



# MONTHLY BOND LETTER

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## ECONOMIC EVENTS

- The stagnation of the Canadian economy continued in October. For the third month in a row, Canada's GDP stagnated as declining activity in goods-producing industries offset growth in services. The manufacturing industry was disrupted by the U.S. auto workers' strike. The construction industry also contracted under the weight of high interest rates. On the services front, industries linked to household consumption performed well. Retail trade (+1.2%), arts and leisure (+0.3%) and hotels and restaurants (+0.9%) all posted gains in October. As of October 2023, the economy has still grown (+0.9%), albeit slowly, but progress is being made nonetheless.
- U.S. retailers reported a 0.3% increase in sales in November, bringing annual growth to 4.1%. Lower prices at the pump led to a 2.9% drop in gas station sales. However, households took advantage of this respite to increase their spending on other goods. Sales at restaurants and bars (+1.6%), online retailers (+1%) and furniture stores (+0.9%) all recorded strong increases, as did car dealers (+0.5%) and clothing stores (+0.6%). Excluding petrol and vehicles, retail sales rose by a robust 0.6% in November.
- The UK economy contracted by 0.3% in October, meaning that GDP has stagnated over the last 3 months. Service industries posted a 0.3% decline, while industrial production (-0.8%) and construction (-0.5%) also contracted. In the year to October 2023, economic growth stood at 0.3%. Employment fell by 12,000 in November, after rising by 39,000 the previous month. As a result, the unemployment rate remained unchanged at 4.2%, 0.7% above its most recent trough.

## RATE TRENDS

- In line with expectations, the Federal Reserve held its key rate steady at 5.5%, indicating that economic growth has slowed from the sustained pace of the third quarter. The accompanying press release said little about current conditions, but surprised with its economic forecasts. According to the forecast summary, there would be no further rate hikes, and the Fed now expects to cut its key rate three times in 2024. As a result, the rate would end the year at 4.625%, compared with 5.125% forecast last September. Nor is this rate cut accompanied by a severe recession or slowdown, as the forecast for growth in 2024 (1.4%) is much the same as last September (1.5%). The unemployment rate is also unchanged from September.

## DECEMBER 2023



This weak progression is even more anemic when we consider that the population grew by 3.0% during this period. On a per capita basis, we're going backwards instead of forwards. For November, Statistics Canada expects slight growth of 0.1%. However, public-sector strikes in Quebec will hamper activity in the final month of the year. Fourth-quarter GDP could therefore post a second consecutive contraction, amounting to a technical recession. Do we need a definition to say that an economy that is stagnant when its population is growing by 3% is in recession?

It's also encouraging to see that financed items such as vehicles and furniture are seeing good sales growth despite the high rates. Crazy Friday and Cyber Monday seem to have benefited retailers. Consumer optimism is back in full force. Slower inflation, lower bond yields in the fourth quarter and the recent excellent performance of the stock markets all combine to provide a favorable backdrop for demand.

The economy is weakening, employment is slowing, and the annual inflation rate is falling, but still remains twice the target. These factors argue in favor of a halt to monetary tightening. However, wages are still rising at a rate (7.3%) incompatible with its inflation target. If the Bank of England wants to ensure that inflation expectations remain anchored at 2%, it cannot afford to declare victory on inflation any time soon.

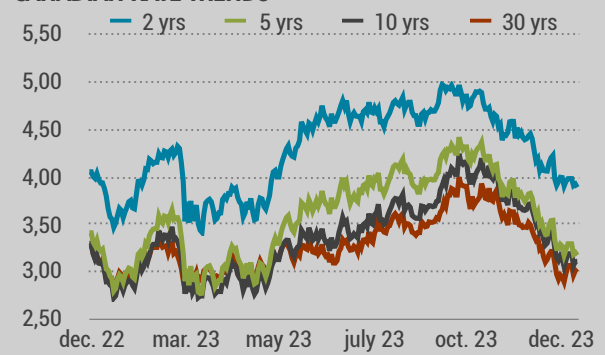
What's surprising about the Fed's December about-face is that it comes on the heels of the rapid fall in rates seen in the markets the previous month. Financial conditions had already eased in November, with rates falling, yield spreads contracting and stock market indices rising. This easing is already supporting growth. The risk is that further easing of financial conditions will reduce the likelihood of the Federal Reserve achieving its 2% inflation target, and that household inflation expectations will become entrenched at a higher level than before.

## BOND RATES

		Monthly Change	Change 2023		Monthly Change	Change 2023
Dec. 29, 2023						
Key Interest Rate	5,00 %	0,00 %	0,75 %	5,50 %	0,00 %	1,00 %
3 months	5,05 %	0,02 %	0,79 %	5,33 %	-0,06 %	0,99 %
2 years	3,89 %	-0,30 %	-0,16 %	4,25 %	-0,43 %	-0,18 %
5 years	3,18 %	-0,46 %	-0,24 %	3,85 %	-0,42 %	-0,16 %
10 years	3,11 %	-0,44 %	-0,19 %	3,88 %	-0,45 %	0,00 %
30 years	3,03 %	-0,32 %	-0,24 %	4,03 %	-0,47 %	0,07 %
RRB 30 years	1,30 %	-0,20 %	0,10 %			

