Q. **Reference:** ***Fair Return and Capital Structure for Newfoundland Power (NP),*** **Evidence of Laurence D. Booth, April 2024, page 26, line 5.**

"RBC's latest forecast (March 2024) is below."

Please provide a copy of the referenced RBC report.

A. Provided, along with the most recent RBC Financial Markets Monthly as Dr. Booth's answers to NP-CA-006 as Attachment 1 and Attachment 2.

RBC Economics & Thought Leadership

Financial Markets Monthly

May 2024

It's hard to leave (higher rates) when you can't find the door (to lower inflation)

Highlights:

- Upside inflation surprises year-to-date in the U.S. will keep the Fed on the sidelines for now – we continue to expect the first cut to the fed funds target in December, contingent on both growth and inflation gradually and persistently slowing.
- The Fed's still hopeful that inflation can cool even if the economy doesn't. But we think persistent unwinding in price pressures won't come without some slowing in the economy.
- In Canada, slowing growth momentum is reaffirming our call for a rate cut from the BoC in June.
- The ECB and BoE are both expected to start easing around the summer as well, but at a slower pace after.

Overview

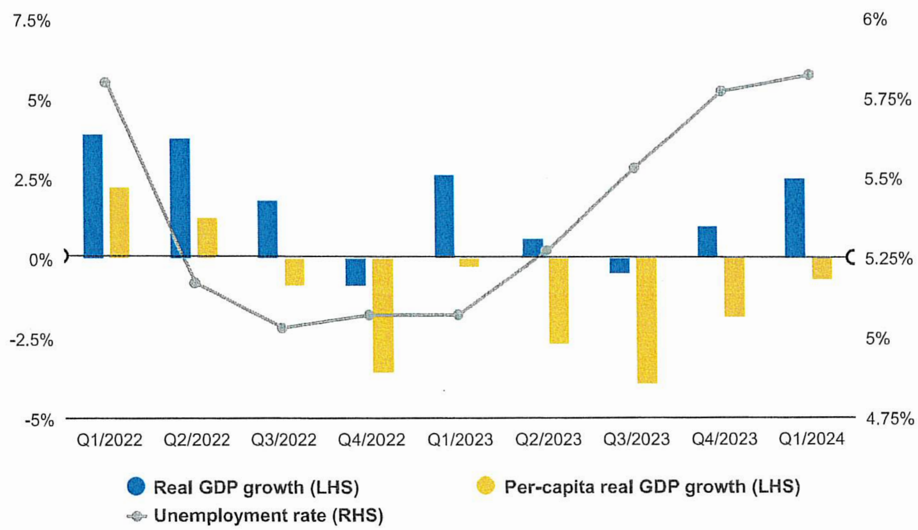
A third consecutive inflation setback in the U.S. in March proved powerful enough to throw pricing for most Fed rate cuts this year out of the window. It also ended a streak of equity market gains, with the S&P 500 in April recording its first monthly decline in six months. Bond yields climbed back towards peak levels that were seen late last summer, and the US dollar regained some strength.

Claire Fan | Economist | claire.fan@rbc.com | 416-974-3639

Markets have since calmed down somewhat over early May, after dovish comments made by Fed chair Powell at the interest rate announcement at the beginning of the month. Despite waning confidence that inflation is slowing, the Federal Reserve stuck with the script that what's needed is more time, not more rate hikes, for price pressures to sustainably slow. We are less convinced that inflation will slow without some softening in the economy, and expect readings for both GDP growth and price gains will start to moderate in the quarters ahead. Contingent on that outlook, we expect the Fed will do nothing and wait until December (past November's elections) to make a first cut in the fed funds target range.

Per-capita GDP in Canada on track for a 7th quarterly decline

% change, annualized rate



Source: Statistics Canada, RBC Economics

The decision to pivot to interest rate cuts this year for the Bank of Canada should be easier. The Canadian economy still looks weak compared to other regions. A jump in Canadian GDP in January appears to have quickly faded with output in Q1 as a whole tracking a seventh consecutive decline on a per-capita basis and early reports pointing to a softening in output in March. As labour markets continue to weaken and inflation readings in Canada also come lower, all ducks seem to be in a row for the Bank of Canada to start cutting the overnight rate as soon as June, with 100 basis points of total cuts expected for this year.

Stuck in the middle are the euro area and the U.K., where progress on inflation have been slower than expected in Q1 while GDP growth is showing signs of strengthening. That's arguing for a more gradual easing cycle from the ECB and the BoE. We expect both the ECB and the BOE will start to move rates lower this summer, but with a more moderate pace of cuts after than expected out of the BoC.

Central bank bias

Central bank	Current policy rate	Next decision
BoC	**5.00%** +0 bps in Apr/24	**-25 bps** Jun/24

The BoC as expected left the overnight rate unchanged in April while leaving options open to (although not committing to) a cut in June. Data releases over the last month have pointed to further softening in economic growth and inflation. Governor Macklem in his recent comments said the central bank is "getting closer" to lowering the policy interest rate. We continue to expect a first move at its next meeting in June.

Central bank	Current policy rate	Next decision
Fed	**5.25-5.5%** +0 bps in May/24	**0 bps** Jun/24

The U.S. Fed as widely expected held interest rates unchanged at its policy announcement in May, while acknowledging the progress with inflation stalled in recent months. The tone of chair Powell's comments erred on the dovish side, saying directly it's "unlikely that the next policy move will be a hike." Contingent on inflation reversing back lower over the year we expect the Fed will start cutting in December.

Central bank	Current policy rate	Next decision
BoE	**5.25%** +0 bps in May/24	**0 bps** Jun/24

The BoE in May held interest rates steady as expected, with the vote split shifting to a more dovish 7-2 (7 members favouring a hold and 2 favouring a cut) from 8-1 in the last meeting. The MPC outlined its expectations that inflation will return to target over the very near-term before trending higher from energy base effects. Contingent on that outlook, we expect a first cut form the BoE will come later in August.

