

Rates Scenario for February 18, 2026

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

Forecast Summary

(avg.)	Actual	Forecasts									
	2026	2026									
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	2026
											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	3.40	3.30	3.30	3.30	3.30	3.30	3.30	3.25	3.25	3.25	3.25
Fed funds ¹	3.63	3.63	3.63	3.63	3.63	3.38	3.38	3.38	3.13	3.13	2.88
10-yr Treasuries	4.21	4.10	4.10	4.10	4.10	4.05	4.05	4.05	4.05	4.00	4.00
C\$ per US\$	1.38	1.37	1.36	1.36	1.36	1.35	1.35	1.35	1.34	1.34	1.34
US\$/€	1.17	1.19	1.19	1.19	1.19	1.19	1.19	1.19	1.20	1.20	1.20
US\$/£	1.35	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36
¥/US\$	157	154	154	154	153	153	153	153	153	152	152

¹ end of period

Sources: BMO Economics, Haver Analytics

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Canada-U.S. Rates

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No Fall in Fed Rates Until (Almost) Summer

As expected, the Federal Reserve and Bank of Canada both left policy rates unchanged last month, after asymmetric actions in December when the Fed cut and the BoC held. Compared to our previous Rates Scenario (January 15), **we now expect this policy symmetry to persist a little longer** (to June versus March before) when the Fed is expected to resume rate reductions with the Bank standing pat all year. Once Canada-U.S. policy rate differentials start moving less negative again (by a total of 75 bps by year-end), we look for bond yield spreads to be trending less negative and the loonie to be gaining against the greenback.

Federal Reserve: The FOMC kept policy rates unchanged on January 28, with the target range for the fed funds rate at 3.50%-to-3.75%. This followed quarter-point cuts in each of the prior three meetings. The vote was 10-to-2 in favour of holding, with Governors Miran and Waller dissenting in favour of a 25 bp rate cut.

The policy statement was a bit more upbeat on the economy than before. For example, it said *“economic activity has been expanding at a solid pace”* (vs. *“moderate”*) and *“the unemployment rate has shown some signs of stabilization”* (vs. *“edged up”*). Importantly, the prior conclusion that the Committee *“judges that downside risks to employment rose in recent months”* was dropped. Meanwhile, *“inflation remains somewhat elevated.”*

Less downside labour market risk plus still somewhat sticky inflation seems to have reduced the Fed’s sense of easing urgency, particularly with policy rates in the *“range of plausible estimates of neutral.”* In the press conference, Chair Powell said there is still *“tension”* between the two mandates, with lingering upside risk to inflation and downside risk to the labour market, but did not say which is weighing heavier. And with the economy starting this year on a *“firm footing”*, this tension looks to linger for longer, as well as the current pause.

So far, the post-confab data have been mixed. Payroll employment expanded at a respectable 130k in January (a 13-month high), but regular and benchmark revisions turned 2025 into a nearly flat year. The monthly average was a puny 15k. Elsewhere, the jobless rate dipped a tenth to 4.3%, further below November’s 4.5% peak. Meanwhile,

total and core CPI inflation were 2.4% and 2.5%, respectively, in January, with the latter the lowest since early 2021. However, absent October data and elevated usage of less accurate imputation methods for recent missing data cast doubt about the reliability of the shorter-term trends. And we still only have November PCE inflation data on hand. A few more monthly reports would help clarify the economic picture.

In consequence, **we pushed back our expectation for the next rate cut to June from March** but still have three quarter-point actions this year. By the end of 2026, we see 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. (So, too, is the fact that rate cuts will be continuing amid 2%-plus real GDP growth, a jobless rate stabilizing around 4½%, and CPI/PCE core inflation running around 2½%.)

Bank of Canada: The BoC also kept the policy rate unchanged on January 28, with the target for the overnight rate at 2.25%, which is at the bottom of the Bank's 2.25%-to-3.25% estimated range for neutral. This marked the second consecutive hold after cutting rates a total of 275 bps starting in June 2024 and over consecutive confabs apart from a six-month pause during March-September 2025. The current pause could last a lot longer.

