

# MONTHLY BOND LETTER

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Capital

## ECONOMIC EVENTS

AUGUST 2023

- Canadian GDP contracted by 0.2% in June and by 0.2% annualized in the second quarter. This was the second contraction in the last three quarters. Forest fires in the west of the country in June disrupted activity in the agriculture, forestry, mining and oil & gas extraction industries. Nevertheless, fires alone cannot explain the spring contraction. Households were more cautious, as their spending grew at an annualized rate of 0.2%, compared with 4.7% in the previous quarter. The construction sector posted its fifth consecutive quarterly decline in the spring (-8.2%), despite the rising population and a housing shortage. International trade also hampered growth in the second quarter. By contrast, business investment in machinery and fixed assets contributed to grow.
- The U.S. labor market has been showing signs of slowing lately. Employment rose by 187,000 in August, the third consecutive month of gains below 200,000. Employment is up in the healthcare industry, as well as in leisure and hospitality and construction. On the other hand, the transportation and warehousing industry lost 34,000 jobs following the bankruptcy of the Yellow trucking company, which left almost 30,000 workers unemployed. The Hollywood actors' strike also disrupted employment. The Bureau of Labor Statistics also made revisions to the previous two months that reduced employment by 110,000 positions.
- China's consumer price index rose by 0.2% in July, following 5 consecutive months of decline. However, this monthly increase was insufficient to prevent the annual inflation rate from falling into negative territory. For the first time since February 2021, China is experiencing deflation, with prices falling by 0.3% over the past 12 months. The Chinese authorities believe that deflation will be temporary, as the effects of comparison with last year's high prices should stop pushing inflation down.

The slowdown in household spending is even more significant when we consider that nominal compensation of employees jumped by 9.1% annualized over the same period. Households prefer savings to consumption. The rise in the key interest rate is slowing down the economy and also complicating the task of property developers. With high financing rates, higher materials costs and a labor shortage, contractors have to sell homes at prices that are too high if they are to make a profit. Rents would be too expensive for some of the pending demand.

Job creation is therefore less robust than before, and companies are also looking for fewer workers. Indeed, the number of job vacancies fell by 338,000 in July to 8.8 million, its lowest level since March 2021. The imbalance in the labor market is still high, but is gradually easing. The Federal Reserve would welcome a deceleration in wages.



To revive its recently faltering economy, the People's Bank of China has announced a 0.10% cut in the prime lending rate on 1-year loans to 3.45%, a new all-time low. This rate cut will not encourage households to consume more. In times of uncertainty, the Chinese tend to save rather than consume.

## RATE TRENDS

- After raising its key rate by 0.25% in June and July, the Bank of Canada decided to maintain it at 5% at its September 6 meeting. The Bank believes that the Canadian economy has entered a period of weaker growth, due to a slowdown in household spending and moderate credit growth. Monetary policy may therefore have dampened consumer enthusiasm. The construction sector is also continuing to contract under the weight of high mortgage rates. The labor market is less tight, but wages are still rising too fast (4-5%). Inflation is therefore not being tackled, and may require a further rate hike. The Bank therefore prefers to analyze the effect of cumulative increases, which are felt with a time lag, before making any further changes.

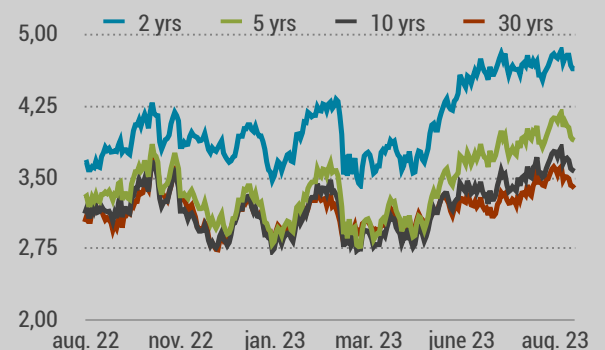
This was to be expected. It was more difficult to justify raising the policy rate when we had just learned that the economy had contracted in the spring. The objective of monetary policy is to weaken excess demand in the economy and eventually restore price stability. For the Bank, its actions are beginning to restore the balance between supply and demand in the economy. However, underlying inflationary pressures are still too high to declare victory. Oil prices are another factor to watch. OPEC+ seems determined to keep oil prices high, announcing production cuts after a price weakness.