Central bank	Current policy rate	Next decision
ECB	**4.00%** +0 bps in Apr/24	**0 bps** Jun/24

The ECB at its April meeting left the deposit rate unchanged at 4% alongside dovish messaging that easing in monetary policy will be warranted as long as incoming data reaffirms broadly slowing inflation pressures. That's in line with our own view that the ECB will cut the deposit rate at its next meeting June, before resorting to a slower, every-other-meeting pace after.

Central bank	Current policy rate	Next decision
RBA	**4.35%** +0 bps in May/24	**0 bps** Jun/24

The RBA held the main interest rate unchanged at its meeting in May, while maintaining a near neutral bias. Governor Bullock made the explicit comment that "rates are at the right level" but said the RBA is watching for upside risks. Given a potentially higher nominal rate of neutral interest rate, we expect the RBA will be cutting later in 2025, and at a much slower pace after (we expect just two cuts for the whole year.)

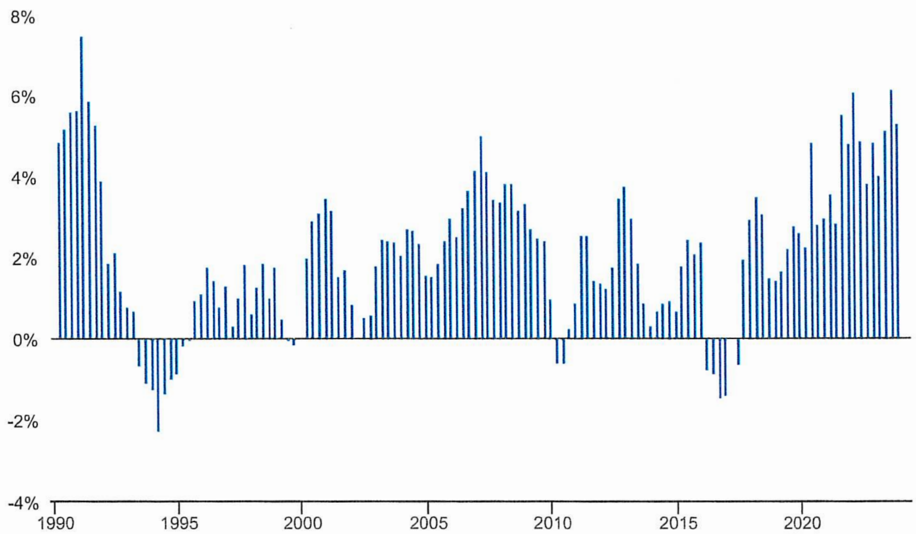
Weakening Canadian economy is arguing for lower interest rates

The case for the BoC to pivot to interest rate cuts soon is relatively straight forward. Evidence is continuing to build that domestic demand is dwindling in the face of persistently elevated borrowing costs, and that's limiting the pace of price growth. Businesses have repeatedly reported a loss of pricing power, as a weakening demand backdrop adds to competitive pressures and pushes bankruptcies higher. That's all suggesting that ongoing easing in price pressures will persist, and the case for interest rate cuts from the BoC is building.

To be sure, that doesn't mean inflationary risks in Canada have fully receded. When testifying in front of Senate and the House of Commons last week, Governor Macklem highlighted a few scenarios where pressures could resurface. Higher energy prices due to heightened global tensions is one. Although not something within the central bank's control, energy expenses still account for a big chunk of consumer spending, so any larger increases will have implications on growth, and are unlikely to be looked through by the BoC completely. Domestically, it's home prices and wage growth that are on BoC's mind. Housing market activity in Canada has remained somewhat subdued in early 2024 but a rebound akin to the one

Elevated wage growth, low productivity pushing labour costs higher in Canada

Year-over-year growth rate, unit labour cost



Source: Statistics Canada, RBC Economics

Finally, higher wage growth relative to productivity growth is driving up unit labour costs (labour cost per unit of output), which in the long run can add to inflationary pressures. But broadly receding labour demand and higher unemployment rate will continue to exert downward momentum on wage growth in the periods ahead. Already, wage growth measured from company payrolls has been showing clearer signs of slowing than growth in average hourly earnings in the timelier monthly labour force survey. Overall, we continue to expect the softer economic growth and inflation backdrop in Canada justifies a more aggressive BoC monetary policy response than in other regions.

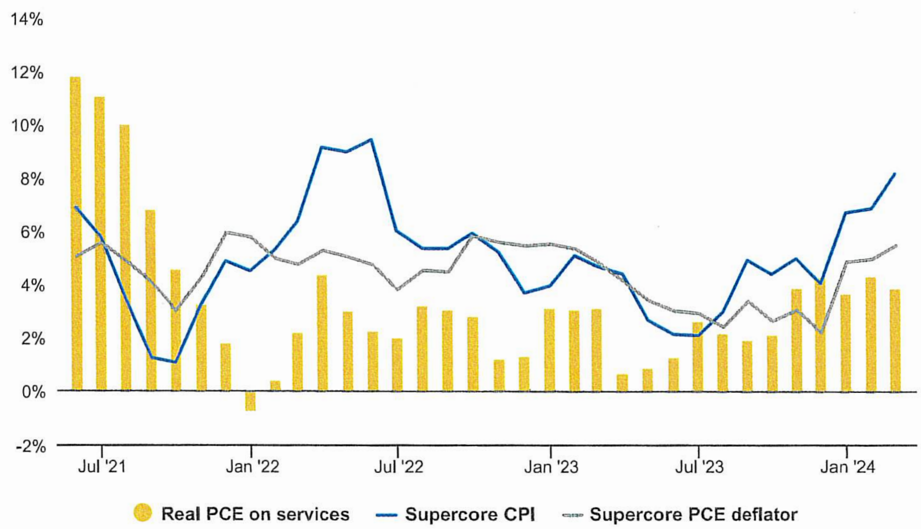
Slowing in U.S. labour markets likely a prerequisite for slower inflation pressures

The Federal Reserve is in a much tougher spot when it comes to arguing for interest rate cuts. Slowing inflation readings last year despite a very strong economic backdrop raised hopes that price pressures could ease without a significant deterioration in the broader economic growth backdrop. Even with CPI readings reaccelerating year-to-date in 2024, the Federal Reserve seems reluctant about giving up hope for a very soft landing.