In the press conference, Governor Macklem said: *"While Council judges the current policy rate is appropriate based on our outlook, the consensus was that elevated uncertainty makes it difficult to predict the timing or direction of the next change in the policy rate."* He added, *"the Canadian economy is adjusting to the structural headwinds of US protectionism... but it will all take some time."* This is 'long pause' talk.

The statement did say *"if the outlook changes, 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. our baseline view of no change in 2026). Further, in balancing between providing the most economic support possible without prodding inflation, the latest inflation figures highlight an emerging capacity to ease if necessary. While the various core inflation measures in January were hovering in a 2.4%-to-2.6% range, nearly all the three-month trends were running under 2% annualized (with none above).

Bond yields: Ten-year U.S. Treasury yields averaged 4.21% in January (a five-month high) but are dropping back down this month. Through February 17, they are averaging 4.17%, but the latest daily closes have been around 4.05%. In each of the past 16 months, an average of at least 4.00% has held (range of 4.06% to 4.6%). Indeed, starting from early October 2024, even among the daily closes, the 4.00% line has held except for four readings during October 2025.

This line in the sand is being drawn 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 (OBBBA) applied further strain. Tariff revenue could cushion some, but not all, of the OBBBA's impact. And now the biggest chunk of this revenue (IEEPA-justified tariffs) could soon be ruled illegal. Investors are also concerned about the erosion of **Fed independence** and **U.S. dollar dominance**.

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**, short of mounting prospects for chunky Fed cuts (>25 bps) or escalating risks of recession.

Meanwhile, Canada-U.S. 10-year yield spreads averaged -81 bps in January, after posting the least negative result in 22 months (-75 bps) in December. And both outcomes are far from the record -139 bps in February 2025. These two extremes are telling. The -139 number occurred as the Bank of Canada continued easing as the Fed held (which happened again in March 2025). The -75 figure occurred as that Fed continued easing while the BoC held; a pattern that should persist as 2026 unfolds.

Although yield spreads haven't budged much so far this month (-82 bps average), we expect the unfolding policy asymmetry will impart net pressure for less negative spreads. However, the ride 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.

U.S. dollar: The Fed's broad trade-weighted dollar index declined 0.8% last month (on average) or 7.5% since January 2025, when the broad index hit a record high. Against the advanced foreign economies (AFE), the greenback was down 0.4% or 8.8% y/y. So far this month (through February 17), the dollar is down a further hefty 1.2% against the AFE (per the Wall Street Journal's Dollar Index).

Since peaking early last year, the greenback has been battered by two forces, Fed rate cuts and the prospects for further easing along with broader economic policy uncertainty. This month's heftier dollar drop is unfolding as the latest data flow is keeping Fed rate cuts on the table (but probably not imminently) as we await the Supreme Court's ruling on the legality of IEEPA-justified tariffs (possibility as early as February 20) and the market mulls over the scenarios for a Kevin Warsh-led Fed. On February 13, Treasury Secretary Bessent said hearings would soon commence in the Senate Banking Committee despite a potential roadblock to a full Senate vote. (Committee member and Republican Senator Tillis said he would block a full Senate vote until the Department of Justice concludes its investigation of the Fed.) We see the broad index down around 2½% y/y by 2026-end and against the majors as well, as 75 bps worth of Fed easing unfolds.

Canadian dollar: The loonie averaged C\$1.38 in January (US\$0.725), firming 0.2% against the greenback and slightly underperforming both the AFE basket and broad index. So far this month, the Canadian dollar has kept pace with the majors, gaining 1.1% to C\$1.36 (US\$0.735). With another 75 bps of Fed rate cuts coming this year and the BoC on a long pause, look for the CAD to continue appreciating to C\$1.33 (US\$0.752), or around 3½% over the year, by the end of 2026, which is a bit better than the rest of the pack, as the Canadian economy rebounds after being hit disproportionately by U.S. trade policy.

