

MONTHLY BOND LETTER

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ECONOMIC EVENTS

AUGUST 2025

- After growing 2.0% in the first quarter, Canada's GDP contracted by 1.6% on an annualized basis over the following three months. As anticipated, Canadian exports fell under the weight of tariffs, dropping 26.7% after a 5.8% increase in the winter. Canadian retaliatory measures also curbed imports (-5.1%). Uncertainty undermined business confidence, leading companies to cut investments by 10.1%. However, there are positives behind this negative headline. Household consumption spending jumped 4.5% in the second quarter after a modest 0.5% increase in the previous quarter, driven by vehicle purchases amid tariff concerns. Federal elections supported government spending (+5.1%), while residential real estate rose 6.3%, fueled by new construction and pent-up demand.
- Employment is now at the center of concerns for investors and the Federal Reserve. The U.S. economy added only 22,000 workers in August, a monthly gain well below expectations. The latest revision of June's figures now shows a decline of 13,000 jobs. The August increase was concentrated in the services sector (+63,000), mainly in health and education (+46,800). The labor force also grew in August, but the economy was not strong enough to absorb this increase, pushing the unemployment rate from 4.2% in July to 4.3% the following month, its highest level since October 2021. This employment report adds to other indicators pointing to a less vigorous labor market.
- China narrowly avoided a return to deflation. The consumer price index rose 0.4% in July, its fastest pace since January. Despite this increase, the annual inflation rate fell from 0.1% to 0%. Excluding energy and food, core inflation recorded a modest annual increase of 0.8%, still its fastest pace in 17 months. On the other hand, deflation remains among producers: the producer price index fell 3.6% year-over-year, marking the 34th consecutive month of deflation.

RATE TRENDS

- The Federal Reserve has opened the door to monetary easing. During his speech at the annual central bank symposium in Wyoming, Jerome Powell indicated that the balance of risks between employment and inflation has shifted. While he acknowledged that inflation could rise again under the impact of tariffs, Powell now believes these effects will remain temporary. Conditions in the labor market appear less robust than before, particularly due to the downward revisions of May and June employment figures. Consequently, the lack of momentum in the labor market suggests that tariff-driven imported inflation is unlikely to feed into wages, thereby limiting the risk of inflationary spirals that the Fed fears. According to them, monetary policy is currently slightly restrictive, and an adjustment may soon be required.

In sum, the contraction was more severe than expected, but some details are encouraging. Excluding international trade and inventory fluctuations, final domestic demand posted solid growth of 3.5%, driven by vehicle purchases. However, over the longer term, obstacles to growth remain. The labor market is less dynamic, limiting wage growth. The household savings rate fell by 1 percentage point to 5%, reducing future consumption capacity. In addition, the decline in immigration represents a headwind for the Canadian economy.

Average job creation over the past three months stands at just 29,000, compared with 206,000 in December 2024.

Employment is less robust, though not collapsing—a scenario the Federal Reserve is striving to avoid at all costs. The Fed is well aware that job losses tend to be self-reinforcing, increasing the risk of a recession. On the other hand, retail trade (+10,500) and leisure and hospitality services (+28,000) contributed to employment, reflecting a degree of resilience in the U.S. economy.

The difficulties weighing on the Chinese economy persist. The slump in the real estate sector continues, undermining household confidence. The absence of a social safety net pushes households to save during periods of uncertainty, which also dampens domestic demand. Faced with industrial overcapacity, producers are therefore lowering their prices to sell off their goods.

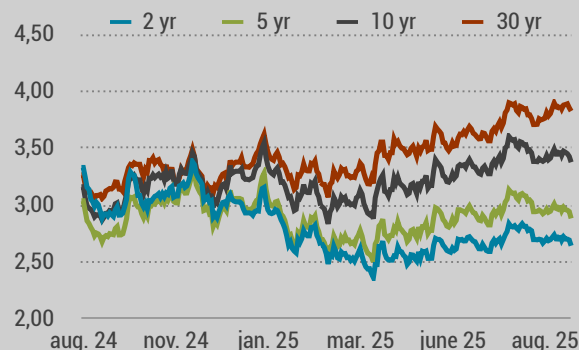
Clearly, the U.S. labor market has lost some of its strength. There are no massive layoffs, but rather a hiring freeze due to the uncertainty linked to tariffs. However, the decline in the labor force in recent months—particularly because of slower immigration—means that the economy now requires less job creation to maintain full employment. To prevent a sharp drop in employment, the Fed will want to cut its policy rate to support the economy. That said, the economy is still growing above its potential pace. If uncertainty subsides, will this monetary easing fuel inflation?