We continue to expect that slowing in inflation pressures will come, but only alongside slower domestic demand, especially for services, and softening labour markets. Moderations in global supply chain constraints mean prices for tradeable goods (outside of food and energy) are already outright lower than they were a year ago. Instead, recent upsides on inflation can be entirely attributed to domestically produced and consumed services, where demand remains ultra-resilient. In March, the Fed's "supercore" measure that's designed to get a gauge at inflation pressures idiosyncratically driven by domestic services consumption rose to over 8% on a three-month annualized basis, double the read of end of last year.

Services inflation heating up in the U.S. amid strong spending

Annualized % change, three-month rolling average



Source: U.S. Bureau of Labor Statistics, RBC Economics

Fed chair Powell had pointed to a slew of alternative indicators including lower job openings and quits rates, and a deceleration in wage growth as evidence that tight labour market conditions are unwinding – arguing that the level of interest rates is 'restrictive' (and doesn't need to move outright higher.) The pace of hiring itself has remained robust but is powered by gains in healthcare, social assistance and the government that are less likely to reflect cyclical trends in the jobs market. A softening in hiring demand combined with slower wage growth means moderations in households income growth ahead. That and already depleted pandemic savings continue to underpin our expectation that U.S. consumers will start to gradually reduce their spending over the rest of the year, slowing inflation pressures before the Fed can pivot to interest rate cuts in December.

To be sure, factors that have helped insulate households from sky-high interest rates over the last two years, including ultra-long mortgage terms and government support (in the forms of cancelled outstanding student loans) could very well continue to act as tailwinds for growth in the U.S. We anticipate the Fed will stay mindful of those trends, and move at a slower pace in 2025 after that first cut in December.

ECB and BoE stuck in the middle

Somewhere stuck in the middle between underperformance in Canada and resilience in the U.S. are euro area and the U.K. In both regions, economic conditions appear to be recovering at a faster pace than previously expected in early 2024 after bottoming out over the second half of last year. GDP growth in the euro area in Q1 2024 came in stronger than we anticipated at 0.3%, with the gain relatively broad-based but led by southern European countries thanks to stronger tourism activity. In the U.K., monthly GDP readings are pointing to a Q1 gain of similar size, but with the increase likely slightly more balanced across manufacturing and services sectors. Early PMI data for April has pointed to the momentum, especially with services activities carrying over to the start to the second quarter. We have revised our growth forecast for both regions higher for the rest of the year.

Echoing those developments are progress on the inflation front that started to stall a bit more later in Q1 in both regions. Services inflation remains very elevated in the U.K. The readings are lower for the euro area although the trend was for it to have outright reaccelerated in Q1. That however, proved of little concern to the ECB, who at its April meeting sent off a clear easing bias by outlining criteria that would allow for a reduction in tight monetary policy soon. All told, we continue to expect both central banks will deliver a first cut this summer, (the ECB in June and the BoE later in August) before moving at a slower once-every-other-meeting pace after. Stronger than expected output growth and lack of progress on services inflation seen out in Q1 should warrant a more cautious approach in this easing cycle, especially given the cautionary tell of surging inflation in the U.S.

Interest rate outlook

Policy rates and government bond yields, end of period

	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
Canada												
Overnight rate	4.50	4.75	5.00	5.00	5.00	4.75	4.25	4.00	3.75	3.25	3.00	3.00
Three-month	4.34	4.90	5.07	5.04	4.99	4.65	4.10	3.95	3.60	3.20	3.00	3.00
Two-year	3.74	4.58	4.87	3.88	4.22	3.95	3.60	3.25	2.90	2.75	2.90	3.00
Five-year	3.02	3.68	4.25	3.17	3.58	3.50	3.25	3.00	2.85	2.90	2.90	3.00
10-year	2.90	3.26	4.03	3.10	3.52	3.45	3.25	3.00	2.90	2.95	3.00	3.10
30-year	3.02	3.09	3.81	3.02	3.41	3.40	3.25	3.05	3.00	3.05	3.10	3.15
United States												
Fed funds midpoint	4.88	5.13	5.38	5.38	5.38	5.38	5.38	5.13	4.88	4.63	4.63	4.63
Three-month	4.85	5.43	5.55	5.40	5.45	5.36	5.23	4.93	4.75	4.53	4.60	4.65
Two-year	4.06	4.87	5.03	4.23	4.66	4.95	4.95	4.90	4.80	4.70	4.70	4.75
Five-year	3.60	4.13	4.60	3.84	4.28	4.60	4.60	4.45	4.35	4.35	4.40	4.50
10-year	3.48	3.81	4.59	3.88	4.27	4.45	4.40	4.30	4.25	4.30	4.40	4.50
30-year	3.67	3.85	4.73	4.03	4.41	4.55	4.45	4.50	4.55	4.60	4.70	4.80
United Kingdom												
Bank rate	4.25	5.00	5.25	5.25	5.25	5.25	4.75	4.25	4.00	3.75	3.75	3.75
Two-year	3.42	5.27	4.91	3.98	4.17	4.40	4.30	4.15	4.00	3.90	4.00	4.00
Five-year	3.33	4.66	4.53	3.46	3.84	3.90	3.80	3.60	3.50	3.55	3.60	3.65
10-year	3.47	4.39	4.46	3.54	3.95	4.00	3.90	3.75	3.70	3.75	3.85	3.95
30-year	3.82	4.42	4.92	4.14	4.49	4.70	4.60	4.50	4.50	4.60	4.70	4.85
Euro area*												
Deposit Rate	3.00	3.50	4.00	4.00	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
Two-year	2.66	3.27	3.20	2.40	2.83	2.70	2.70	2.60	2.50	2.40	2.30	2.30
Five-year	2.30	2.58	2.79	1.94	2.32	2.40	2.30	2.20	2.15	2.20	2.20	2.25
10-year	2.28	2.39	2.85	2.03	2.29	2.40	2.35	2.20	2.20	2.20	2.25	2.30
30-year	2.35	2.38	3.05	2.27	2.46	2.60	2.50	2.50	2.50	2.50	2.60	2.70
Australia												
Cash target rate	3.60	4.10	4.10	4.35	4.35	4.35	4.35	4.35	4.10	3.85	3.85	3.85
Two-year	2.96	4.21	4.09	3.71	3.76	4.10	4.00	3.95	3.75	3.85	3.90	4.00
10-year	3.30	4.02	4.49	3.95	3.97	4.30	4.25	4.10	4.00	4.05	4.15	4.20
New Zealand												
Cash target rate	4.75	5.50	5.50	5.50	5.50	5.50	5.50	5.00	4.50	4.50	4.50	4.50
Two-year swap	5.01	5.46	5.69	4.63	4.78	4.95	4.80	4.65	4.60	4.70	4.75	4.80
10-year swap	4.27	4.46	5.13	4.12	4.35	4.50	4.45	4.40	4.35	4.45	4.55	4.65

