

The Yield Curve

November 28, 2008

New measures will be taken as deflation risks intensify Bond rates will keep declining

HIGHLIGHTS

- A substantial period of disinflation has begun: The 10-year rates seem to be poised to close in on 1950 lows. The U.S. yield curve will continue to flatten.
- The Federal Reserve is taking more and more unconventional measures: buying up MBS (mortgage-backed securities) from the agencies should put downward pressure on longer-term interest rates, but the need for a zero rate policy seems inevitable.
- The Bank of Canada will speed up the pace of monetary easing. As inflation is quickly receding, the key rate could go to a record low of 1.0% in 2009.
- The economic and financial situation will keep Canadian bond rates very low in the next few quarters.

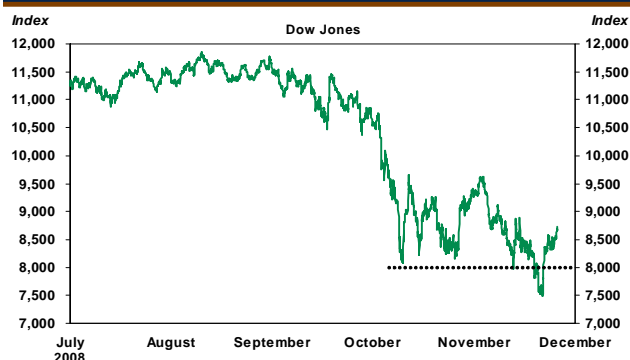
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Summary

Hopes of seeing the financial system consolidate evaporated in November. The publication of several statistics that showed that economic activity had deteriorated more than anticipated, the uncertainty created by the struggles of the big three automakers and, in particular, the U.S. Treasury's change of heading regarding the use of the Troubled Assets Relief Program (TARP) revived the fears of financial market investors. After testing its October 8 low, the American stock market went further in November, driving the main indexes to their lowest points since 1997, and correcting over 50% in the space of about a year (graph 1).

Graph 1 – The stock market rebounded from a new low ...



Sources: Bloomberg and Desjardins, Economic Studies

With Tim Geithner's well-received appointment as the Obama administration's Treasury Secretary and the Citigroup bailout plan¹, New York was able to recover some of the losses

¹ On November 24, 2008, the U.S. Treasury announced that it would guarantee the securities held by Citigroup for up to US\$306B. The Treasury also committed to injecting US\$20B into the institution. This follows the US\$25B injection the bank received under the TARP in October. In exchange for the cash and guarantees, the Treasury will receive US\$27B in preferred shares paying an 8% dividend.

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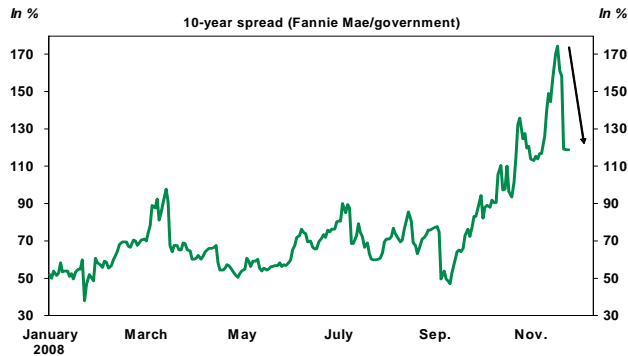
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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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in the last few days. Moreover, measures implemented by the Federal Reserve (Fed) to purchase mortgage-backed securities (MBS) lead to a narrowing of agency credit spreads, but the situation is still highly fragile (graph 2).

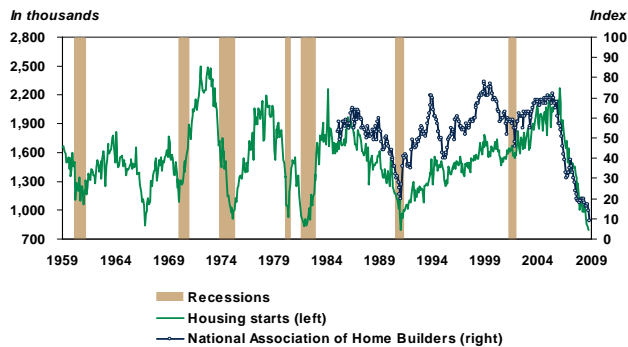
Graph 2 – ...and the agencies' credit spreads received a boost from the Fed's announcement that it would buy up MBS



Sources: Bloomberg and Desjardins, Economic Studies

October's economic figures are clear. The housing market's slide is taking on bottomless proportions, with the lowest level of starts ever recorded and unparalleled pessimism among American home builders (graph 3).

Graph 3 – The housing market remains fragile

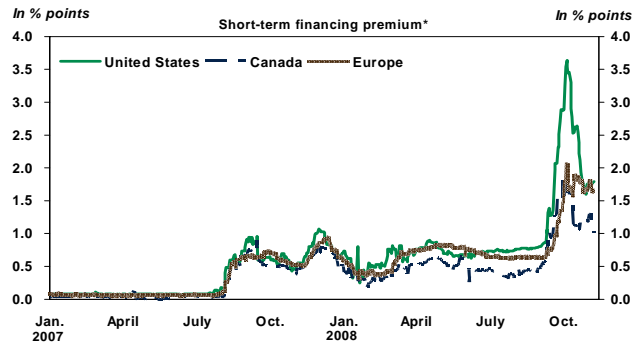


Sources: Datastream and Desjardins, Economic Studies

And there is nothing to show that the situation is nearly ironed out. While interbank money market spreads have resolved somewhat (graph 4), retail rates are still feeling the impact of the climate of uncertainty. Higher mortgage interest rates combined with drastically tightened credit conditions at banks do not promise an imminent turnaround by the real estate market (graph 5).

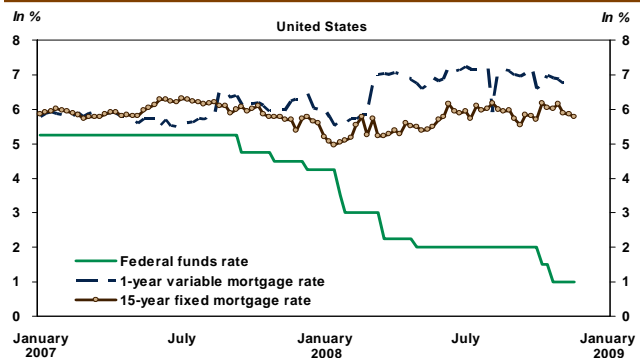
American consumers are increasingly affected as well. Already hurt by the loss of wealth associated with the decline in home prices and stock market correction, consumers are facing an acceleration in job losses (graph 6), which will keep downside pressure on wages.

Graph 4 – Financing spreads are gradually resolving...



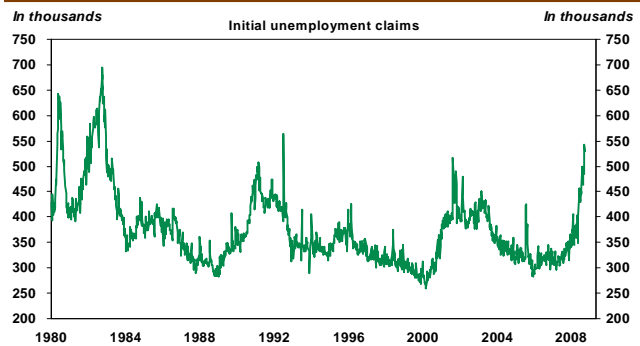
* Spread between the 3-month Libor rate and overnight swap rates.
Sources: Bloomberg and Desjardins, Economic Studies

Graph 5 – ...but retail rates are still higher than they were at the beginning of the crisis



Sources: Bloomberg and Desjardins, Economic Studies

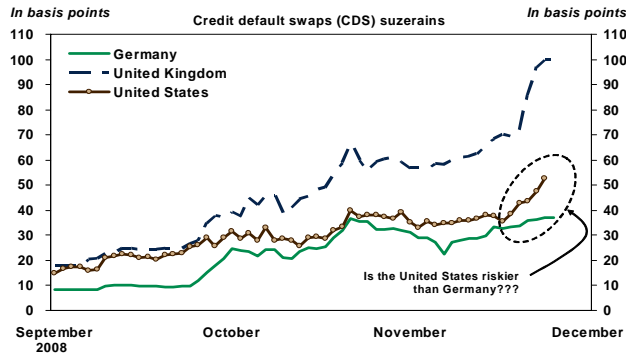
Graph 6 – The labour market deteriorates further



Sources: Datastream and Desjardins, Economic Studies

Under these conditions, it is a given that President Elect Barack Obama is busy putting together a recovery plan to create almost 2.5 million jobs over the next two years. The colossally expensive plan (near US\$700B, or 4-5% of the GDP), added to the substantial number of financial and tax measures already in place, will sustain the discussions about the U.S. government's ability to finance deficits (graph 7).