BOND RATES

		Monthly Change	Change 2025		Monthly Change	Change 2025
Aug. 31, 2025						
Key Interest Rate	2,75 %	0,00 %	-1,75 %	4,50 %	0,00 %	-1,00 %
3 months	2,67 %	-0,02 %	-0,48 %	4,14 %	-0,20 %	-0,18 %
2 years	2,64 %	-0,13 %	-0,29 %	3,62 %	-0,34 %	-0,62 %
5 years	2,88 %	-0,14 %	-0,08 %	3,70 %	-0,27 %	-0,69 %
10 years	3,38 %	-0,08 %	0,15 %	4,23 %	-0,14 %	-0,34 %
30 years	3,82 %	0,06 %	0,49 %	4,93 %	0,03 %	0,15 %
RRB 30 years	1,75 %	0,02 %	0,30 %			

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	2025	month	2025	month	2025
Royal Bank, Bail-in-debt	AA	80	105	135	10	0	10	0	10	-5
Royal Bank, NVCC	A	115	145	185	0	-10	0	-15	0	-20
Sun Life, subordinated debt	A	100	130	170	10	5	10	-5	10	-5
Hydro One	A high	55	85	110	10	-5	5	-5	5	-10
Enbridge Inc	A low	95	135	165	5	5	10	10	10	-10
Altalink LP	A	55	85	110	10	-5	5	-5	5	-10
GTAA	A high	50	80	105	5	-5	5	-5	5	-10
Bell Canada	BBB	95	130	160	10	-5	5	-15	10	-30
Rogers Communications	BBBL	95	135	160	5	-10	5	-15	10	-30
Loblaw	BBB high	75	110	140	10	0	5	-5	10	-20
Canadian Tire	BBB	95	130	165	10	-10	5	-15	10	-30
Province Québec	AA low	17	58	87	-2	-7	-1	-7	1	-3
Province Ontario	AA low	19	57	84	0	-5	1	-5	0	-2
CMHC	AAA	12	30	-	1	-1	0	-6		

Source: National Bank Financial

CREDIT MARKET

● Canadian corporate bond new issuance reached \$11.5 billion in August, up \$1.5 billion from the previous month and \$2.8 billion more than in August 2024. Since the beginning of the year, total bond financing amounts to \$88.6 billion, 2.1% higher than at the same time last year. This marks the busiest August on record, with 29 issues from 21 different issuers. Among them was a Maple bond issuance by McDonald's Corporation (BBB) worth \$750 million for a 7-year term. In our view, this bond offered an insufficient yield spread (0.85%) compared with a Canadian bank, given that the company may use the proceeds of this issuance to pay dividends and repurchase common shares.

● The Canadian banking system once again demonstrated its strength. In the third quarter of their fiscal year, the six major Canadian banks collectively generated \$61.5 billion in revenue, up 11.8% from the third quarter of 2024. They also reduced their loan-loss provisions by \$1.2 billion compared with the previous quarter, bringing them down to \$5.2 billion. In recent quarters, banks had prepared for potential defaults on commercial loans, credit cards, and mortgages due to the trade war with the United States. As the impact proved smaller than expected, they posted profits totaling \$17.2 billion, up 16.9% from the previous quarter.

● After only one quarter into their fiscal year, some provinces have already revised their public accounts. Alberta, for instance, now projects a deficit of \$6.5 billion for fiscal 2025-2026, \$1.3 billion more than budgeted. The recent weakness in oil prices and the appreciation of the Canadian dollar have resulted in a \$1.4 billion shortfall in resource revenues compared with initial forecasts. The \$4 billion contingency reserve in the budget was also cut by \$1.5 billion, reflecting a lower-than-expected surplus for fiscal 2024-2025. Saskatchewan has also been hit by falling oil prices and now forecasts a deficit of \$349 million, instead of a surplus of \$12.2 million for 2025-2026.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Aug. 25	2025
Universe	100 %	0,37 %	1,07 %
Short Term	41,6 %	0,56 %	2,69 %
Mid Term	31,6 %	0,87 %	2,53 %
Long Term	26,8 %	-0,50 %	-2,95 %
Federal	42,1 %	0,53 %	1,15 %
Provincial	31,6 %	0,29 %	-0,08 %
Corporates	24,5 %	0,21 %	2,47 %
RRB		0,42 %	1,02 %

Source: ftse.com

The impact of tariffs on the Canadian economy has been less pronounced than Canadian banks had anticipated. Just over 90% of Canadian exports to the United States were exempt from tariffs in June, as the products complied with the Canada- United States-Mexico Agreement (CUSMA).

The revisions affect the oil-producing provinces, due to a decline in royalties. However, the situation could be different for provinces where the manufacturing sector plays a larger role. Budget forecasts had anticipated a sharp deterioration in conditions, but the high proportion of exports exempted from tariffs should limit the impact on public finances.

STRATEGIC POSITIONNING

After several years of closely monitoring risks associated with a resurgence of inflation, the Federal Reserve is now focusing its attention on the labor market and the risks of deviating from full employment. Several recent indicators suggest a slowdown in labor market strength linked to economic uncertainty. The Fed therefore appears open to resuming monetary easing as early as September. Trump will finally get the rate cut he has long demanded—but not for the reasons he cites. He seeks a lower policy rate in a flourishing economy, supported by a robust labor market that he attributes to his policies. These elements are highly contradictory. If the Fed lowers the rate, it is to revive an economy showing signs of fatigue. This rationale for monetary policy could be undermined as Trump attempts to take control of the Fed's Board of Governors. Allegations of fraud against Lisa Cook illustrate this. Such political influence over the Federal Reserve is concerning. The control of inflation in recent decades is certainly attributable to central bank independence, but even more so to globalization and increased competition. As the United States seeks to move away from international trade and repatriate some production domestically, the Fed's independence appears as a key safeguard against inflation. If it is compromised, long-term inflationary risks will be higher.