OCTOBER 2018

Debt Market Monitor

Debt Capital Markets Services

Rising interest rates could threaten economic growth

The U.S. Federal Reserve's September 0.25% interest-rate increase came as no surprise to anyone. Unemployment rates are ultra-low, wages seem to have gained traction and upward momentum, and gross domestic product recently exceeded 4% with solid predictions for the remainder of this year. This good news provides a greater confirmation that the Federal Open Market Committee and the Board of Governors of the Federal Reserve (the Fed) will continue with more frequent interest-rate increases. December's anticipated Fed interest-rate increase of an another 0.25% is all but certain; however, some traders are wondering whether a 0.50% increase is possible. Many Fed watchers are worried that, in 2019, interest rate-increases could occur as many as five more times. The added worry is that these accelerated rate increases could very well slow economic growth. Of course, these anticipated hikes constitute guesswork presently and are, perhaps, unlikely. But who knows?

The Fed is anxious to raise rates back to normal levels in order to have a defense against the next recession. Officials face a delicate balance. When do you raise rates? By how much? To what level? And, how do you prevent economic growth from stalling in a fairly volatile environment? Some Fed watchers have sensed that it would like to see rates about 2% higher than the current levels of 1.75% to 2.00%. If this prediction is accurate, that would mean a Fed Funds rate of 3.75% to 4.00% by somewhere around 2020. The Fed hopes that it would have that amount of runway to increase rates; however, officials may not have that much time before another recession occurs – if one does. Typically, interest rates decline during a recession to provide stimulus for economic growth. Is there a policy mistake in the offing? Another consideration that is more near-term is the shape of the yield curve. With the Fed pushing short- term rates higher, they could cause the yield curve to go negative or become inverted whereby shorter- term interest rates become higher than longer-term ones. Surprisingly, some Fed members have indicated that they are not worried about such a scenario. In the past, negative yield curves have been symptoms of recessions – not the cause.

The Fed is highly reactive, relying on metrics that are slow to become available. By the time the indicators of a recession are clear, it is often too late for the Fed to be proactive. Consequently, there may be no policy measures available to fight a recession.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
September 2018	1.75	3.70
One month ago	1.75	3.70
One year ago	1.25	3.20

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
September 2018	2.32	2.41	2.41
One month ago	2.16	2.22	2.35
One year ago	1.75	2.10	2.47

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
September 2018	1.50 - 2.20	1.60 - 2.20
One year ago	1.50 - 2.25	1.90 - 2.35

Insured	5-Year	10-Year
September 2018	0.80 - 1.10	0.80 - 1.10
One year ago	0.95 - 1.15	0.95 - 1.25

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

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Highlighted Transaction

Asset Type	Multi residential project
Location	Major Canadian city
Facility Details	A $10.5M senior, permanent mortgage charge insured by CMHC for refinance purposes. The loan structure included a 5 year term, amortized over 25 years at a competitive rate of interest, on a non-recourse basis.

Intelligent Debt Financing Solutions

The Avison Young Debt Capital Markets dedicated team is focused on providing innovative North American-wide debt and equity solutions to accomplish goals. We originate debt and equity for all types of real estate and all types of clients. Debt origination includes fixed and floating rate structures, permanent and construction financing, structured finance, bridge and mezzanine debt and insured agency financing - CMHC and Fannie Mae / Freddie Mac.

Our years of combined debt/equity capital markets experience has created meaningful relationships that we can put to work for you.

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

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