Graph 7 – The increase in the U.S. debt is starting to weigh heavily on the American default risk

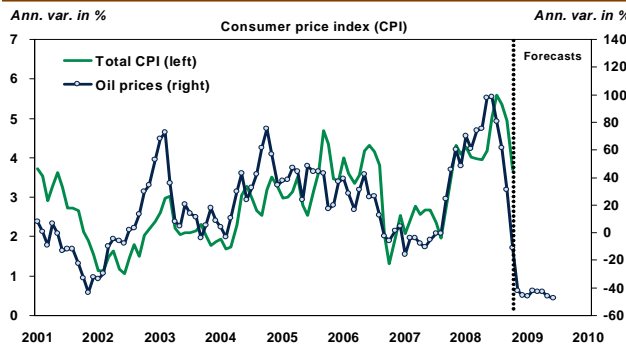


Sources: Bloomberg and Desjardins, Economic Studies

However, we are confident that, against the backdrop of an increase in surplus production, bank deleveraging, a return to savings and massive job losses, deflation will remain 2009's dominant theme.²

Like several of the other economic statistics published for October, the results for inflation provide yet more evidence of contracting activity in the economy south of the border. The period of disinflation (decline in the rate of price growth) we had been expecting is now well underway (graph 8). The minutes of the last Fed meeting agree:

Graph 8 – Energy prices' sharp drop should quickly slash total inflation



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

“[...] participants generally expected inflation to decline to levels consistent with price stability. Others, though, saw a risk that if resource utilization remained weak for some time, inflation could fall below levels consistent with the Federal Reserve's dual mandate for promoting price stability and maximum employment, a development that would pose important

² See November 4's *The Yield Curve* for more details on why not to worry about the increase in the debt.

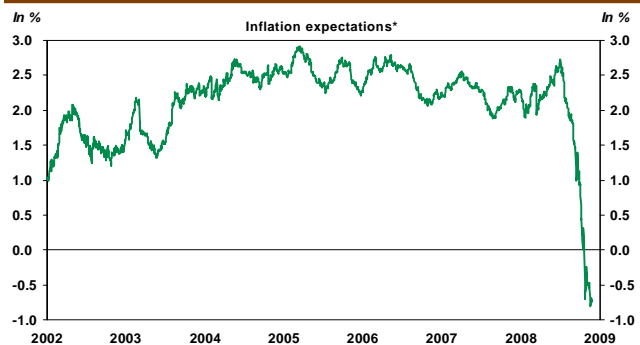
policy challenges in light of the already-low level of the Committee's federal funds rate target.”

The precariousness of consumers' situation is reflected in clothing prices, which dipped 1.0% that month. Transport prices are also down substantially, a result of the tumble by gas prices (-13.9%), as well as a third straight drop in prices for the new and used vehicle component (-0.7%). Core inflation (which excludes food and energy) thus exceeded our forecast to the downside, recording its first monthly drop since the recession in the early 80s.

Thanksgiving (November) and Christmas (December) sales promise to be critical for core inflation (which excludes food and energy). A soft patch could translate into larger than usual holiday discounts, which could quickly take core inflation close to 1%, a situation that would concern the Fed.

In our opinion, given that inflation expectations have been slashed (graph 9), the Fed will have to privilege a zero interest rate policy (ZIRP) and commit to keeping rates low as long as necessary.

Graph 9 – The markets are focused on possible deflation

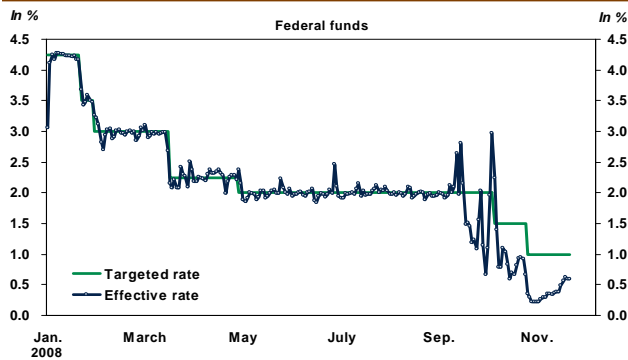


*Derived from 5-year Treasury Inflation Protected Securities (TIPS).
Sources: Bloomberg and Desjardins, Economic Studies

For technical reasons,³ the Fed could stop at 0.25%, but the marginal effect would be the same. The effective federal funds rate has gone up a little in the last few days due to the increase in the interest rate paid on excess reserves (now remunerated at the target rate), but this level signals that the Fed is getting ready to lower its key rate further at its December 16 meeting (graph 10).

³ Among other things, a rate of 0% could create distortions in money market funds if low rates put yields below the costs of managing the funds and force investors to liquidate their positions. However, the example of Japan, which kept its key rate at 0% for a long time, shows that there is, in practice, no limit.

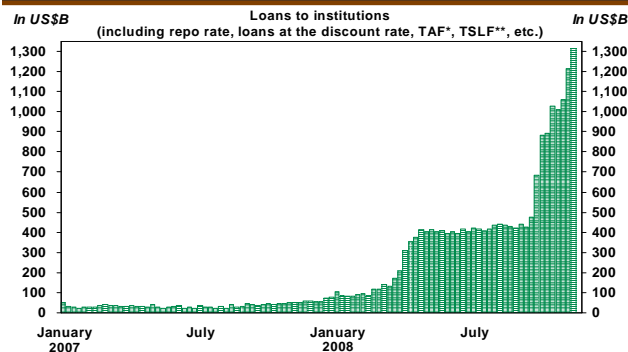
Graph 10 – Effective rates are still below the target rate



Sources: Federal Reserve and Desjardins, Economic Studies

Moreover, unconventional, more quantitative measures (injection of surplus liquidity) will continue. Letting the monetary base growing faster, the Fed is no longer fully sterilizing its liquidity injections in the financial system (graph 11), and credit facilities have proliferated.

Graph 11 – The Fed takes its action even further



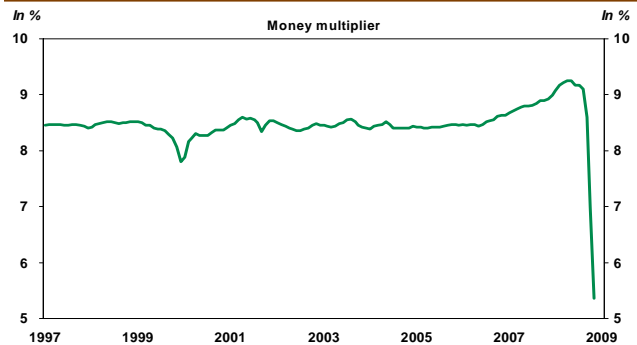
* Term Auction Facility; ** Term Securities Lending Facility.
Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies

Following the measures to directly buy up commercial paper from businesses (US\$1,800B) and money market funds, this week, the Fed announced that it intended to mobilize US\$600B for real estate credit⁴ and US\$200B for consumer credit, driving the government's commitment to date to astronomical levels (table 1 on page 5). The latter measures are essentially designed to stabilize (and preferably bring down) retail rates.