Sources: Refinitiv, BoC, Fed, BoE, ECB, RBA, RBNZ, RBC Economics, RBC Capital Markets | *German government bond yields

Economic outlook

Real GDP, quarter-over-quarter percent change

	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	2021	2022	2023	2024	2025
Canada*	3.9	3.8	1.8	-0.9	2.6	0.6	-0.5	1.0	2.5	1.4	1.4	1.8	1.8	1.8	2.0	2.1	5.3	3.8	1.1	1.3	1.8
United States*	-2.0	-0.6	2.7	2.6	2.2	2.1	4.9	3.4	1.6	2.5	1.0	1.2	1.8	1.8	1.8	1.8	5.8	1.9	2.5	2.4	1.6
United Kingdom	0.5	0.1	-0.1	0.1	0.2	0.0	-0.1	-0.3	0.2	0.1	0.2	0.2	0.3	0.3	0.3	0.3	8.7	4.3	0.1	0.2	1.1
Euro area	0.6	0.8	0.5	0.0	0.0	0.1	-0.1	-0.1	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	5.9	3.5	0.5	0.7	1.5
Australia	0.5	0.8	0.2	0.8	0.6	0.5	0.3	0.2	0.2	0.4	0.6	0.7	0.8	0.8	0.8	0.7	5.6	3.8	2.1	1.4	2.9

*annualized

Inflation, year-over-year percent change

	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	2021	2022	2023	2024	2025
Canada	5.8	7.5	7.2	6.7	5.1	3.5	3.7	3.2	2.8	2.8	2.2	1.9	2.0	1.9	1.9	1.8	3.4	6.8	3.9	2.4	1.9
United States	8.0	8.6	8.3	7.1	5.8	4.0	3.5	3.2	3.2	3.4	3.1	2.8	2.2	1.8	1.9	1.9	4.7	8.0	4.1	3.1	1.9
United Kingdom	6.2	9.2	10.0	10.8	10.2	8.4	6.7	4.2	3.5	2.8	2.9	2.7	2.2	1.7	1.9	1.8	2.6	9.1	7.3	3.2	1.9
Euro area	6.1	8.0	9.3	10.0	8.0	6.2	5.0	2.7	2.6	2.5	2.1	2.4	2.2	2.2	2.2	2.1	2.6	8.4	5.4	2.4	2.2
Australia	5.1	6.1	7.3	7.8	7.0	6.0	5.4	4.1	3.6	3.7	3.2	3.3	3.2	3.1	3.1	3.0	2.9	6.6	5.6	3.5	3.1

Sources: StatCan, BLS, ONS, EuroStat, ABS, RBC Economics, RBC Capital Markets

Currency outlook

US dollar cross rates, end of period

	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
USD/CAD	1.35	1.32	1.35	1.32	1.35	1.37	1.39	1.40	1.41	1.42	1.41	1.40
EUR/USD	1.09	1.09	1.06	1.11	1.08	1.06	1.05	1.07	1.08	1.08	1.09	1.08
GBP/USD	1.24	1.27	1.22	1.27	1.26	1.25	1.22	1.23	1.23	1.21	1.21	1.19
USD/JPY	133	144	149	141	151	158	160	162	162	160	158	156
AUD/USD	0.67	0.67	0.65	0.68	0.65	0.64	0.65	0.66	0.67	0.67	0.68	0.68

Canadian dollar cross rates

	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
EUR/CAD	1.47	1.44	1.43	1.46	1.46	1.45	1.45	1.50	1.52	1.53	1.54	1.51
GBP/CAD	1.67	1.68	1.65	1.68	1.71	1.71	1.69	1.72	1.73	1.72	1.71	1.66
CAD/JPY	98	109	110	107	112	115	116	116	115	113	112	111
AUD/CAD	0.91	0.88	0.87	0.90	0.88	0.88	0.90	0.92	0.94	0.95	0.96	0.95

Sources: Federal Reserve Board, Bank of Canada, RBC Economics, RBC Capital Markets

RBC Economics & Thought Leadership

Financial Markets Monthly

March 2024

U.S. outperformance continues but no sunshine yet for the Canadian economy

Resilience in the U.S. economy continued to buoy investors' confidence, driving equities higher and narrowing credit spreads in February. Conditions also looked to have bottomed in the euro area and U.K. as purchasing manager indices pointed to a sustained rebound in services demand. In Canada, things are much less upbeat—output growth in Q4 2023 inched along but per-capita output continues to decline. Insolvencies among businesses and consumers are continuing to rise, sounding the alarm for downside economic risks ahead.