Source: Bloomberg

## CANADIAN RATE TRENDS



## CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Change								
		Spread			5 yrs		10 yrs		30 yrs	
		5 yrs	10 yrs	30 yrs	month	2023	month	2023	month	2023
Royal Bank, Bail-in-debt	AA	130	165	195	-10	-35	-5	-35	-5	-35
Royal Bank, NVCC	A	185	230	270	-15	-40	-10	-40	-10	-40
Sun Life, subordinated debt	A	165	205	235	-10	-35	-10	-35	-10	-35
Hydro One	A high	85	115	140	-5	-25	-5	-25	0	-20
Enbridge Inc	BBB high	130	175	220	-15	-45	-15	-40	-10	-40
Altalink LP	A	85	115	140	-5	-20	-5	-20	0	-15
GTAA	A high	80	110	130	-5	-25	-5	-25	-5	-25
Bell Canada	BBB high	125	165	200	-5	-35	-15	-30	-10	-25
Rogers Communications	BBBL	145	185	230	-5	-35	-15	-40	-10	-40
Loblaw	BBB high	105	140	175	-5	-45	-10	-45	-5	-35
Canadian Tire	BBB	120	160	205	-5	-50	-10	-50	-5	-50
Province Québec	AA low	38	66	88	1	-8	-3	-6	0	-6
Province Ontario	AA low	40	68	90	1	-8	-3	-6	0	-5
CMHC	AAA	28	44	---	3	-8	2	-2		

Source: National Bank Financial

## CREDIT MARKET

- Canadian corporate bond new issuance totaled \$7.7 billion in December, down \$2.8 billion on the previous month and \$675 million less than in December 2022. In the last quarter of the year, the total was \$20.6 billion, \$950 million less than in the third quarter. For the full year 2023, bond financing totals \$95.2 billion, down 18% on 2022. This is in fact the lowest annual of new issuance total since 2018. Rising bond yields have therefore dampened corporate financing intentions.
- Limited visibility on Laurentian Bank's long-term strategic trajectory and weaker profitability prospects have taken their toll on DBRS Morningstar's credit rating. The agency reduced the Bank's credit rating from A(low) to BBB(high), while maintaining a negative outlook on the rating. It should be recalled that the Bank's management had undertaken a complete review of its strategic options during the summer, which resulted in the optimization of capital towards more profitable business units. The realization of this plan remains uncertain, and the Bank also encountered operational difficulties following a computer breakdown which paralyzed its activities for several days. These factors will have a negative impact on the Bank's earnings and growth prospects in the short and medium term. "The Bank is facing these fundamental changes and operational issues in an uncertain economic environment facing increasing headwinds," DBRS stated.
- Provincial bond performance recovered in the final quarter. They produced a return of 10.42% for the last three months of the year, taking performance for 2023 into positive territory at 7.31%. In the long-term sector, provincial bonds returned 15.04% in the last quarter and 9.21% for the year. This quarterly performance was largely due to a 0.78% drop in 30-year Government of Canada bond yields, but also to a compression of yield spreads over the quarter (-5 bps). Provincial bonds thus benefited from investors' attraction to riskier assets during the quarter, despite higher deficits due to more difficult economic conditions across the country.

## FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2023	2023
Universe	100 %	3,43 %	6,69 %
Short Term	42,4 %	1,51 %	5,02 %
Mid Term	28,9 %	3,66 %	6,13 %
Long Term	28,8 %	6,09 %	9,51 %
Federal	39,0 %	2,83 %	5,00 %
Provincial	33,8 %	4,22 %	7,31 %
Corporates	25,2 %	3,27 %	8,37 %
RRB		3,67 %	1,99 %

Source: ftse.com

The Bank will also need to shore up customer confidence in the wake of recent events. As at October 31, 2023, deposits from personal customers were down 1% quarter-on-quarter, while those from business customers were down 4% over the same period. By way of comparison, National Bank increased its personal customer deposits in the fourth quarter by 1.5% and its business customer deposits by 2.4%.

Speaking of difficult economic conditions, Quebec's GDP contracted at an annualized rate of 0.8% in the third quarter, following a 1.5% decline in the previous quarter. However, final consumption expenditure grew by 3.6% and investment by 1.2%. The decline is explained by international trade. It's dishonest to talk of a recession when final demand and employment are growing at the same rate.

## STRATEGIC POSITIONNING

The transition period in monetary policy is beginning. With inflation slowing, the bellicose tone of central banks has given way to greater flexibility. Some bankers have indicated their intention to keep rates high for an extended period, while others, like the Federal Reserve, are talking about cutting rates further in 2024. However, the economic climate is not conducive to this. The US economy is vigorous, the employment imbalance still favors workers, and household incomes are rising faster than inflation, helping to sustain consumption. Households are also less indebted, and their mortgage refinancing cycle is long, weakening the transmission of US monetary policy to the economy. On the other hand, the Canadian economy is weakening under the weight of rate hikes and frequent mortgage refinancing. Nevertheless, the Bank of Canada is not yet ready to give up in the face of the threat of inflation. In its speech, it remains concerned about the inflationary effect of immigration, which is exacerbating the housing shortage and pushing up rental prices. So, no rate cuts are planned by the Bank of Canada for the time being, even if economic conditions may indicate otherwise. Financial markets take a different view, predicting that the Bank will have to act in 2024 if it is to avoid a recession. Faced with economic weakness, it is more likely to cut its key rate before the Fed does.