⁴ Of this amount, up to US\$100B will be used to directly buy back the bonds of Government Sponsored Enterprises (GSE) associated with the housing market, and up to US\$500B will be used to redeem GSE mortgage-backed securities (MBS) on the secondary market.

The Fed has significantly broadened its balance sheet, with major repercussions for the monetary base, but the tightened credit conditions mean that banks are not inclined to lend funds. Under these circumstances, the money multiplier⁵ has plummeted in recent weeks (graph 12), a situation that is looking more and more like a liquidity trap. To resolve the situation, it seems inevitable that the Fed will end up lowering its key rate to almost 0% to get the banks to lengthen the terms of their bank loans.

Graph 12 – The monetary base grows faster than the money supply



Sources: Datastream and Desjardins, Economic Studies

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⁵ The money multiplier is the ratio between the money supply, in the broad sense (M2), and the monetary base (M0).

Table 1
Costs of the government measures announced

	<i>Date of announcement</i>	<i>Amount allocated</i>	<i>Amount used</i>
In US\$B (Data available as per 27 November 2008)			
Federal Reserve		5,554.9	
Term Auction Facility (TAF) Loans of up to 28 days in exchange for collateral.	Dec. 12, 2007	900.0	415.3
Term Securities Lending Facility (TLSF) Leading traders can get Treasury bonds in exchange for other securities.	Mar. 11, 2008	205.0	191.3
Net Portfolio Maiden Lane Funds for J.P. Morgan's purchase of Bear Stearns.	Mar. 14, 2008	28.8	26.9
Primary Dealer Credit Facility Line of credit for leading traders and brokerage firms.	Mar. 16, 2008	50.2	50.2
ABCP MMMF* Liquidity Facility Loans to banks to buy ABCPs** held by mutual funds.	Sep. 19, 2008	69.8	69.8
Net Portfolio Commercial Paper Funding Purchase of commercial papers issued by corporations.	Oct. 7, 2008	1,800.0	265.7
Money Market Investor Funding Facility (MMIFF) Facilitates the sale of money market assets on the secondary market.	Oct. 21, 2008	540.0	n.a.
Term Asset-Backed Securities Loan Facility (TALF) Loans collateralized by securities backed by consumer and small business loans.	Nov. 25, 2008	200.0	0.0
GSEs Direct Obligations and MBS Purchase of bonds issued by the GSEs and GSE-guaranteed MBS.	Nov. 25, 2008	600.0	0.0
Discount Window Permanent lending facility for commercial banks.	---	91.7	91.7
Securities Lending Overnight Facility Overnight loans of Treasury securities.	---	14.2	14.2
Other Credit Extensions Assistance to American International Group (AIG) (\$122.8B) and Citigroup (\$326B).	---	448.8	448.8
Other Assets	---	606.4	606.4
Federal Deposit Insurance Corp (FDIC)		1,400.0	
FDIC Temporary Liquidity Guarantee Program Guarantees on interbank loans, including \$139B to GE Capital.	Oct. 14, 2008	1,400.0	n.a.
Treasury Department		1,147.0	
Economic Stimulus Act Tax rebate cheques.	Feb. 13, 2008	168.0	168.0
Freddie Mac and Fannie Mae Bailout Purchase of short-term debt securities issued by Freddie Mac and Fannie Mae.	Sep. 7, 2008	200.0	0.0
Treasury Exchange Stabilization Fund Use of the exchange stabilization fund to guarantee money market funds.	Sep. 18, 2008	50.0	50.0
Tax Breaks for Banks Tax rebate for institutions that buy struggling banks.	Sep. 30, 2008	29.0	0.0
Troubled Asset Relief Program (TARP) \$700B Paulson Plan.	Oct. 3, 2008	700.0	350.0
Federal Housing Administration (FHA)		300.0	
Hope for Homeowners Loan guarantees for struggling mortgage lenders.	Oct. 1, 2008	300.0	300.0
Total		8,401.9	

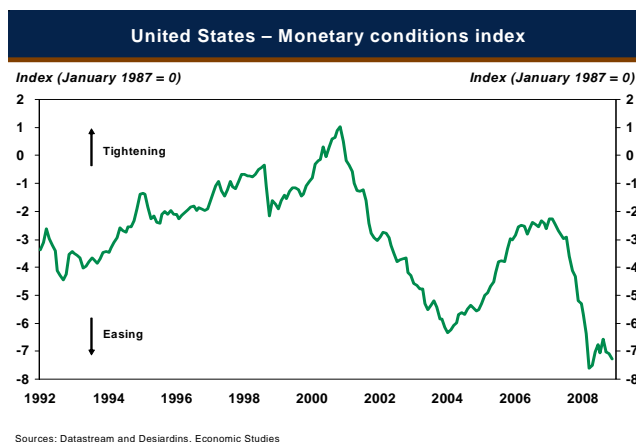
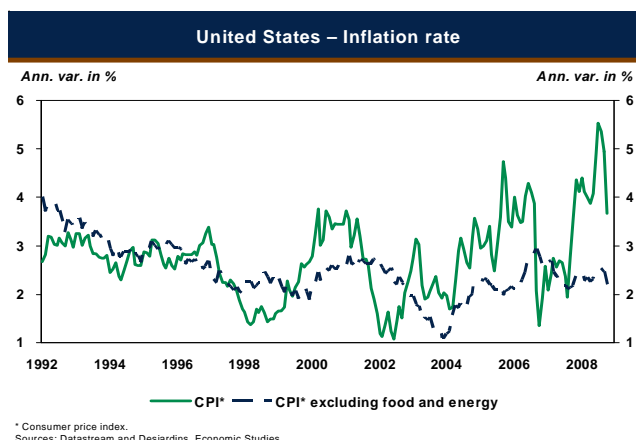
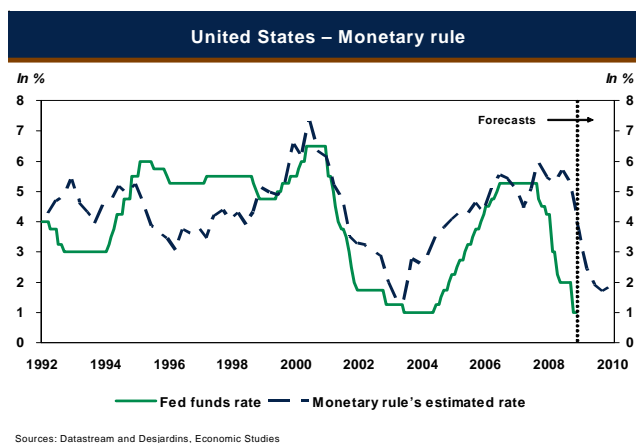
n.a. : not available; * Asset-Backed Commercial Paper (ABCP) Money Market Mutual Fund (MMMF); ** Asset-backed commercial papers.
Source: Desjardins, Economic Studies