Highlights:

- Global central banks are reiterating that more progress is still needed on inflation before they can commit to cutting interest rates.
- We continue to expect the U.S. Federal Reserve to make its first cut to rates in its June meeting, and the Bank of Canada and European Central Bank in the week prior to the Fed (also in June), and a much more hawkish sounding Bank of England to follow suit later in August.
- Resurfacing inflation pressures in the U.S. over early 2024 means a more cautious Fed after the start of rate cuts. We expect them to go by a slower pace (once every other meeting) for the rest of 2024.
- Topic in focus: Business insolvencies have surged in Canada in early 2024. Granted, the increase is from exceptionally low levels during the pandemic, and the January deadline for federal CEBA pandemic support loans is likely playing a role. But the trend looks concerning nonetheless and serves as a reminder that downside economic growth risks remain, and further deterioration in labour market conditions and household incomes are not entirely off the radar.

Overview

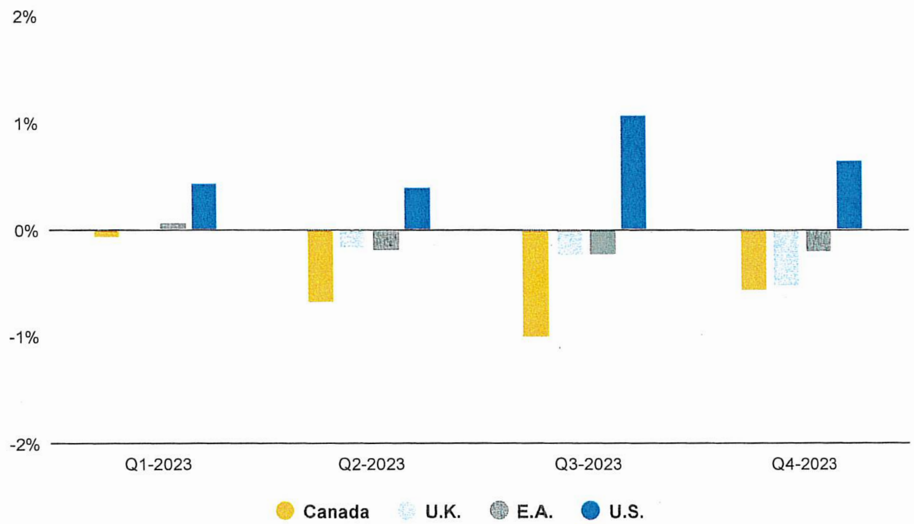
Claire Fan | Economist | claire.fan@rbc.com | 416-974-3639

U.S. resilience stretching on but inflation risks also resurfacing

The outperformance of the U.S. economy persisted for another month. Personal spending on services was still running hot in January, and February's payroll report extended the streak of solid employment gains. A strong macro backdrop won't be problematic as long as inflation stays low. However, CPI data over early 2024 also showed price pressures reaccelerating. That's likely to set the Federal Reserve back a step in its assessment of the sustainability of low inflation over the second half of last year. Markets have pared back pricing for rate cuts this year, moving towards a June starting point that is consistent with our forecast. Beyond then however, we expect fewer cuts this year at a pace of every other meeting for the rest of 2024 (we had expected the Fed to cut in every meeting previously), leaving the Fed Funds range 50 bps higher than we previously expected, at 4.5% - 4.75% by the end of this year.

Economic growth disparity persisting among economies

Quarterly growth in per-capita GDP



Source: Haver, RBC Economics calculations | *Estimates for UK and the EA are based on working age population

Economic conditions in Canada, euro area and the U.K. remain much softer. Gross domestic product growth in Canada trudged along in Q4 2023 with a surge in exports masking a large contraction in business investment. GDP growth in Q4 also came in weak in the euro area (barely changed from Q3) and the U.K. (a larger than expected -0.3% non-annualized decline.) Monthly PMI surveys did show a rebound in activities in both regions over the early months of 2024, primarily driven by stronger demand for services as the sub-indices are now within the expansion zone for both. The same cannot be said about Canada, where insolvencies are still rising and labour market conditions continue to soften.

Despite the divergence in economic growth backdrops, the messaging from global central banks has remained largely uniform—more progress is needed on inflation before they can commit to cutting interest rates. The BoC and ECB both reiterated that message last month while delivering widely expected holds on interest rates. U.S. economic outperformance has raised concerns that the Fed will need to be more cautious about easing than previously expected. But comments from policymakers, including chair Jerome Powell, have largely reinforced the central bank's preference, which is to begin cutting interest rates this year. We continue to look for the BoC, Fed and the ECB to start to move rates lower in June, followed by BoE in August and the Reserve Bank of Australia later in December.

Central bank bias

Central bank	Current policy rate (latest move)	Next decision
BoC	**5.00%** +0 bps in Mar/24	**0 bps** Apr/24

The BoC left rates unchanged for a fifth meeting in March, highlighting softening in the economy as evidence that monetary policy is working to restrict activity. The catch is still elevated core inflation readings, which the BoC expects to gradually fall in the second half. We continue to expect price pressures to keep easing, driving a first rate cut around mid-year.

Central bank	Current policy rate (latest move)	Next decision
Fed	**5.25-5.50%** +0 bps in Jan/24	**0 bps** Mar/24

Recent CPI data showed a rebound in underlying price pressures in the U.S. in early 2024. That coupled with the backdrop of a booming economy means the Fed will likely be extra cautious around their assessment of where inflation is heading (our expectation is still down), and when rates should be moving lower. We continue to expect a first cut in June after inflation follows rent growth lower.

Central bank	Current policy rate (latest move)	Next decision
BoE	**5.25%** +0 bps in Feb/24	**0 bps** Mar/24

Impact on monetary policy in the U.K. from the recently announced budget is expected to be minimal. The boost to aggregated demand from measures announced is expected to be offset by added labour supply and is not expected to add to inflation. The BoE expressed the need to see persistent signs of CPI returning to target before cutting rates. We expect the first move to come in August.

