumulative deficit by US\$3.4 trillion through 2034, according to the CBO. This pushes above \$4 trillion after including added interest payments. 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, declines in import volumes, or the (legal) longevity of tariffs levied under the International Emergency Economic Powers Act (IEEPA). Federal finances were already unsustainable before OBBBA, and tariffs can't stop further fiscal deterioration.

Meanwhile, **Canada-U.S. 10-year yield spreads** averaged -92 bps last month and have moved less negative so far this month (-83 bps through August 6). This continues the pattern of under-performance 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 rate cuts expected to total much more than the BoC's. Part of the pattern also reflects Canada's own fiscal risks. A post-election budget for FY25/26 has yet to be presented, and the Liberals' platform estimate topping C\$62 billion will likely be surpassed. Given recent policy measures and higher defence spending targets, along with efforts to restrain spending elsewhere, it wouldn't be surprising to see the federal deficit jump toward \$80 billion or about 2.5% of GDP (the last estimate for FY24/25 was \$48 billion).

U.S. dollar: The Fed's broad **trade-weighted dollar index** weakened 0.4% on average last month, marking the smallest move among the past six months of steady depreciation (for a total of 6.6%). The Wall Street Journal's index has followed the same pattern (albeit down a cumulative 7.4%), but it's starting August on a firmer tone. Perhaps this year's tug-of-war between the boost owing to tariffs and drag due to more hesitant inflows of foreign investment is becoming more balanced. In any event, we still see Fed cuts as being the final arbiter on the dollar's direction. By this December, we see the Fed's index down around 8% from January's record high, meaning only a modest downward trend from current levels (a pattern which should continue next year).

Canadian dollar: The loonie averaged C\$1.361 last month (US\$0.730), drifting a hint weaker (-0.1%), and it's starting this month on a softer tone (currently trading above C\$1.37). When the Fed's U.S. dollar index peaked 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 broad depreciation of the big dollar since has been the loonie's main driver, tempered by the end of more aggressive (than the Fed) Bank of Canada easing and heightened concern about Canada's economic exposure to U.S. trade policy (which is lingering). In the absence of a trade deal on August 1, U.S. tariffs on Canadian goods not compliant with the USMCA were lifted to 35% from 25%. However, once the Fed starts (cumulatively) outpacing BoC rate cuts, we look for the loonie to resume appreciating. It also helps that the broad economic hit from U.S. tariffs has not been as bad as worst fears and that growth prospects are getting a lift 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.

Overseas

Jennifer Lee, Senior Economist

There is more clarity now on the trade front, as numbers have been determined (ranging from as low as 10% for some, to as high as 50% for others), although the negotiations will continue. America's trading partners will attempt to lower their respective tariffs and get some carve-outs. For example, Brussels is still trying to exclude wine and spirits from its 15% tariff, given that it also agreed to invest \$600 bln in the U.S.

But at least there is a starting point. Meantime, central bankers can continue moving on monetary policy as they see fit. Most will still be dovish, except for the Bank of Japan. However, the **mild weakening in the U.S. dollar is expected to continue** as investors remain cautious over these protectionist moves, as well as the uncertainty over the future independence of the Federal Reserve and the various statistical agencies.

BoE ... The August 7 monetary policy meeting was one for the history books. The Bank cut rates 25 bps to 4.00%, as expected, although it was not easy to arrive there as it took two rounds of voting. The **first round** saw 4 in favour of a 25 bp cut, 1 in favour of a 50 bp cut, and 4 in favour of holding rates steady. The **second round** saw the more dovish-leaning policymaker move to the majority, so the final result became 5 in favour of cutting 25 bps and the remaining 4 in favour of holding. (Much has been made about the 2 dissenting votes on the FOMC but at the BoE, it is quite normal!) As Governor Bailey said, *"It was a finely balanced decision."* As far as the next moves go, *"Interest rates are still on a downward path but any future rate cuts will need to be made gradually and carefully."* For the record, **this is the last rate move BMO has pencilled in for the BoE this year** but things can, obviously, change. Judging by the vote, and the MPC's view that *"the upside risks around medium-term inflationary pressures have moved slightly higher since May" ... the bar to cut again is high* (much like at the ECB). Hence, the surge in the GBP immediately after the announcement. There was also a notable mention of the impact from QT... that *"QT has a greater impact on market functioning than previously"*. This suggests that the Bank's reduction of its Gilt holdings could be slowed, similar to the BoJ.