FEDERAL RESERVE

There is not much leeway, but key rates will continue to come down

- The scope of the financial crisis and the markets' inability to achieve a lasting calm prompted Federal Reserve (Fed) and U.S. Treasury leaders to further action. In the last two weeks, we have seen the bailout of Citigroup and the institution of new measures to facilitate the credit market. The Fed has also continued to inject huge sums in the form of liquidity and loans to institutions to keep the crisis from deteriorating.
- These measures are being undertaken parallel to conventional monetary policy that focuses on changes in the target for the federal funds rate. The fact that the Fed is adding more and more credit facilities does not, however, mean that monetary policy is not a useful tool. However, the tightening of credit conditions has sharply restricted the reach of the huge key rate cuts. Moreover, at 1.0%, there is not that much left in the armoury. Further rate cuts can be expected at the next few meetings and a zero rate policy can no longer be ruled out.
- This summer's hesitations about the monetary policy's inflationary effect have now been pushed aside by the magnitude of the financial crisis and the economic slowdown, as well as by the sharp drop in the pressure on prices. Gas prices have come down by more than 50% in the United States, a key factor in the disinflation that has been noted for the last few months. Prices for other commodities are also contributing to falling inflation. In October, the consumer price index (CPI) underwent the biggest monthly contraction on record: -1.0%. This pullback took year-over-year inflation from 4.9% to 3.7%. Energy was not the only component that played a role in the decline. Prices retreated in other categories of goods such as clothing and motor vehicles, so much so that, for the first time since 1983, the core CPI, which excludes food and energy, also fell in October (-0.1%). Year over year, this measure went from 2.5% to 2.2%.
- Prices can be expected to moderate further. Firstly, energy costs are still declining. Secondly, by reining in demand growth, increasing excess production and making the labour market deteriorate, the recession is also putting downside pressure on the evolution of other prices. The rapid inflation of a few months ago is giving way to disinflation, which could turn into deflation if the financial and economic crisis persists. Our base scenario, however, is for all-items inflation to reach about 0.5% around mid-2009.

Forecasts: The magnitude of the crisis and the fact that inflation pressures have turned into deflation pressures will prompt the Fed to bring key rates down further, though future movements will of course be limited by how low the target rate for federal funds is now. The rate will go from 1.00% to 0.50% at the December 15-16 meeting. The next move should occur in January, taking the rate to 0.25% and leaving it there throughout 2009.

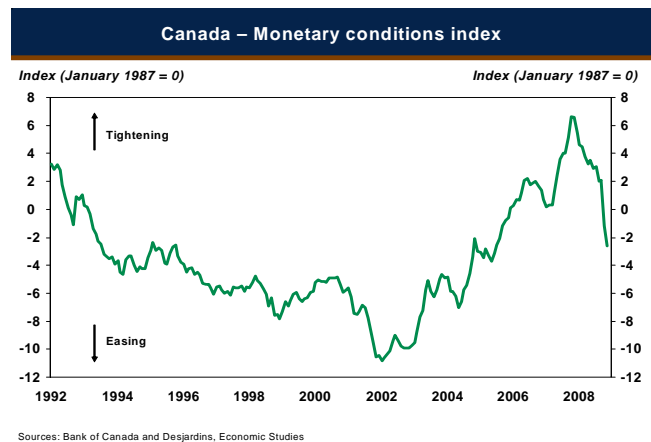
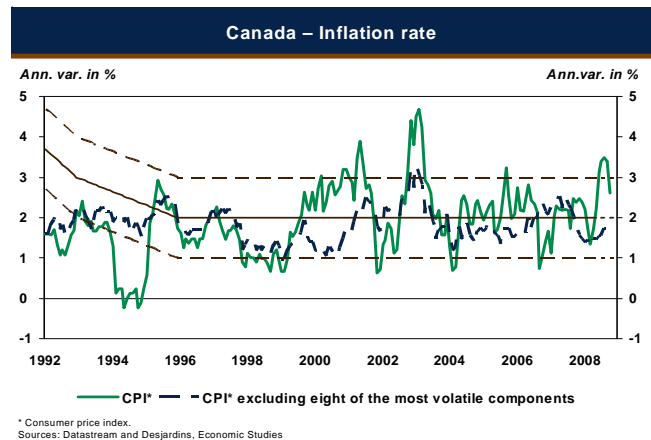
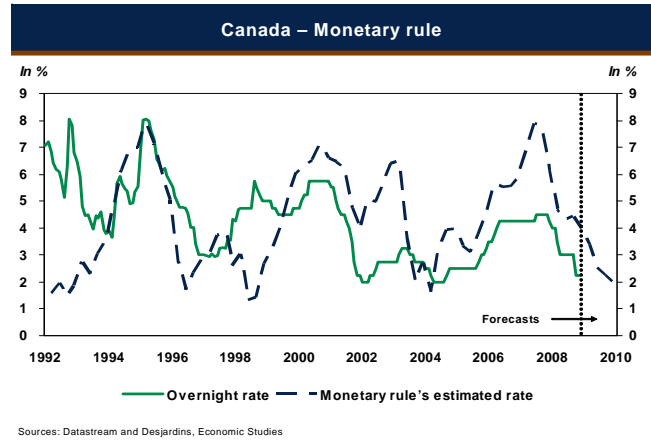


BANK OF CANADA

There will be further monetary easing in the next few months

- Canada's economy is still doing well but a period of economic contraction now seems inevitable. Retail sales rose 1.1% in September, once again showing the extent to which consumer spending is a pillar for Canadian economic growth. However, there is reason to fear that substantial cracks could materialize in these pillars shortly. For one thing, Canadian consumer confidence plunged again in October and November, to its lowest level since the recession in the 90s. While the summer quarter looks positive, Canada's economy is likely to go into recession at the end of 2008 and early 2009.
- According to the Department of Finance, Canada should be going through a technical recession in late 2008 and early 2009. However, the government does not intend to run a deficit to jump start the economy. Instead, the minister proposes to cut spending by \$4.9B during fiscal 2009-2010 to balance his budget.
- In the same vein, Bank of Canada (BoC) Governor Mark Carney delivered an unequivocal speech in London on November 19. "Notwithstanding the advantages of its financial sector, as one of the most open economies in the world, Canada has been importantly affected by global events. [...] some further monetary stimulus will likely be required to achieve the inflation target over the medium term."
- The BoC has all the leeway it needs. Because energy prices have fallen sharply, a pullback by inflation had to be expected in October. However, prices for other goods and services have also come down substantially, with the result that total inflation and core inflation (which excludes the eight most volatile components) have dropped more than forecast. Given the unending financial crisis, the decline in crude oil prices and recession in the United States and around the globe (so probably in Canada, too), the downside pressures on prices will intensify over the coming months. The year-over-year inflation rate should therefore continue to slide until the summer of 2009, where it is expected to bottom out close to 0%. Under the circumstances, the possibility of several months of deflation (negative annual change in prices) cannot be ruled out.

Forecasts: Inflation should oscillate below the BoC's target range (from 1% to 3%) within the next several months. This means that monetary authorities could become increasingly concerned with deflation risks. The context is thus favourable for further key rate cuts in the next few months. Following the 25 basis point cut ordered in October, the BoC should continue to add monetary stimulus with another 50 basis point cut at its December 9 meeting, taking the rate to 1.75%.



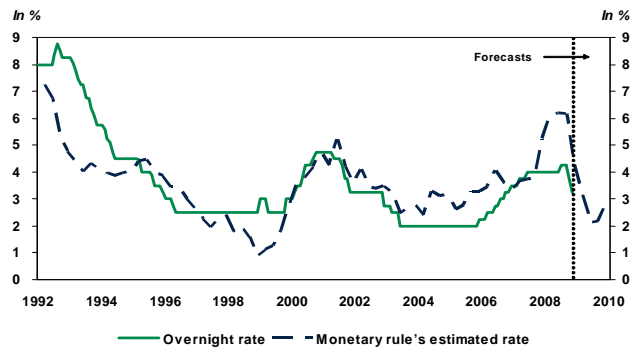
EUROPEAN CENTRAL BANK

Easing will continue in the euro zone

- As forecast, the European Central Bank (ECB) reduced its key rate again in November, proceeding with a second 50 basis point cut in under a month. A 75-point cut was even discussed at the meeting, which clearly keeps the door open for further easing in the months to come.
- Euroland's economy contracted by a non-annualized 0.2% in the third quarter, a decline in line with the previous quarter's, confirming that the zone is in recession. Real GDP should continue to contract over the next few quarters, as the indicators for manufacturing and service sector activity reached a new low in November. The latest statistics also indicate that, in Germany and France, the zone's two engines, business confidence is at its lowest point since the recession in the 90s. Without yet mentioning a "credit crunch", the ECB now acknowledges that the "recent intensification of the financial tensions has triggered a slower provision of bank credit to euro area residents". Several times, it stressed how important it was for the banking sector to do its job and not overly restrict personal and business credit. The slight easing to monetary conditions due to the euro's devaluation and the 100-point decline in the key rate do not seem sufficient, given this large a deterioration in the economic outlook. Fiscal stimulus measures will also provide Europe's economy with support—the European Commission has just tabled a recovery plan valued at €200B, equivalent to 1.5% of the European Union's GDP.
- The unprecedented correction by commodity prices and economic slowdown have sharply reduced inflation pressure in the euro zone. From a peak of 4% this summer, the annual inflation rate shrank to 2.1% in November, according to the flash estimate. This trend should continue over the next few months. The ECB now expects inflation to return to close to its 2% target in 2009, adding that "some even stronger downside movement in HICP inflation cannot be excluded around the middle of next year." However, it does not see any serious risk of deflation for now, as wage growth remains strong.