Central bank	Current policy rate (latest move)	Next decision
ECB	**4.00%** +0 bps in Mar/24	**0 bps** Apr/24

The ECB left the deposit rate unchanged in its March meeting with the updated staff forecast showing downgrades to the near and medium-term inflation forecast. February's early euro area inflation data showed a lack of progress especially in the services components, but still tracks closely to ECB's forecast on a quarter basis. President Christine Lagarde endorsed a first rate cut in June in line with our view.

Central bank	Current policy rate (latest move)	Next decision
RBA	**4.35%** +0 bps in Feb/24	**0 bps** Mar/24

Q4 GDP data was on consensus to confirm softening in the Australian economy, especially in interest rate sensitive sectors. Labour market conditions have weakened, although not to a degree that would warrant immediate easing from the RBA. Our base case remains for rate cuts to begin in Q4 (50bps total in the quarter), followed by two more cuts in the first half of 2025 taking the cash rate to 3.35%.

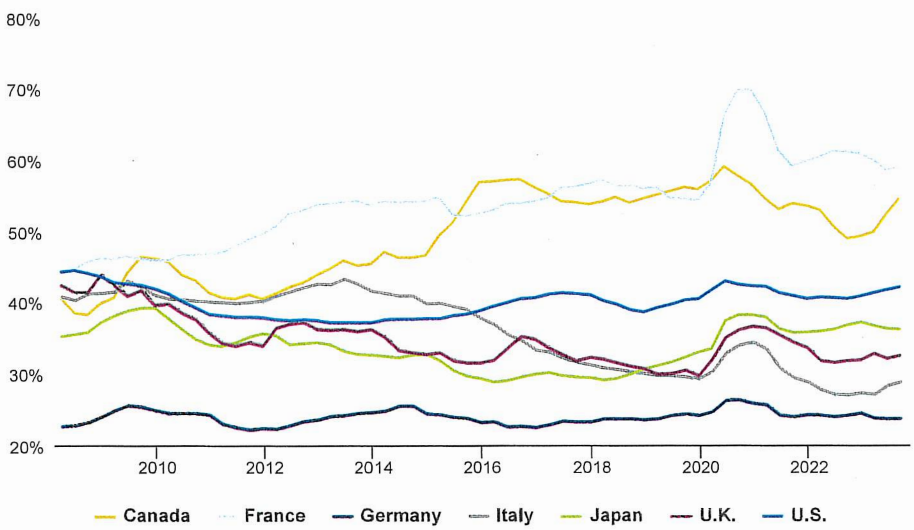
Corporate bankruptcies are rising in Canada

Business insolvencies surged in Canada in early 2024 to levels not seen since the great financial crisis. What's concerning is that most of the insolvencies were driven by actual bankruptcies that have more than doubled since last fall, instead of proposals for businesses to settle debt with creditors under conditions outside of the existing terms. Part of the increase may have been tied to the end of some government pandemic support programs. The repayment deadline for federal CEBA loans was in January. The rise also follows a period of exceptionally low business insolvencies during the pandemic.

Data from the Business Investment Survey also showed a large pickup in the Canadian non-financial corporate sector's debt servicing ratio. Several factors likely contributed, including a more indebted non-financial corporate sector as a whole (debt-to-GDP ratio was the second highest among G7 just after France), and differences in term structures for business non-mortgage borrowing.

Debt servicing for Canadian businesses jumps as rates rise

Debt service ratio for private non-financial businesses

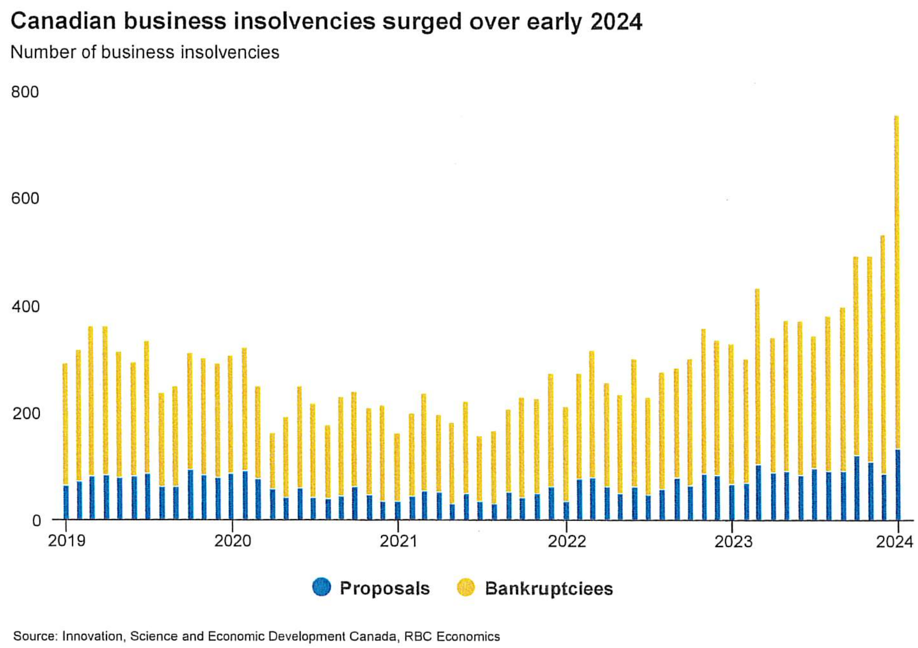


Source: Bank of International Settlement, RBC Economics

Consumer facing sectors harder hit

Many Canadian companies that survived the pandemic with the help of government support are now facing a triple whammy of slowing consumer demand, rising borrowing costs and deteriorating productivity. The conditions look worse for businesses in consumer-facing sectors such as retail, housing and accommodation, food, and recreation, which have seen the largest increase in insolvencies and the worst deterioration in credit access. Lenders have tightened standards in part due to anticipating softer demand in these areas, according to the Q4 2023 Bank of Canada Business Outlook Survey.