ECB ... We look for one more rate cut by the ECB, likely in September, but it is not a done deal. The central bank stayed on the sidelines on July 24, when President Lagarde declared that *"we are at 2%"* (inflation) and that *"there is actually a forecast of undershooting in 2026 for all sorts of base effects"*. This was in response to a question about disinflation. But what she said was accurate: ECB staff forecasts are for a 2% CPI rate this year, 1.6% next year, and 2% in 2027. In May and June, when using more than 1 decimal place, Euro Area inflation actually came in below 2%, but it held right on the 2.0% target in July. Core CPI was steady at 2.3% y/y, while services CPI slowed 0.2 ppts to a 3-year low of 3.1% y/y. It is not obvious how the ECB will react to this: the headline and core results could be viewed as sticky, but slower services inflation is good news. And, there will still be another CPI report before the next meeting on September 11. If inflation cools further, and Europe has moved forward with 15% tariffs slapped on its goods arriving in the U.S., the ECB will probably ease once again. But lots can happen before that next date. Secret sources say that **the bar to cut is high**: policymakers want to see evidence of weaker inflation and weaker economic growth; plus, whatever the ECB staff have for their new forecasts. It is not all clear yet.

BoJ ... The **Bank of Japan** unanimously decided to leave policy rates unchanged at *"around 0.5%"* on July 31 but there were **signs that would support our call for a September rate hike**. Inflation forecasts were bumped up: core CPI is now expected to hit 2.7% in FY2025 (the last projection was 2.2%), and 1.8% for FY2026 (from 1.7%). Although it expects the rise in food prices (such as rice) to wane, the Bank noted that there will be *"a sense of labour shortages"* as economic growth picks up. That is, perhaps, a subtle hint for businesses to keep lifting wages, which would support spending, and so on. But, the sixth straight decline in real cash earnings puts a damper on any moves to tighten policy. Governor Ueda also mentioned the trade deal with the U.S., that it was a *"big step forward"* and will go some way to lower uncertainty. But, the BoJ chief tempered rate hike expectations, saying that price pressures were supply-led, and he is so far not seeing a major impact from tariffs.

RBA ... *"Break's over.... get ready to cut on August 12th!"* The **RBA** looks to be cleared to ease in August given the latest inflation numbers. **Consumer prices** slowed to a 2.1% y/y pace in Q2, down from 2.4% in Q1 and the smallest increase in four years. The **trimmed mean**, which is what the central bank zooms in on, decelerated as well and at 2.7% y/y, is the slowest pace in three years. For June, headline CPI also slowed... to 1.9% y/y, while the trimmed mean hit 2.1%. That is still notable, even though the RBA has said time and time again that it focusses on the quarterly data. In any event, after pausing in July at 3.85%, **the RBA is expected to resume easing next week**, taking the cash rate down 25 bps to 3.60%.

