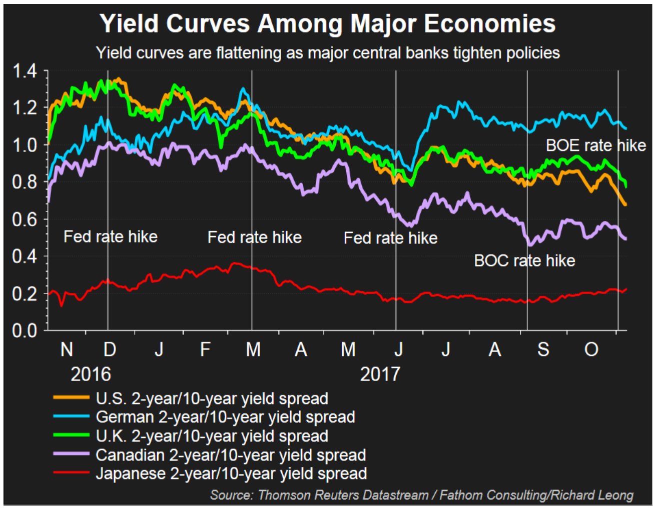
JANUARY 2018

Debt Market Monitor

National Debt Capital Markets Services

How low can the yield curve go in 2018?



Many revered bond-fund managers and analysts are sensing that 2018 will bring a flat yield curve. The U.S. Federal Reserve Bank has been successful in moving the short end of the curve, but not so much the long end. Further plans to hike rates three or four more times in 2018 will see the short end of the yield curve moving closer to the long end and, thus, flattening. T. Rowe Price Group, which manages about $950 billion, has forecast a zero-yield curve in 2018. Morgan Stanley, which is also forecasting the same flat yield curve to occur in the third quarter of 2018, indicates that the 30-year yield is expected to hit 2% – which would be the lowest level since the global financial crisis – in the fourth quarter of 2018.

The question is: What will push the long end of the curve lower? With a strong global economy forecast for 2018, the demand for longer-term debt will continue to buoy prices. Coupled with the U.S. central bank's plan to raise rates three or four more times in 2018, the effect will cause a narrowing of the yield curve. If the U.S. grows more rapidly and targeted inflation of 2% or even more shows up, look for rates to be raised quicker and in larger increments consequently producing a zero-yield curve sooner in 2018. Those items that constitute treasury yields – policy, inflation and term premium – all seem to lead to the flattening of the yield curve. The yield curve spread from two-to-10-year treasuries is now as low as it has been since April 2005 – about two and a half years before the recession began. It remained close to zero for about 18 months.

If a zero-yield curve reveals itself, the markets could react negatively with concern of a recession. However, it is interesting to note that the S&P 500 Index peaked well after the previous two instances when the yield curve completely flattened.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending
December 2017	1.25	3.20
One month ago	1.25	3.20
One year ago	0.75	2.70

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
December 2017	1.86	2.04	2.26
One month ago	1.63	1.89	2.23
One year ago	1.11	1.72	2.26

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
December 2017	1.50 - 2.00	1.65 - 2.00
One year ago	1.70 - 2.00	1.85 - 2.35

Insured	5-Year	10-Year
December 2017	0.90 - 1.10	0.90 - 1.10
One year ago	0.95 - 1.10	1.00 - 1.20

*Spreads are indicative of high quality real estate in major Canadian markets.

Highlighted Transaction

Asset Type	Multi-tenanted office building
Location	Major Canadian city
Facility Details	A senior charge facility in the amount of $29,500,000 for a 5 year term and a 25 year amortization at a very low rate of interest.

Intelligent Debt Financing Solutions

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Please contact our National Debt Capital Markets team for more details related to debt financings or real estate transactions.

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