## BOND RATES

		Monthly Change	Change 2023		Monthly Change	Change 2023
Aug. 31, 2023						
Key Interest Rate	5,00 %	0,00 %	2,50 %	5,50 %	0,00 %	3,00 %
3 months	5,14 %	0,08 %	0,88 %	5,44 %	0,04 %	1,09 %
2 years	4,65 %	-0,03 %	0,59 %	4,86 %	-0,01 %	0,44 %
5 years	3,89 %	-0,01 %	0,48 %	4,25 %	0,08 %	0,25 %
10 years	3,56 %	0,06 %	0,26 %	4,11 %	0,15 %	0,23 %
30 years	3,39 %	0,08 %	0,11 %	4,21 %	0,20 %	0,25 %
RRB 30 years	1,60 %	0,06 %	0,41 %			

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	150	185	215	10	-15	10	-15	10	-15
Royal Bank, NVCC	A	210	255	295	10	-15	10	-15	10	-15
Sun Life, subordinated debt	A	185	225	255	5	-15	0	-15	5	-15
Hydro One	A high	95	125	145	0	-15	0	-15	0	-15
Enbridge Inc	BBB high	150	200	240	5	-25	5	-15	5	-20
Altalink LP	A	95	125	145	0	-10	0	-10	0	-10
GTAA	A high	90	120	140	0	-15	0	-15	0	-15
Bell Canada	BBB high	145	190	220	0	-15	5	-5	5	-5
Rogers Communications	BBBL	175	225	260	0	-5	0	0	5	-10
Loblaw	BBB high	125	165	195	-5	-25	0	-20	5	-15
Canadian Tire	BBB	145	195	240	-5	-25	5	-15	10	-15
Province Québec	AA low	45	71	91	-3	-1	2	-1	2	-3
Province Ontario	AA low	47	72	92	-2	-1	1	-2	2	-3
CMHC	AAA	35	45	---	-5	-1	0	-1		

Source: National Bank Financial

## CREDIT MARKET

- Canadian corporate bonds new issuance totalled \$4.2 billion in August, down \$2.1 billion on the previous month and \$2 billion less than in August 2022. Year-to-date, bond financing totals \$59.5 billion, down 23% on the same period last year. The new issues calendar is often devoid of activity in August due to the summer vacations. However, the sum of new issues this month is equivalent to the 10-year average for August. The second least active month is December, also due to vacations.
- RBC Bank has announced its financial results for the quarter ending July 31. The bank's revenues totaled \$14.5 billion, up 19.5% on the same period last year. Higher interest rates boosted revenues from personal and commercial banking activities. The insurance segment also reported higher sales during the quarter. However, the bank's net income remained essentially unchanged, rising from \$3.85 billion in the third quarter last year to \$3.87 billion this year. The economic slowdown forced the bank to increase its provisions for credit losses by \$276 million to \$616 million at July 31. The bank also had to contend with an increase in non-interest expenses. These totaled \$7.86 billion at the end of the quarter, a jump of 23% on the same period last year and 4.9% higher than the previous quarter.
- The province of Alberta released an economic update reiterating its forecast of a \$2.4 billion surplus set when the 2023-24 budget was tabled. Oil prices (WTI) were weaker than expected due to lower global demand, but the spread between Canadian (WCS) and U.S. (WTI) oil prices narrowed. In short, oil royalty revenues declined. On the other hand, strong population growth boosted tax revenues, as well as the province's overall income compared to budget. Expenses also rose at the same pace as revenues, and the province had to draw on its contingency reserve to pay bills related to the spring forest fires.

## FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2023	2023
Universe	100 %	-0,18 %	1,19 %
Short Term	42,6 %	0,37 %	1,29 %
Mid Term	28,8 %	-0,07 %	0,64 %
Long Term	28,7 %	-1,12 %	1,51 %
Federal	38,8 %	0,00 %	0,38 %
Provincial	33,9 %	-0,45 %	1,08 %
Corporates	25,3 %	-0,09 %	2,51 %
RRB		-1,35 %	-4,26 %

Source: ftse.com

After increasing its headcount by more than 7% in 2022, the bank has decided to reduce its workforce in order to control expenses at a time when banking activities are slowing down. The bank had 93,753 employees on the payroll as of July 31. While some will lose their jobs in Canada, the bank has operations in 27 different countries, and the planned reduction will also affect workers abroad.

The province of Alberta's revenues will be underpinned by a number of factors this year. Population growth, international interest in Canada's politically secure oil and the willingness of OPEC+ members to set a floor price for world oil. The budget surplus could therefore be applied to debt repayment, improving the province's fiscal situation.

## STRATEGIC POSITIONNING

The period of rising key interest rates is drawing to a close. There may still be some minor adjustments to be made, but central bankers believe that the delayed effect of the cumulative hikes will slow the economy sufficiently in the coming months to bring monetary tightening to an end. Have they raised rates too much, and will they make a U-turn soon? To answer this question, we need to assess whether the pre-pandemic economic climate will still prevail. The 2010s are characterized by a period of deleveraging of US households, cheap labor from China, access to a multitude of inexpensive goods and an absence of inflationary pressures. This deleveraging means that monetary tightening in the US is less likely than before to slow the economy. Moreover, globalization is set to change the face of the world economy completely. The pandemic has highlighted the shortcomings of long supply chains, while the war in Ukraine has reshaped the map of geopolitical alliances, forcing companies to develop production alternatives that are often more costly. An ageing population and the energy transition are also important structural factors that are changing the economic climate compared with the last decade. As a result, key interest rates may soon reach their peak, but the new economic climate means that they could remain high for a long time to allow inflation to return to its target.