Foreign Exchange Forecasts

(local currency per US\$: avg.)	Actual 2025 Jul	Forecasts 2025									
		Aug	Sep	Oct	Nov	Dec	2026 Jan	2026 Q1	Q2	Q3	Q4
Canadian Dollar											
C\$ per US\$	1.37	1.37	1.36	1.36	1.35	1.35	1.35	1.35	1.34	1.34	1.33
US\$ per C\$ ¹	0.730	0.732	0.735	0.737	0.739	0.741	0.742	0.742	0.745	0.747	0.749
Trade-weighted	115.2	115.6	115.7	115.9	116.0	116.2	116.2	116.3	116.5	116.6	116.8
U.S. Dollar											
Trade-weighted ²	120.5	120.6	120.3	120.0	119.7	119.4	119.3	119.2	118.8	118.4	118.0
European Currencies											
Euro ¹	1.17	1.16	1.17	1.17	1.18	1.18	1.18	1.18	1.19	1.19	1.20
Danish Krone	6.39	6.40	6.35	6.35	6.35	6.35	6.30	6.30	6.30	6.25	6.25
Norwegian Krone	10.16	10.15	10.15	10.10	10.10	10.10	10.10	10.05	10.00	10.00	9.95
Swedish Krone	9.60	9.55	9.55	9.50	9.50	9.45	9.45	9.45	9.40	9.35	9.30
Swiss Franc	0.80	0.80	0.80	0.79	0.79	0.79	0.79	0.79	0.79	0.78	0.78
U.K. Pound ¹	1.35	1.34	1.35	1.35	1.36	1.36	1.36	1.36	1.37	1.37	1.38
Asian Currencies											
Chinese Yuan	7.17	7.17	7.16	7.16	7.15	7.15	7.15	7.14	7.13	7.12	7.10
Japanese Yen	147	147	146	145	144	143	143	143	142	142	141
Korean Won	1,379	1,380	1,380	1,380	1,380	1,380	1,380	1,380	1,375	1,375	1,370
Indian Rupee	86.2	87.5	87.4	87.3	87.1	87.0	87.0	86.9	86.8	86.6	86.5
Singapore Dollar	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.28	1.27	1.27
Malaysian Ringgit	4.23	4.25	4.25	4.25	4.20	4.20	4.20	4.20	4.20	4.20	4.20
Thai Baht	32.5	32.4	32.4	32.3	32.3	32.2	32.2	32.2	32.1	32.1	32.0
Philippine Peso	56.9	56.9	56.9	56.9	56.9	56.9	56.9	56.8	56.7	56.6	56.5
Taiwan Dollar	29.3	29.4	29.5	29.6	29.6	29.7	29.7	29.7	29.6	29.6	29.5
Indonesian Rupiah	16,299	16,280	16,265	16,250	16,235	16,220	16,210	16,200	16,170	16,140	16,115
Other Currencies											
Australian Dollar ¹	0.654	0.655	0.656	0.657	0.659	0.660	0.661	0.662	0.664	0.667	0.669
New Zealand Dollar ¹	0.599	0.595	0.596	0.598	0.599	0.600	0.601	0.603	0.606	0.610	0.614
Mexican Peso	18.69	18.65	18.60	18.60	18.55	18.50	18.50	18.45	18.40	18.30	18.25
Brazilian Real	5.53	5.50	5.40	5.35	5.30	5.25	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	17.7	17.7	17.6	17.6	17.5
Cross Rates											
Versus Canadian Dollar											
Euro (C\$/€)	1.60	1.58	1.59	1.59	1.59	1.59	1.59	1.59	1.60	1.60	1.60
U.K. Pound (C\$/£)	1.85	1.83	1.83	1.83	1.83	1.84	1.84	1.84	1.84	1.84	1.84
Japanese Yen (¥/C\$)	108	108	107	107	106	106	106	106	106	106	106
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 (£/€)	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87
Japanese Yen (¥/€)	172	171	170	170	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 2025 Jul	Forecasts 2025						2026 Jan	2026 Q1	Q2	Q3	Q4
