MONTHLY BOND LETTER

ECONOMIC EVENTS

JANUARY 2024

- Canada's consumer price index fell by 0.3% in December, raising the annual variation from 3.1% to 3.4%. The annual inflation rate climbed because prices had fallen by 0.6% in December 2022 due to lower gasoline prices. This base effect driving the annual inflation upward will disappear in the months ahead, as the CPI recorded significant monthly gains at the start of 2023. For December, gasoline (-0.4%), clothing and footwear (-2.2%) and travel packages (-18.2%) pulled the price index down. By contrast, air fares (+31.1%), mortgage interest costs (+1.8%) and rents (+0.7%) contributed to inflation. In the year to December 2023, rents rose by 7.7%, compared with 7.4% the previous month.

The structural housing shortage is putting upward pressure on inflation, which the Bank of Canada is proving powerless to address. The all-items price index may weaken in coming months, but the core inflation measures tracked by the Bank of Canada remain high and persistent. The average of these two indicators was 3.65%, compared with 3.55% in November. Even though GDP per capita is down more than 2% since its peak, the Bank of Canada believes that the economy still requires high rates to bring inflation back on target. No more new hikes, however

- After growing at an annualized rate of 4.9% in the third quarter, U.S. GDP posted annualized growth of 3.3% in the final quarter of the year. The US economy is estimated to have grown by 2.5% for 2023, 0.6% faster than the previous year. Consumer spending remained robust (+2.8%), as did business investment (+1.9%). Investment in residential property also increased (1.1%), but at a slower pace than in the previous quarter (+6.7%). Nevertheless, this was a second positive quarter after 9 consecutive quarters of decline, despite higher financing rates. Government spending and foreign trade also contributed to growth in the final quarter.

This consumer resilience can be explained by the historic deleveraging of American households since 2008, and a slower monetary policy transmission mechanism than in Canada. Indeed, although the cost of financing has soared over the past 2 years, the effective rate on mortgages has risen only slightly. The majority of American households financed their property before the pandemic with a 30-year mortgage. Since debt servicing as a proportion of disposable income is still low, it's hard to envisage many rate cuts.

- The Chinese economy has succeeded in reaching its growth target for 2023. Did anyone doubt it? China's GDP grew by 1.0% quarter-on-quarter in December, taking annual growth to 5.2%, 0.2% above the leaders' target. Industrial production propelled the economy last quarter with annual growth of 6.8%, 0.2% higher than in the previous quarter. Consumers are still contributing to growth, but are more timid. Retail sales posted an annual increase of 7.4%, significantly weaker than in the third quarter (+10.1%).

All in all, this economic performance is disappointing, as the post-Covid recovery was expected to be more vigorous. Calls for economic support will resurface, but the authorities will be cautious before acting. Private sector over-indebtedness continues to worry the authorities, who dare not stimulate the economy further with easy credit.

RATE TRENDS

- Both the Bank of Canada and the Federal Reserve kept their policy rates unchanged at their respective meetings this month. Both also made it clear that the period of monetary tightening is over, and that they prefer to adopt a more passive stance given that the risks associated with inflation and employment are now better balanced. The Bank of England and the ECB have also extended their pause in monetary policy. For the Bank of Canada, conditions have not been met to ease financial conditions. A return to the inflation target is not expected before next year, and wage growth of around 4% to 5% is a cause for concern if the objective of price stability is to be achieved. A reduction in the key interest rate will occur this year, it is simply delayed.

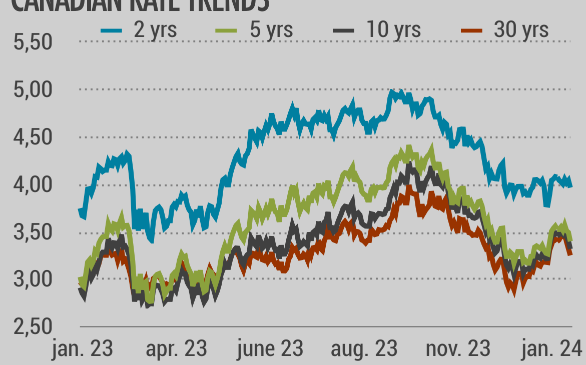
You can't stop an investor's heart from loving rate cuts, but the market's expectations of policy rate cuts are too aggressive. Central banks have had to set the record straight. The normalization of world production chains and the fall in energy prices have taken their toll on goods inflation. However, the consumer basket is also made up of services, and price pressures are still present in these industries. Central banks therefore want to ensure that the whole basket is moving convincingly and steadily towards the inflation target before easing financing conditions.