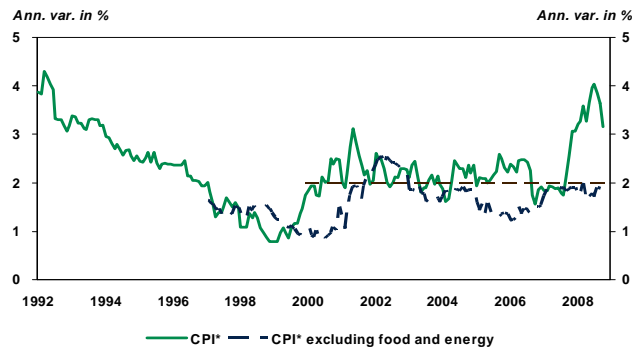
Forecasts: Even though it does not seem ready to lower its key rate as quickly as its American and British counterparts, the ECB will continue to relax its monetary policy over the coming months to try to support Euroland's economy. We are therefore expecting another key rate cut of at least 50 points as of December 4. The rate should reach a low of 2.0% next year.

Euro zone – Monetary rule



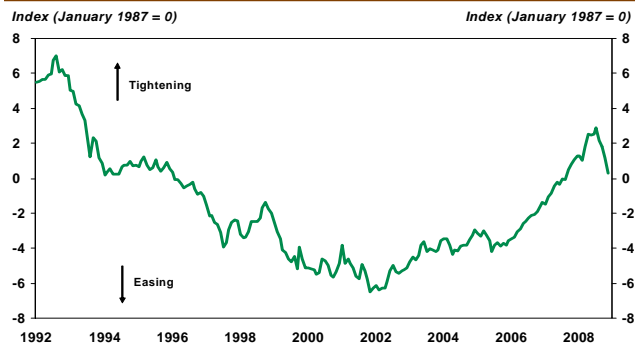
Sources: Datastream and Desjardins, Economic Studies

Euro zone – Inflation rate



* Consumer price index.
Sources: Datastream and Desjardins, Economic Studies

Euro zone – Monetary conditions index



Sources: Datastream and Desjardins, Economic Studies

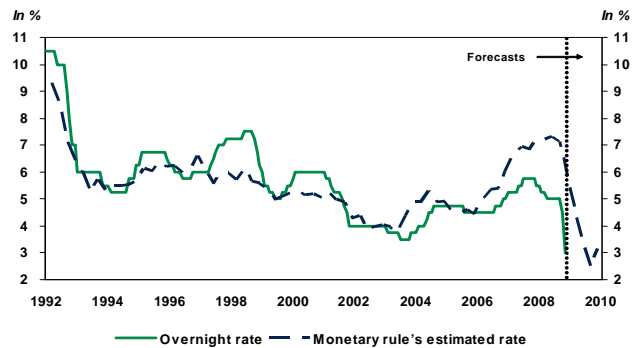
BANK OF ENGLAND

The Bank is dropping its key rate at high speed

- The Bank of England (BoE) daringly lowered its key rate from 4.50% to 3.00% in November. The spectacular 150-point cut took analysts by surprise—they had been expecting more gradual easing. The minutes of the last BoE meeting reveal that “the projections in the Inflation Report implied that a very significant reduction in the Bank Rate—possibly in excess of 200 basis points—might be required in order to meet the inflation target in the medium term.” Further key rate cuts thus seem certain over the next few months.
- The pound sterling’s tumble and substantial drop in the British key rate have already created substantial easing in monetary conditions in the United Kingdom. However, the deterioration in the economic context is such that further action will certainly be necessary. The recession in the United Kingdom was official with a non-annualized 0.5% contraction in real GDP in the third quarter of 2008. Further sharp declines seem inevitable over the coming quarters, as all sectors of Britain’s economy are struggling. Household consumption, investment and exports all contracted this fall. The British government is doing what it can to limit the damage. After having instituted important measures to support banks, in the last few days, it announced £20B in tax measures, including a temporary 2.5% cut to the sales tax, to try to rein in the recession.
- Inflation has finally started to moderate—the annual rate went from 5.2% to 4.5% in October. Thanks to the collapse in energy prices, inflation will continue to moderate and the BoE now expects it to return close to the 2% target sometime early next year. The BoE’s main fear now is that the recession will take inflation under the 2% target. If this concern materializes, we can expect rates to go very low, as Governor Mervyn King recently stated that monetary authorities “are prepared to cut the bank rate to whatever level is necessary.”

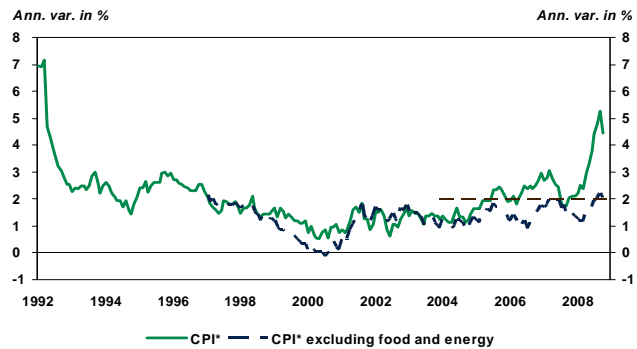
Forecasts: All British players acknowledge that the economy will suffer a major recession and that inflation is no longer the enemy. The BoE could once again surprise the markets by lowering its key rate rapidly; we anticipate a 100 basis point cut at December’s meeting.

United Kingdom – Monetary rule



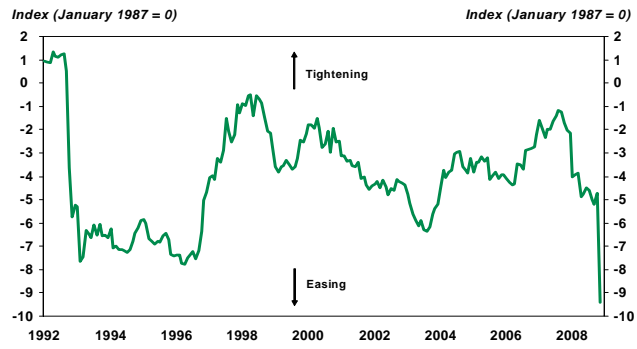
Sources: Datastream and Desjardins, Economic Studies