A high concentration of small businesses in these sectors also likely explains part of the underperformance, as small businesses tend to have less diverse financing sources. The deadline for small businesses to pay back CEBA loans without forgoing the forgivable portion likely further exacerbated the situation. We already saw an unusual increase in chartered banks' business loans advanced towards the end of last year, likely driven by higher demand among small businesses to refinance debt to meet the CEBA January deadline.



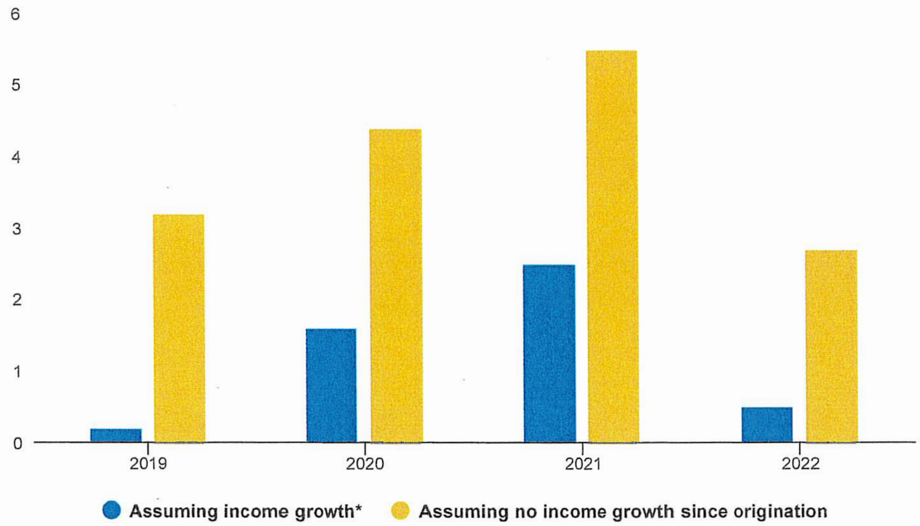
Surging insolvencies pose risks to household income

It remains to be seen whether this recent rise in business insolvencies will be "transitory" (remember the last time that word was used to describe inflation?), or if it's reflective of persistent underlying weakness in businesses operating conditions. Regardless, it will have a negative impact on the labour market.

As highlighted in the last Financial Market Monthly, the current cycle already counts as the longest where the unemployment rate has risen without the Bank of Canada cutting interest rates. The biggest reason behind that is rising inflation risks that have yet to fully subside. It also has to do with the fact that most of the deterioration in labour market conditions to date has not been coming from outright layoffs, implying less spillover to household income and credit conditions. That outlook will be put to the test in the coming quarters if the acceleration in business closures is followed by an acceleration in layoffs.

Rise in mortgage payments managable, if income continues to grow

Median increase in mortgage debt service ratio at renewal



Source: Bank of Canada, RBC Economics*Assumes income grows by 2.4% per year - the average growth rate over last 10 years

Loss of employment and income could be especially dangerous in an environment where households are highly indebted and expected to keep facing payment increases as fixed-rate mortgages get renewed at higher interest rates. Earlier analysis from the BoC highlighted continued income growth as key for households to be able to handle increasing mortgage payments. The expected increase in the mortgage debt servicing ratio could more than double or in some cases quintuple if households lose their income from layoffs.

We continue to expect a mild slowing in the Canadian economy (on a per capita basis) with some improvement over the second half thanks to strong population growth and expected easing from the BoC. But the rise in business bankruptcies is a reminder that downside risks remain.

Interest rate outlook

Policy rates and government bond yields, end of period

	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
Canada												
Overnight rate	4.50	4.75	5.00	5.00	5.00	4.75	4.25	4.00	3.75	3.25	3.00	3.00
Three-month	4.34	4.90	5.07	5.04	4.95	4.65	4.10	3.95	3.60	3.20	3.00	3.00
Two-year	3.74	4.58	4.87	3.88	4.20	3.80	3.50	3.25	2.90	2.75	2.90	3.00
Five-year	3.02	3.68	4.25	3.17	3.45	3.30	3.10	3.00	2.85	2.90	2.90	3.00
10-year	2.90	3.26	4.03	3.10	3.40	3.25	3.10	3.00	2.90	2.95	3.00	3.10
30-year	3.02	3.09	3.81	3.02	3.35	3.25	3.15	3.05	3.00	3.05	3.10	3.15
United States												
Fed funds midpoint	4.88	5.13	5.38	5.38	5.38	5.13	4.88	4.63	4.63	4.38	4.38	4.13
Three-month	4.85	5.43	5.55	5.40	5.33	5.01	4.78	4.53	4.58	4.33	4.33	4.08
Two-year	4.06	4.87	5.03	4.23	4.60	4.50	4.35	4.30	4.25	4.20	4.20	4.25
Five-year	3.60	4.13	4.60	3.84	4.15	4.05	3.95	3.95	3.95	4.00	4.10	4.20
10-year	3.48	3.81	4.59	3.88	4.15	4.05	3.95	4.00	4.05	4.10	4.20	4.30
30-year	3.67	3.85	4.73	4.03	4.30	4.20	4.15	4.20	4.25	4.30	4.35	4.40
United Kingdom												
Bank rate	4.25	5.00	5.25	5.25	5.25	5.25	4.75	4.25	4.00	3.75	3.75	3.75
Two-year	3.42	5.27	4.91	3.98	4.50	4.40	4.30	4.15	4.00	3.90	4.00	4.00
Five-year	3.33	4.66	4.53	3.46	4.00	3.90	3.80	3.60	3.50	3.55	3.60	3.65
10-year	3.47	4.39	4.46	3.54	4.10	4.00	3.90	3.75	3.70	3.75	3.85	3.95
30-year	3.82	4.42	4.92	4.14	4.75	4.70	4.60	4.50	4.50	4.60	4.70	4.85
Euro area*												
Deposit Rate	3.00	3.50	4.00	4.00	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
Two-year	2.66	3.27	3.20	2.40	2.75	2.70	2.70	2.60	2.50	2.40	2.30	2.30
Five-year	2.30	2.58	2.79	1.94	2.50	2.40	2.30	2.20	2.15	2.20	2.20	2.25
10-year	2.28	2.39	2.85	2.03	2.55	2.40	2.35	2.20	2.20	2.20	2.25	2.30
30-year	2.35	2.38	3.05	2.27	2.70	2.60	2.50	2.50	2.50	2.50	2.60	2.70
Australia												
Cash target rate	3.60	4.10	4.10	4.35	4.35	4.35	4.35	3.85	3.35	3.35	3.35	3.35
Two-year	2.96	4.21	4.09	3.71	3.70	3.65	3.50	3.40	3.40	3.40	3.60	3.75
10-year	3.30	4.02	4.49	3.95	4.30	4.25	4.10	4.00	3.95	3.95	4.00	4.25
New Zealand												
Cash target rate	4.75	5.50	5.50	5.50	5.50	5.50	5.00	4.50	4.00	4.00	4.00	4.00
Two-year swap	5.01	5.46	5.69	4.63	5.00	4.75	4.40	4.25	4.25	4.25	4.30	4.35
10-year swap	4.27	4.46	5.13	4.12	4.50	4.40	4.30	4.25	4.30	4.45	4.50	4.60