BOND RATES

Jan. 31, 2024		Monthly Change	Change 2024		Monthly Change	Change 2024
Key Interest Rate	5,00 %	0,00 %	0,50 %	5,50 %	0,00 %	1,00 %
3 months	5,02 %	-0,04 %	-0,03 %	5,36 %	0,03 %	0,03 %
2 years	3,97 %	0,08 %	0,08 %	4,21 %	-0,04 %	-0,04 %
5 years	3,40 %	0,23 %	0,23 %	3,84 %	-0,01 %	-0,01 %
10 years	3,32 %	0,21 %	0,21 %	3,91 %	0,03 %	0,03 %
30 years	3,26 %	0,22 %	0,22 %	4,17 %	0,14 %	0,14 %
RRB 30 years	1,51 %	0,21 %	0,21 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2024	Change 10 yrs month	Change 10 yrs 2024	Change 30 yrs month	Change 30 yrs 2024
Banque Royale, dette recapitalisation interne	AA	120	155	185	-10	-10	-10	-10	-10	-10
Banque Royale, dette subordonnée FPUNV	A	170	215	255	-15	-15	-15	-15	-15	-15
Sun Life, dette subordonnée	A	145	185	215	-20	-20	-20	-20	-20	-20
Hydro One	A high	80	110	140	-5	-5	-5	-5	0	0
Enbridge Inc	BBB high	130	170	220	0	0	-5	-5	0	0
Altalink LP	A	80	110	140	-5	-5	-5	-5	0	0
GTAA	A high	70	100	125	-10	-10	-10	-10	-5	-5
Bell Canada	BBB high	120	160	200	-5	-5	-5	-5	0	0
Rogers Communications	BBBL	135	175	220	-10	-10	-10	-10	-10	-10
Loblaw	BBB high	105	140	180	0	0	0	0	5	5
Canadian Tire	BBB	120	160	210	0	0	0	0	5	5
Province Québec	AA low	39	68	88	1	1	2	2	0	0
Province Ontario	AA low	41	70	89	1	1	2	2	-1	-1
SCHL	AAA	29	40	---	1	1	-4	-4		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totaled $12.6 billion in January, up $4.9 billion on the previous month and $2.7 billion more than in January 2023. The major Canadian banks were active at the start of the year, with 3 large-scale borrowings, each with a 5-year term. CIBC borrowed $1.25 billion, while TD Bank and BNS Bank each issued $2 billion. The sum of all bank debt accounted for 48% of new issues during the month.

- The spectre of the US regional bank crisis in March 2023 returned to haunt investors at the end of January. New York Community Bancorp announced a loss of $185 million in the fourth quarter of its fiscal year due to significant provisions for credit losses totaling $552 million. A significant portion of this provision relates to its commercial real estate loan portfolio, notably office buildings, where occupancy rates have remained low since the pandemic. To strengthen its balance sheet and reconstitute its capital, the bank also announced a 70% reduction in its dividend. Deutsche Bank has also made provisions for losses in commercial real estate in the United States. These totaled €123 million in the last quarter, 4 times more than in the same period last year. For Deutsche Bank, certain loans will have to be refinanced at a time when property values are being eroded by vacancy.

- Quebec's Finance Minister seems to be setting the table for a postponement of the balanced budget which, at the time of the economic update at the end of 2023, was forecast for the 2027-28 fiscal year. As is the case across the country, the economy is expected to slow in 2024, thereby reducing the province's income tax revenues. At the same time, the agreement reached between the Legault government and the various Front Common unions should boost government spending. Quebec has agreed to pay wage increases of 17.4% over five years. The salaries of 600,000 workers will jump by 8.8% starting this year - taking into account the 6% increase granted for 2023 and the 2.8% increase applicable from April 1, 2024. The agreement has yet to be approved.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Jan. 2024	2024
Universe	100 %	-1,37 %	-1,37 %
Short Term	42,6 %	-0,18 %	-0,18 %
Mid Term	29,1 %	-1,22 %	-1,22 %
Long Term	28,2 %	-3,28 %	-3,28 %
Federal	39,3 %	-1,20 %	-1,20 %
Provincial	33,5 %	-2,05 %	-2,05 %
Corporates	25,2 %	-0,68 %	-0,68 %
RRB		-2,95 %	-2,95 %

Source: ftse.com

The problems of the regional banks have migrated from a liquidity crisis last year to a credit problem today. The quality of the assets held by certain banks is being called into question, resulting in losses for shareholders. Commercial real estate does not have the same influence on banks as residential real estate, but the regional banks are very present in this sector, with the majority of loans granted.

With 2 months left in the fiscal year ending March 31, the Quebec government has almost completed all of its financing requirements, i.e. 97% of the planned amount to be borrowed. Even if the government postpones a return to balanced budgets, its sound borrowing program management through frequent pre-financing should not cause too much concern for provincial spreads.

STRATEGIC POSITIONNING

Central banks have gradually moved away from their restrictive monetary stance to adopt a more balanced stance on inflation and employment risks. They don't want to declare victory in the battle against inflation, because in many countries, service prices and wage growth remain persistently high. The Canadian economy would need a monetary shot in the arm to avoid a deep recession, but the Bank of Canada has to contend with the strength of our main trading partner's economy. The effect of rate hikes is not the same on the personal finances of American households. Household indebtedness is lower in the US, and the monetary policy transmission mechanism is longer due to 30-year fixed mortgages. The manufacturing sector has recently risen from the ashes, thanks to the explosion in investment in this sector over the past two years. There is, however, a new shadow over the balance sheet of US regional banks. Although commercial real estate loans account for only 7% of the assets of all banks, they account for 18% of the assets of the smallest US banks. This proportion includes loans for commercial, industrial and office buildings. Since it is only office buildings that seem to be problematic, their weight is around 2% of all bank assets, and less of a threat to the economy as a whole.