United Kingdom – Inflation rate



* Consumer price index.
Sources: Datastream and Desjardins, Economic Studies

United Kingdom – Monetary conditions index



Sources: Datastream and Desjardins, Economic Studies

BANK OF JAPAN

No more rate cuts... for now

- The Bank of Japan (BoJ) opted to leave its key rate steady at 0.30% at its last monetary policy meeting on November 20. The decision had been anticipated, especially since the monetary policy committee had not been unanimous about the previous cut, announced in October. Japan's economy has not been spared the economic and financial problems hitting the rest of the world, but monetary authorities should wait some time before taking rates to 0%.
- Japan's real GDP contracted by an annualized 0.4% in the third quarter. This is the second straight contraction, making a technical recession official. In its last Monthly Report of Recent Economic and Financial Developments, the BoJ states that the economy's problems should persist over the next several quarters as the slowdown spreads to the global economy. Japan's exports have been down since August, which also led to a slight trade deficit. For now, the decline in demand is mainly focused in Western Europe and the United States, but shipments to Asia are already cresting. Japan's domestic demand will also be under pressure due to low consumer and business confidence. Non-residential investment recorded an annualized 6.7% decline in the third quarter.
- Japan's total inflation is falling, given to the drop in energy and commodity prices. In October, the inflation rate was 1.7%, down 4 tenths of a point from the month before. However, if we exclude the annual change in prices for energy and fresh food, the inflation rate is still timidly positive, at 0.2%. Over the medium term, a return to deflation cannot be ruled out.
- The monetary conditions index is still rising due to the yen's appreciation. Its levels are similar to levels seen in 2000 and 2001, when the BoJ had to put its key rate at 0%. However, the real GDP contraction was larger at that time and the price trend was clearly deflationary.

Forecasts: A recession in Japan is confirmed and inflation is down. The International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) respectively expect Japan's real GDP to shrink by 0.2% and 0.1% in 2009. The BoJ should maintain the status quo, but a return to a quantitative policy and a key interest rate of 0% would win credibility if the situation deteriorates more than forecast.

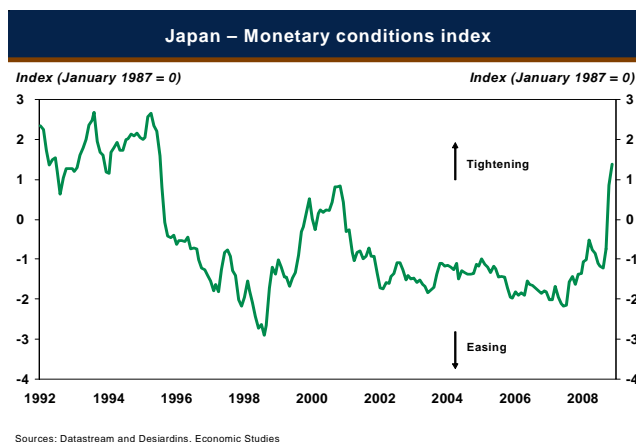
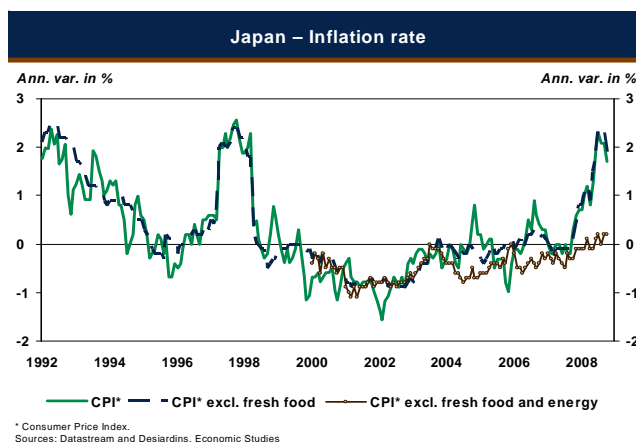
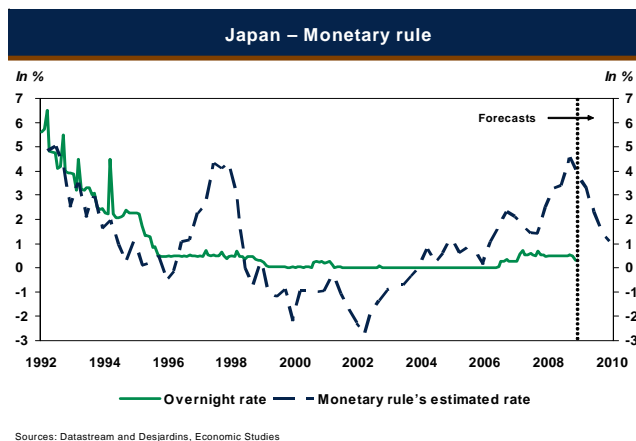


Table 2
Key interest rates

End of period in %	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
United States												
Federal funds	5.25	5.25	4.75	4.25	2.25	2.00	2.00	0.50	0.25	0.25	0.25	0.25
Canada												
Overnight funds	4.25	4.25	4.50	4.25	3.50	3.00	3.00	1.75	1.25	1.00	1.00	1.00
Euro zone												
Refinancing rate	3.75	4.00	4.00	4.00	4.00	4.00	4.25	2.50	2.00	2.00	2.00	2.00
United Kingdom												
Base rate	5.25	5.50	5.75	5.50	5.25	5.00	5.00	2.00	1.50	1.50	1.50	1.50
Japan												
Overnight funds	0.50	0.50	0.50	0.50	0.50	0.50	0.54	0.30	0.30	0.30	0.30	0.30

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Table 3
Schedule and key rates

Date	Central Bank	Decision	Rate
September 2008			
16	Federal Reserve	s.q.	2.00
18	Swiss National Bank	s.q.	2.75
19	Bank of Mexico	s.q.	8.25
24	Bank of Norway	s.q.	5.75
October 2008			
2	European Central Bank	s.q.	4.25
6	Reserve Bank of Australia	-100 b.p.	6.00
6	Bank of Japan	s.q.	0.50
8	European Central Bank	-50 b.p.	3.75
8	Bank of England	-50 b.p.	4.50
8	Bank of Sweden	-50 b.p.	4.25
8	Bank of Canada	-50 b.p.	2.50
8	Swiss National Bank	-25 b.p.	2.50
8	Federal Reserve	-50 b.p.	1.50
15	Bank of Norway	-50 b.p.	5.25
17	Bank of Mexico	s.q.	8.25
21	Bank of Canada	-25 b.p.	2.25
22	Reserve Bank of New Zealand	-100 b.p.	6.50
23	Bank of Sweden	-50 b.p.	3.75
29	Bank of Norway	-50 b.p.	4.75
29	Bank of Brazil	s.q.	13.75
29	Federal Reserve	-50 b.p.	1.00
30	Bank of Japan	-20 b.p.	0.30
November 2008			
3	Reserve Bank of Australia	-75 b.p.	5.25
6	Bank of England	-150 b.p.	3.00
6	European Central Bank	-50 b.p.	3.25
20	Bank of Japan	s.q.	0.30
28	Bank of Mexico	s.q.	8.25

s.q.: status quo; b.p. : basis points

Source: Desjardins, Economic Studies

Table 4
Coming soon

Date	Central Bank
December 2008	
1	Reserve Bank of Australia
3	Reserve Bank of New Zealand
4	Bank of England
4	European Central Bank
9	Bank of Canada
10	Bank of Brazil
11	Swiss National Bank
16	Federal Reserve
17	Bank of Sweden
18	Bank of Japan
January 2009	
8	Bank of England
15	European Central Bank
20	Bank of Canada
21	Bank of Brazil
22	Bank of Japan
28	Federal Reserve
29	Reserve Bank of New Zealand
February 2009	
3	Reserve Bank of Australia
4	Bank of Norway
5	Bank of England
5	European Central Bank
10	Bank of Sweden
19	Bank of Japan
March 2009	
3	Reserve Bank of Australia
3	Bank of Canada
5	Bank of England

