AVISON YOUNG

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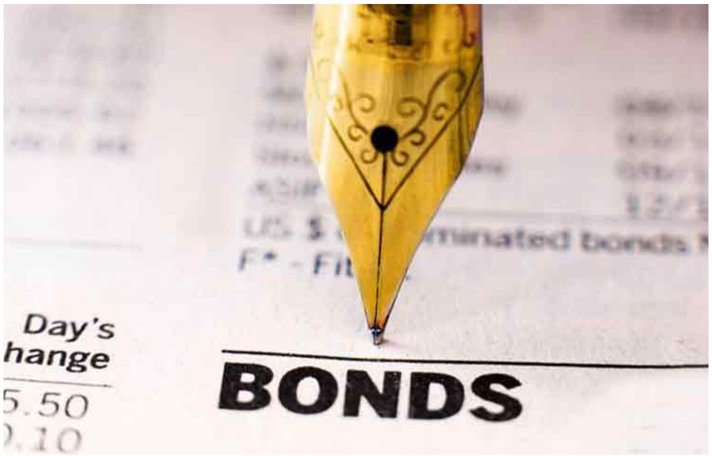
Debt market monitor

Do bonds trade in reaction to market effects such as inflation?



Bond markets are probably the most manipulated markets in the world. Central banks have unlimited money-printing capabilities that are utilized to make bond markets react as desired.

Take the U.S. Treasury market, for example. The 10-year Treasury yield was 1.75% at the end of March 2021, but by July 19, it had dropped to 1.19%, and five days later it closed at 1.30%. This drop in yield occurred even as inflation spiked. The Consumer Price Index (CPI) rate of inflation jumped from 1.9% year-over-year to 5.4% in June 2021. The implication of this bond market movement is that inflation is nothing to worry about and CPI will be at 1% or 1.5% in the near term; and that the bond market is right, and CPI, oddly, is not.

Historically, the 10-year Treasury yield is usually higher than the rate of annual CPI inflation, meaning the real 10-year yield after inflation is positive. There have been very few (and brief) periods when the 10-year yield was below the CPI, for a negative yield. Currently, with the 10-year yield at 1.3% and the annual CPI at 5.4%, the 10-year real yield is negative 4.1% – the furthest into negative territory since June 1980.

The U.S. Federal Reserve Bank (the Fed) controls the short end of the Treasury market through its policy interest rates and manipulates the long-term bond markets with its bond purchases. Quantitative Easing (QE) is designed to push down long-term interest rates. The Fed has recently been buying \$80 billion in treasury securities and \$40 billion in mortgage-backed securities each month (all figures in USD); additionally, it has been buying the maturing and refinanced securities. Therefore, the total monthly intervention in the bond market is closer to \$200 billion than \$120 billion. Other central banks, such as the European Central Bank and the Bank of Japan, have repressed interest rates into the negative, which has also had some spillover effects on the U.S. bond market.

The trillions in liquidity created by global QE since March 2020 is chasing assets and yield, which has led to an artificial phenomenon compressing yields, such as BB-rated U.S. junk bond yields, which dropped to 3.15% as of June 2021 – meaning a negative real yield even for junk bonds.

Fiscal snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
July 2021	0.50	2.45
June 2021	0.50	2.45
July 2020	0.50	3.95

Government of Canada benchmark bond yields

	5-Year	10-Year	Long
July 2021	0.81	1.20	1.76
June 2021	0.97	1.39	1.84
July 2020	0.31	0.46	0.92

Indicative commercial mortgage spreads* Over Government of Canada bond yields

Conventional	5-Year	10-Year
July 2021	1.40 - 1.90	1.50 - 2.00
July 2020	1.60 - 2.00	1.70 - 2.10

Insured	5-Year	10-Year
July 2021	0.85 - 1.00	0.95 - 1.10
July 2020	0.90 - 1.20	0.90 - 1.20

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

Source(s): Bank of Canada

Debt Capital Markets Services

Highlighted transaction

Asset type	Development Land
Location	Secondary Canadian city
Facility details	A bridge facility to development, to assist with the acquisition of a 35-acre parcel of commercial land, was arranged for a two-year term in the amount of $15,500,000, at a competitive rate of interest.

Intelligent debt financing solutions

The Avison Young Debt Capital Markets Group 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.

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

Avison Young creates real economic, social and environmental value as a global real estate advisor, powered by people. As a private company, our clients collaborate with an empowered partner who is invested in their success. Our integrated talent realizes the full potential of real estate by using global intelligence platforms that provide clients with insights and advantage. Together, we can create healthy, productive workplaces for employees, cities that are centers for prosperity for their citizens, and built spaces and places that create a net benefit to the economy, the environment and the community.

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

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