However, the **key risk** for the Canadian dollar remains **U.S. trade policy**, with the review of the USMCA scheduled for mid-year. While U.S. official talks with Mexico have begun, U.S. Trade Representative Greer (on February 11) said, *"with the Canadians, it's more challenging"*, seemingly wanting concessions made to start the process. And now, the soon-to-be-opened Gordie Howe International Bridge has gotten into the Administration's crosshairs. Our working assumption is that the USMCA will still be around by the start of 2027 (with Canadian and Mexican compliant goods still sheltered from whatever potentially replaces IEEPA tariffs), perhaps not yet having been renegotiated. We also assume some tariff-rate quotas will be hammered out to deal with select Section 232 'national security' tariffs. If the actual overall outcome is more favourable for Canada, the loonie should fare even better. And the opposite also holds.

Overseas

Jennifer Lee, Senior Economist

There's a little bit of tightening, easing and holding going on.....

The **RBA** did not waste time. At the December 9th meeting, it was noted that inflation risks had *"tilted to the upside"* but the Board wanted time to assess their persistence. At the February 4th meeting, eight weeks later, after digesting a pick-up in Q4 and December inflation, a surge in job growth and a 7-month low unemployment rate, policymakers decided *"the outlook and risks had materially shifted"*, there was *"greater capacity pressure"* and, *"without a policy response, inflation could remain persistently above target for too long"*. And that was why the RBA raised the cash rate for the first time since November 2023, by 25 bps to 3.85%. This is not necessarily the start of an aggressive tightening phase. There is plenty of uncertainty surrounding its stance; in fact, the Board warned that *"it was not possible to have a high degree of confidence in any particular path"*. In other words, the RBA will continue watching the data and assessing the risks. For now, **BMO looks for another 25 bp hike around mid-year.**

The RBA now joins the **BoJ** in making monetary policy a little more restrictive. The BoJ began to tighten policy in March 2024, and has raised its overnight target rate 85 bps to 0.75% over that time period. **We continue to look for a couple more hikes this year:** 25 bps in April, and again in July, bringing its key rate to a 30-year high of 1.25%. The path is not clear-cut, though. Core inflation has eased but remains above target at 2.4%. And, policymakers are wary of the inflationary impact caused by the yen's depreciation. Although the JPY has made considerable strides from its near 4-decade lows of ¥161 in 2024, to ¥154, currently, that is still far weaker than the average ¥118 over that time period. But, the economy just barely skirted a recession at the end of 2025, giving PM Takaichi an even stronger mandate to roll out fiscal stimulus. She will not want the BoJ to get in the way of her job, but she is also aware of the impact of sticky inflation on growth.

Then, there are central banks that are torn between holding steady and easing rates. Case in point: the **BoE**. The MPC has cut its Bank Rate 150 bps over the past two years and is currently at a 3-year low of 3.75%. Policymakers are torn over what the next move will be: the last three decisions were made by a wafer-thin 5-to-4 vote, with Governor Bailey providing the swing ballot (opting to hold in November, cut in December, then hold again in February). He sees scope for some further easing (*"going into March, 50-50 is not a bad place to be"*). And, the normally hawkish Catherine Mann described *"new analysis and current developments have moved the appropriate time for a cut in Bank Rate close"*. In addition, the data since the February 4th meeting support a rate cut: real GDP had a soft end to 2025 (in Q4 and in December), payrolls were reduced for the fifth month in a row in December, the jobless rate hit a 5-year high of 5.2%, private sector wage growth slowed to a 5-year low of 3.4%, and core inflation eased to a near 5-year low of 3.1%. Don't be shocked if Governor Bailey, accompanied by Catherine Mann, moves over to the "cut" camp in **March**, allowing for a **25 bp rate cut to 3.50%**.