Source: Desjardins, Economic Studies

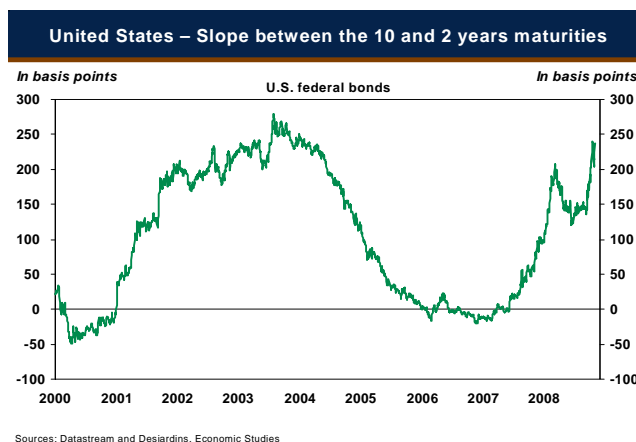
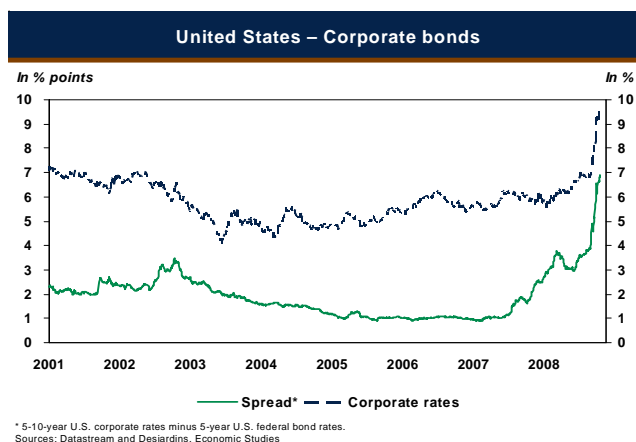
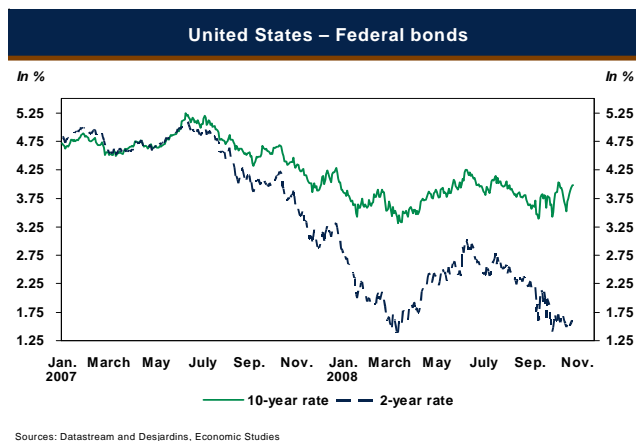
FIXED INCOME MARKET

The period of disinflation is resulting in curve flattening

U.S. FEDERAL BONDS

- Due to the darkening economic outlook, the short end of the yield curve stayed on a down trend in recent weeks. Two-year rates thus dropped below 1.0% for the first time in history on November 21. With the Federal Reserve (Fed) in easing mode, the short end of the yield curve is on the way to record new lows.
- After the fears associated with the substantial increase in American debt, inflation's faster-than-forecast retreat in October was good for longer maturities in the bond market. The ten-year rate tumbled, going from close to 4.0% at the beginning of the month to under 3% recently.
- The substantial increase in the debt will continue to fuel debate about the United States' ability to finance astronomical deficits but, in the short term, the deterioration in the economic situation and spectre of deflation will remain front and centre. Under the circumstances, the rates for longer maturities are likely to remain on a down trend. The possibility that negative nominal real GDP growth will be recorded in 2009 could take the ten-year rates to their lowest level since the 1950s. Then, ten-year rates had reached a historic low of almost 1.50%.
- The economic and financial problems and the risk of deflation should prod the Fed to persist with monetary easing but, at almost 1.0%, the potential for further cuts to two-year rates is fairly small, which should result in flattening of the yield curve. After going to over 250 basis points, the spread between the ten-year and two-year maturities has narrowed by about 60 points to 190 basis points. The expected decline in ten-year rates should help close this gap further.
- The last measures implemented by the Fed to purchase mortgage-backed securities (MBS) lead to a narrowing of agency credit spreads, but the situation is still highly fragile. In particular, corporate credit spreads remain elevated, and on the rise, due to a deterioration of the economic context and the possibility of higher rates of default.

Forecasts: Despite a substantial increase in American public debt, the darkening economic outlook and start of a period of disinflation are now compatible with a flattening of the yield curve.

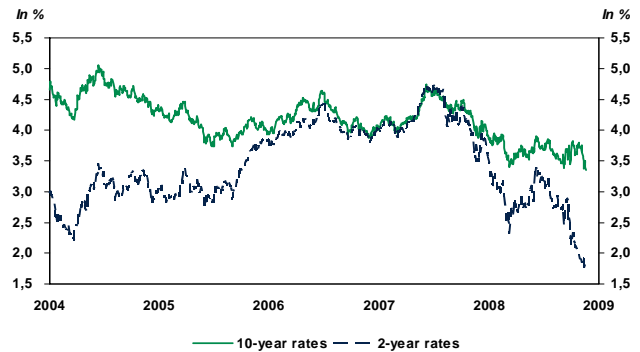


CANADIAN FEDERAL BONDS

- As forecast, ongoing financial tension, the darkening global economic outlook and substantial disinflationary pressures created by the collapse in commodity prices have continued to play in favour of Canadian federal bonds.
- The rates on two-year terms went from 2% at the end of October to around 1.75% now. This level, the lowest in several decades, reflects the expectations for Canadian key rate cuts. Canada's key rate could bottom out at 1% next year. The rate on ten-year terms has also dropped sharply since mid-November, even falling below 3.35%. The pullback can be chalked up by the decline in inflation pressure and influence of U.S. rates. After going over 180 points in early November, the Canadian curve's slope flattened slightly to around 160 points, similar to where it was at the end of October.
- Although Canada's federal rates have declined substantially, they did not come down as far as their U.S. counterparts in November. The spread between Canadian and American two-year rates thus went from just over 40 basis points to close to 70 points. Canada's ten-year rate, which was lower than the U.S. rate last month, is now almost 30 points higher. Note that the risks of deflation do not seem as extensive on this side of the border.
- Once again, the substantial decline in federal bond rates did not really help Canadian businesses. Corporate bond rates have been almost stable in the last few weeks. The spread between corporate and federal rates widened quickly in November, nearing 300 points.

Forecasts: The economic and financial situation will keep Canadian bond rates very low in the next few quarters. We continue to recommend banking on rates edging down until mid-2009, as the Bank of Canada will continue to relax its monetary policy. Although the American budget situation is worsening, Canada's ten-year rate should stay slightly higher than the U.S. rate given that Canada's economy and inflation are not expected to slow as sharply.

Canada – Federal bonds



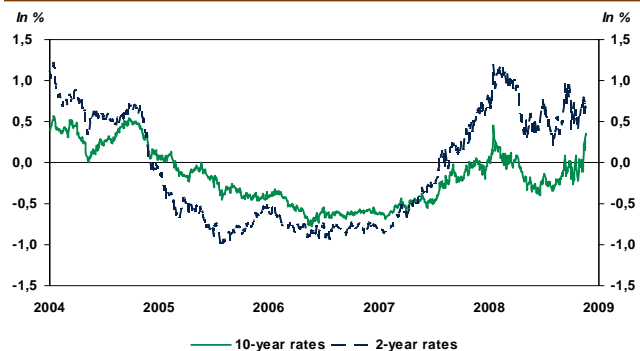
Sources: Datastream and Desjardins, Economic Studies

Canada – Slope between the 10 and 2 years maturities



Sources: Datastream and Desjardins, Economic Studies

Canada – Spread with the U.S. federal bond



Sources: Datastream and Desjardins, Economic Studies

PROVINCIAL BONDS

- Unlike corporate bonds, provincial bonds have benefited from the recent decline in Canadian bond rates. Ten-year provincial bond rates have retreated by about 30 basis points since the end of October. The spread between provincial and federal securities was thus almost stable. Relatively speaking, British Columbia bonds appreciated, especially in comparison with Ontario's, which may be a reflection of B.C.'s better economic and budget situation.
- As elsewhere in the world, the provinces' economic outlooks are still being revised downward. Ontario is especially hard hit by soft demand from the U.S. and the problems in the automotive industry. Ontario's production primarily concerns gas guzzlers, so its automobile plants are at risk as the major three U.S. automakers restructure. A recession, which could last three quarters, thus seems inevitable in Ontario. Québec is also being sorely impacted, but could manage to avoid a recession by a hair thanks to the substantial government investments in infrastructures. Lastly, the provinces that had previously been benefiting from the surge in raw material prices will now have to absorb the impacts of the collapse in commodity prices.