Sources: Refinitiv, BoC, Fed, BoE, ECB, RBA, RBNZ, RBC Economics, RBC Capital Markets | *German government bond yields

Economic outlook

Real GDP, quarter-over-quarter percent change

	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	2021	2022	2023	2024	2025
Canada*	3.9	3.8	1.8	-0.9	2.6	0.6	-0.5	1.0	0.3	1.4	1.8	2.2	2.0	2.1	2.6	2.9	5.3	3.8	1.1	0.8	2.1
United States*	-2.0	-0.6	2.7	2.6	2.2	2.1	4.9	3.2	2.0	0.5	1.0	1.2	1.8	1.8	1.8	1.8	5.8	1.9	2.5	2.1	1.5
United Kingdom	0.5	0.1	-0.1	0.1	0.2	0.0	-0.1	-0.3	0.0	0.1	0.2	0.2	0.3	0.3	0.3	0.3	8.7	4.3	0.1	0.0	1.1
Euro area	0.6	0.8	0.5	0.0	0.0	0.1	-0.1	0.0	0.0	0.1	0.2	0.3	0.3	0.4	0.4	0.4	5.9	3.5	0.5	0.2	1.2
Australia	0.5	0.8	0.2	0.8	0.6	0.5	0.3	0.2	0.3	0.6	0.9	0.7	0.8	0.8	0.8	0.7	5.6	3.8	2.1	1.6	3.1

*annualized

Inflation, year-over-year percent change

	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	2021	2022	2023	2024	2025
Canada	5.8	7.5	7.2	6.7	5.1	3.5	3.7	3.2	3.0	2.8	2.2	2.0	2.0	1.9	1.9	1.8	3.4	6.8	3.9	2.5	1.9
United States	8.0	8.6	8.3	7.1	5.8	4.0	3.5	3.2	3.1	3.0	2.8	2.7	2.3	2.2	2.1	2.1	4.7	8.0	4.1	2.9	2.2
United Kingdom	6.2	9.2	10.0	10.8	10.2	8.4	6.7	4.2	4.3	2.8	2.9	2.7	2.2	1.7	1.9	1.8	2.6	9.1	7.3	3.2	1.9
Euro area	6.1	8.0	9.3	10.0	8.0	6.2	5.0	2.7	2.6	2.5	2.1	2.3	2.2	2.1	2.1	2.1	2.6	8.4	5.4	2.4	2.1
Australia	5.1	6.1	7.3	7.8	7.0	6.0	5.4	4.1	3.5	3.4	2.9	3.1	3.0	2.9	2.9	2.8	2.9	6.6	5.6	3.2	2.9

Sources: StatCan, BLS, ONS, EuroStat, ABS, RBC Economics, RBC Capital Markets

Currency outlook

US dollar cross rates, end of period

	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
USD/CAD	1.25	1.29	1.38	1.35	1.35	1.32	1.35	1.32	1.34	1.36	1.33	1.31	1.31	1.30	1.30	1.29
EUR/USD	1.11	1.05	0.98	1.07	1.09	1.09	1.06	1.11	1.08	1.06	1.06	1.08	1.10	1.12	1.15	1.18
GBP/USD	1.32	1.22	1.11	1.21	1.24	1.27	1.22	1.27	1.27	1.25	1.23	1.24	1.24	1.23	1.24	1.26
USD/JPY	121	136	145	132	133	144	149	141	145	145	150	150	146	141	138	135
AUD/USD	0.75	0.69	0.64	0.68	0.67	0.67	0.65	0.68	0.65	0.64	0.65	0.66	0.68	0.70	0.71	0.73

Canadian dollar cross rates

	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
EUR/CAD	1.39	1.35	N/A	1.45	1.47	1.44	1.43	1.46	1.45	1.44	1.41	1.41	1.44	1.46	1.49	1.52
GBP/CAD	1.64	1.57	N/A	1.63	1.67	1.68	1.65	1.68	1.70	1.70	1.64	1.63	1.61	1.60	1.60	1.62
CAD/JPY	97	105	N/A	97	98	109	110	107	108	107	113	115	112	108	107	105
AUD/CAD	0.94	0.89	N/A	0.92	0.91	0.88	0.87	0.90	0.87	0.87	0.86	0.86	0.89	0.91	0.92	0.94

Sources: Federal Reserve Board, Bank of Canada, RBC Economics, RBC Capital Markets