So while those central banks are busily raising and lowering their official policy rates, the **ECB** is sitting back, leaving its deposit rate at a 2½-year low of 2.00%, where it has been since June 2025. Although she didn't say it right away at the February 4th press conference, President Lagarde finally declared that *"monetary policy is in good shape because it is agile"* and that in terms of risks, *"we are broadly balanced"*. So while **rates are likely to stay unchanged for the near future**, the Governing Council is putting the onus on governments and fiscal policy. In fact, the ECB gave a checklist to the informal EU leaders' retreat in mid-February, with recommendations on how to *"enhance growth, improve productivity, and to really unleash the talent of Europe."* It does seem that the leaders have good intentions to do just that (make Europe more independent and self-reliant), starting with Germany and its €500 bln investment/defence spending fund. Keep an eye on price pressures, though. Headline inflation in the Euro Area is at a 16-month low of 1.7%, while Germany's rate is on target at 2.0%, France is at a 5-year low of 0.4%, and Italy is at a 15-month low of 1.0%. That might push the ECB out of its comfy chair.

Foreign Exchange Forecasts

(local currency per US\$: avg.)	Actual 2026	Forecasts 2026									2026
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Q4
Canadian Dollar											
C\$ per US\$	1.38	1.37	1.36	1.36	1.36	1.35	1.35	1.35	1.34	1.34	1.34
US\$ per C\$ ¹	0.726	0.733	0.734	0.736	0.738	0.740	0.741	0.743	0.745	0.747	0.748
Trade-weighted	113.5	113.7	113.9	114.1	114.3	114.5	114.7	115.0	115.2	115.4	115.6
U.S. Dollar											
Trade-weighted ²	119.2	117.8	117.7	117.6	117.5	117.4	117.3	117.2	117.1	117.0	116.9
European Currencies											
Euro ¹	1.17	1.19	1.19	1.19	1.19	1.19	1.19	1.19	1.20	1.20	1.20
Danish Krone	6.36	6.30	6.30	6.30	6.30	6.25	6.25	6.25	6.25	6.25	6.25
Norwegian Krone	9.93	9.55	9.55	9.55	9.50	9.50	9.50	9.45	9.45	9.45	9.45
Swedish Krona	9.09	8.95	8.95	8.95	8.95	8.90	8.90	8.90	8.90	8.90	8.85
Swiss Franc	0.79	0.77	0.77	0.77	0.77	0.78	0.78	0.78	0.78	0.78	0.78
U.K. Pound ¹	1.35	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36
Asian Currencies											
Chinese Yuan	6.97	6.92	6.92	6.92	6.91	6.91	6.91	6.91	6.91	6.90	6.90
Japanese Yen	157	154	154	154	153	153	153	153	153	152	152
Korean Won	1,455	1,450	1,445	1,445	1,445	1,445	1,445	1,445	1,445	1,445	1,445
Indian Rupee	90.9	90.6	90.6	90.6	90.6	90.5	90.5	90.5	90.5	90.5	90.5
Singapore Dollar	1.28	1.27	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26
Malaysian Ringgit	4.02	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.90
Thai Baht	31.3	31.3	31.3	31.3	31.2	31.2	31.2	31.1	31.1	31.1	31.0
Philippine Peso	59.2	58.2	60.7	63.2	65.7	68.3	70.8	73.3	75.8	78.3	72.3
Taiwan Dollar	31.5	31.5	31.4	31.4	31.4	31.4	31.4	31.4	31.4	31.4	31.4
Indonesian Rupiah	16,810	16,815	16,815	16,810	16,810	16,810	16,810	16,805	16,805	16,805	16,805
Other Currencies											
Australian Dollar ¹	0.679	0.706	0.706	0.707	0.707	0.708	0.708	0.708	0.709	0.709	0.710
New Zealand Dollar ¹	0.585	0.604	0.605	0.605	0.606	0.606	0.607	0.608	0.608	0.609	0.609
Mexican Peso	17.64	17.20	17.15	17.15	17.15	17.10	17.10	17.10	17.05	17.05	17.00
Brazilian Real	5.33	5.20	5.20	5.20	5.15	5.15	5.10	5.10	5.05	5.05	5.00
South African Rand	16.3	16.0	16.0	16.0	15.9	15.9	15.9	15.9	15.8	15.8	15.8
Cross Rates											
Versus Canadian Dollar											
Euro (C\$/€)	1.62	1.62	1.62	1.61	1.61	1.61	1.61	1.61	1.61	1.60	1.60
U.K. Pound (C\$/£)	1.86	1.86	1.85	1.85	1.84	1.84	1.83	1.83	1.83	1.82	1.82
Japanese Yen (¥/C\$)	114	113	113	113	113	113	113	114	114	114	114
Australian Dollar (C\$/A\$)	0.94	0.96	0.96	0.96	0.96	0.96	0.96	0.95	0.95	0.95	0.95
Versus Euro											
U.K. Pound (£/€)	0.87	0.87	0.87	0.87	0.87	0.88	0.88	0.88	0.88	0.88	0.88
Japanese Yen (¥/€)	184	182	182	182	182	182	182	182	182	182	182