Forecasts: The recent declines in rates on provincial bonds, despite ongoing intense financial tensions, are encouraging. Provincial credit spreads are still very large, however, and there is a risk of another increase in the short term as the economic context could favour federal securities. However, we continue to expect spreads to narrow over the medium term, especially as of mid-2009.

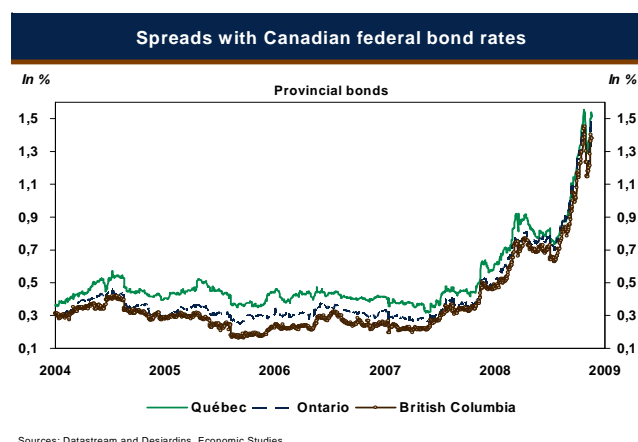
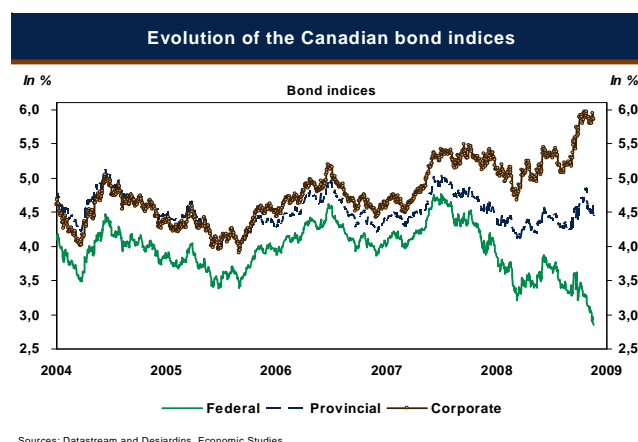


Table 5
Canada: public finance of the federal and provincial governments

	Surplus (deficit) (1) in \$M		Budget surplus (deficit) in % of GDP	Total debt (2) in % of GDP	Credit rating	
	2007-2008	2008f-2009f	2008f-2009f	2007f-2008f	S&P	Moody's
Federal government	9,597	800	0.1	34.9	AAA	Aaa
Newfoundland	1,377	544	1.9	35.0	A	Aa2
Prince Edward Island	-37	-35	-0.8	37.6	A	Aa2
Nova Scotia	-67	-170	-0.5	34.4	A+	Aa2
New Brunswick	87	19	0.1	28.9	AA-	Aa1
Québec	1,201	-1,072	-0.4	55.3	A+	Aa2
Ontario	600	-500	-0.1	26.4	AA	Aa1
Manitoba	576	96	0.2	30.4	AA	Aa1
Saskatchewan	1,282	3,020	5.9	26.5	AA	Aa1
Alberta	4,581	8,533	3.3	0.0	AAA	Aaa
British Columbia	2,886	1,770	0.9	17.0	AAA	Aaa

f: forecasts; (1) Include contingency reserves for some governments, (2) Adjusted based on the Dominion Bond Rating Service.
Sources: Budget of the federal government, ministère des Finances du Québec and Desjardins, Economic Studies

Table 6
United States: fixed income market

End of period in %	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
Key rate												
Federal funds	5.25	5.25	4.75	4.25	2.25	2.00	2.00	0.50	0.25	0.25	0.25	0.25
Treasury bills												
3-month	5.04	4.82	3.82	3.36	1.38	1.90	0.92	0.10	0.10	0.10	0.10	0.20
Federal bonds												
2-year	4.58	4.87	3.96	3.07	1.62	2.61	1.99	1.10	0.95	0.90	0.90	1.00
5-year	4.54	4.93	4.23	3.46	2.47	3.33	2.98	2.10	1.85	1.70	1.80	2.00
10-year	4.65	5.03	4.58	4.03	3.43	3.98	3.82	3.00	2.70	2.50	2.60	2.75
30-year	4.85	5.13	4.83	4.45	4.30	4.53	4.30	3.70	3.60	3.55	3.60	3.70
Yield curve												
5-year - 3-month	-0.50	0.11	0.41	0.10	1.09	1.43	2.06	2.00	1.75	1.60	1.70	1.80
10-year - 2-year	0.07	0.16	0.62	0.96	1.81	1.36	1.84	1.90	1.75	1.60	1.70	1.75
30-year - 3-month	-0.19	0.31	1.01	1.09	2.92	2.63	3.38	3.60	3.50	3.45	3.50	3.50

f: forecasts

Sources: Datastream and Desjardins, Economic Studies

Table 7
Canada: fixed income market

End of period in %	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
Key rate												
Overnight funds	4.25	4.25	4.50	4.25	3.50	3.00	3.00	1.75	1.25	1.00	1.00	1.00
Treasury bills												
3-month	4.18	4.43	3.98	3.83	1.88	2.50	1.90	1.50	1.20	1.00	1.00	1.20
Federal bonds												
2-year	3.98	4.58	4.08	3.74	2.63	3.25	2.79	1.75	1.65	1.65	1.65	1.70
5-year	4.01	4.56	4.21	3.87	2.91	3.46	3.17	2.50	2.45	2.25	2.30	2.40
10-year	4.11	4.55	4.34	3.99	3.43	3.74	3.76	3.25	2.95	2.80	2.80	2.90
30-year	4.20	4.49	4.45	4.10	3.94	4.08	4.23	3.90	3.90	3.75	3.85	3.95
Yield curve												
5-year - 3-month	-0.17	0.13	0.23	0.04	1.03	0.96	1.27	1.00	1.25	1.25	1.30	1.20
10-year - 2-year	0.13	-0.03	0.26	0.25	0.80	0.49	0.97	1.50	1.30	1.15	1.15	1.20
30-year - 3-month	0.02	0.06	0.47	0.27	2.06	1.58	2.33	2.40	2.70	2.75	2.85	2.75
Spreads (Canada - U.S.)												
3-month	-0.86	-0.39	0.16	0.47	0.50	0.60	0.98	1.40	1.10	0.90	0.90	1.00
2-year	-0.60	-0.29	0.12	0.67	1.01	0.63	0.80	0.65	0.70	0.75	0.75	0.70
5-year	-0.53	-0.37	-0.02	0.41	0.44	0.13	0.19	0.40	0.60	0.55	0.50	0.40
10-year	-0.54	-0.48	-0.24	-0.04	0.00	-0.24	-0.07	0.25	0.25	0.30	0.20	0.15
30-year	-0.65	-0.64	-0.38	-0.35	-0.36	-0.45	-0.07	0.20	0.30	0.20	0.25	0.25

f: forecasts

Sources: Datastream and Desjardins, Economic Studies