	Aug	Sep	Oct	Nov	Dec							
Canada												
Overnight target (period end)	2.75	2.75	2.50	2.50	2.50	2.25	2.25	2.00	2.00	2.00	2.00	
Overnight target	2.75	2.75	2.65	2.50	2.50	2.34	2.25	2.18	2.00	2.00	2.00	
CORRA ²	2.75	2.75	2.65	2.50	2.50	2.34	2.25	2.18	2.00	2.00	2.00	
3-month bills	2.66	2.65	2.55	2.40	2.40	2.25	2.20	2.10	1.95	1.95	1.95	
6-month	2.68	2.70	2.60	2.45	2.45	2.30	2.25	2.20	2.05	2.05	2.05	
1-year	2.69	2.70	2.60	2.50	2.45	2.30	2.20	2.15	2.05	2.10	2.15	
2-year bonds	2.76	2.70	2.60	2.50	2.40	2.30	2.20	2.10	2.05	2.15	2.25	
3-year	2.77	2.70	2.65	2.60	2.55	2.50	2.45	2.40	2.35	2.45	2.50	
5-year	3.03	2.95	2.90	2.85	2.80	2.80	2.75	2.70	2.70	2.70	2.75	
7-year	3.22	3.15	3.10	3.10	3.05	3.05	3.05	3.00	3.00	3.00	3.00	
10-year	3.48	3.40	3.40	3.35	3.35	3.35	3.35	3.35	3.30	3.30	3.25	
30-year	3.79	3.75	3.75	3.70	3.70	3.70	3.70	3.70	3.65	3.65	3.60	
Prime rate	4.95	4.95	4.85	4.70	4.70	4.54	4.45	4.38	4.20	4.20	4.20	
United States												
Fed funds target (period end)	4.38	4.38	4.13	4.13	4.13	3.88	3.88	3.63	3.38	3.13	2.88	
Fed funds target	4.38	4.38	4.27	4.13	4.13	3.96	3.88	3.84	3.59	3.34	3.07	
EFFR ³	4.33	4.33	4.23	4.09	4.09	3.93	3.85	3.81	3.57	3.32	3.06	
SOFR ⁴	4.34	4.34	4.24	4.09	4.09	3.93	3.85	3.81	3.57	3.32	3.05	
3-month bills	4.41	4.30	4.20	4.05	4.05	3.90	3.80	3.80	3.55	3.30	3.00	
6-month	4.31	4.15	4.05	3.95	3.95	3.80	3.75	3.70	3.50	3.25	3.05	
1-year	4.08	3.90	3.85	3.75	3.70	3.60	3.55	3.50	3.35	3.15	3.00	
2-year notes	3.88	3.70	3.65	3.60	3.55	3.50	3.45	3.40	3.25	3.10	2.95	
3-year	3.84	3.65	3.60	3.55	3.55	3.50	3.50	3.45	3.35	3.30	3.20	
5-year	3.95	3.75	3.75	3.75	3.70	3.70	3.65	3.65	3.60	3.50	3.45	
7-year	4.15	3.95	3.95	3.95	3.90	3.90	3.90	3.90	3.85	3.80	3.75	
10-year	4.39	4.20	4.20	4.20	4.15	4.15	4.15	4.15	4.10	4.05	4.00	
30-year bonds	4.92	4.80	4.80	4.80	4.75	4.75	4.75	4.70	4.65	4.60	4.60	
Prime rate	7.50	7.50	7.40	7.25	7.25	7.09	7.00	6.97	6.72	6.46	6.19	
Other G7												
ECB Deposit Rate ¹	2.00	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	
10yr Bund	2.66	2.60	2.55	2.55	2.50	2.45	2.45	2.40	2.35	2.30	2.25	
BoE Repo ¹	4.25	4.00 ⁶	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	
SONIA ⁵	4.22	4.01	3.97	3.97	3.97	3.97	3.97	3.97	3.97	3.97	3.97	
10yr Gilt	4.60	4.55	4.50	4.50	4.45	4.40	4.40	4.35	4.35	4.30	4.25	
BoJ O/N ¹	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	
10yr JGB	1.52	1.50	1.47	1.45	1.42	1.40	1.40	1.39	1.38	1.37	1.35	

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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