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

Sources: BMO Economics, Haver Analytics

Interest Rate Forecasts

(% : avg.)	Actual 2026 Jan	Forecasts 2026									2026 Q4
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	
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	2.26	2.26	2.24	2.24	2.24	2.24	2.24	2.24	2.24	2.24	2.24
3-month bills	2.19	2.20	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15
6-month	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
1-year	2.36	2.30	2.30	2.30	2.35	2.35	2.35	2.35	2.35	2.35	2.35
2-year bonds	2.56	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
3-year	2.52	2.40	2.45	2.45	2.50	2.55	2.55	2.60	2.60	2.65	2.65
5-year	2.93	2.85	2.85	2.85	2.85	2.85	2.85	2.85	2.85	2.85	2.85
7-year	3.08	2.95	3.00	3.00	3.00	3.00	3.00	3.00	3.05	3.05	3.05
10-year	3.40	3.30	3.30	3.30	3.30	3.30	3.30	3.25	3.25	3.25	3.25
30-year	3.85	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	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
United States											
Fed funds target (period end)	3.63	3.63	3.63	3.63	3.63	3.38	3.38	3.38	3.13	3.13	2.88
Fed funds target	3.63	3.63	3.63	3.63	3.63	3.52	3.38	3.38	3.26	3.13	3.07
EFFR ³	3.64	3.64	3.64	3.64	3.64	3.54	3.39	3.39	3.27	3.13	3.07
SOFR ⁴	3.67	3.68	3.71	3.71	3.71	3.59	3.43	3.43	3.30	3.15	3.08
3-month bills	3.67	3.70	3.70	3.70	3.70	3.55	3.40	3.40	3.25	3.10	3.05
6-month	3.59	3.60	3.60	3.60	3.60	3.50	3.35	3.35	3.25	3.10	3.05
1-year	3.51	3.45	3.45	3.40	3.40	3.30	3.25	3.20	3.10	3.05	3.00
2-year notes	3.54	3.45	3.40	3.35	3.30	3.25	3.15	3.10	3.05	3.00	2.95
3-year	3.61	3.50	3.50	3.45	3.40	3.35	3.35	3.30	3.25	3.25	3.20
5-year	3.78	3.70	3.65	3.65	3.60	3.60	3.55	3.55	3.50	3.50	3.45
7-year	3.99	3.90	3.85	3.85	3.85	3.80	3.80	3.80	3.75	3.75	3.75
10-year	4.21	4.10	4.10	4.10	4.10	4.05	4.05	4.05	4.05	4.00	4.00
30-year bonds	4.84	4.75	4.75	4.75	4.70	4.70	4.70	4.70	4.65	4.65	4.65
Prime rate	6.75	6.75	6.75	6.75	6.75	6.65	6.50	6.50	6.39	6.25	6.19
Other G7											
ECB Deposit Rate ¹	2.00	2.00 ⁶	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
10yr Bund	2.85	2.85	2.80	2.80	2.80	2.80	2.75	2.75	2.75	2.75	2.70
BoE Bank Rate ¹	3.75	3.75 ⁶	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
SONIA ⁵	3.73	3.73	3.63	3.48	3.48	3.48	3.48	3.48	3.48	3.48	3.48
10yr Gilt	4.45	4.45	4.45	4.40	4.40	4.40	4.35	4.35	4.35	4.35	4.30
Boj O/N ¹	0.75	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.25	1.25	1.25
10yr JGB	2.19	2.20	2.21	2.22	2.23	2.24	2.25	2.26	2.27	2.28	2.29

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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