

Central banks are tapering – what will happen next?

Many central banks have announced or commenced plans to begin tapering their bond-buying activities, known as quantitative easing. The U.S. central bank – the most influential in the world – will reduce the pace of its monthly purchases from US\$120 billion per month to \$105 billion in November and \$90 billion in December. If the amount purchased continues to decrease by \$15 billion each month, the entire program could be unwound by mid-2022.

The bond market was already pricing in an ever-more-hawkish Federal Reserve (Fed) for the last several weeks, resulting in a steepening of front-end yields and flattening of back-end yields. As the inflation reading remains high, global bond markets started to increase two- and five-year interest rates, anticipating faster and more aggressive rate hikes. The U.S. Treasury bond market even started to consider the idea of rate hikes as early as June 2022, just as the Fed's tapering program was expected to conclude.

Faster and more aggressive rate hikes are seen as negative for long-term economic growth, and thus the back end of the Treasury curve started to flatten



significantly. Fed Chairman Jerome Powell announced the tapering plan the market expected, but when pressed on the issue of rate hikes, Powell pushed back on the idea that they are coming soon and provided an indication that rate hikes will come after the tapering plan, pushing the first rate-hike expectation back towards September or December 2022.

Initial market reactions are mostly noise and are often reversed, but the knee-jerk move in the yield curve was a dovish reaction, pushing back rate hikes and steepening the Treasury yield curve.

Fiscal snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
October 2021	0.50	2.45
September 2021	0.50	2.45
October 2020	0.50	2.45

Government of Canada benchmark bond yields

	5-Year	10-Year	Long
October 2021	1.50	1.72	2.02
September 2021	1.11	1.51	1.98
October 2020	0.40	0.66	1.25

Indicative commercial mortgage spreads* Over Government of Canada bond yields

Conventional	5-Year	10-Year
October 2021	1.35 - 1.85	1.45 - 2.00
October 2020	1.65 - 2.00	1.75 - 2.10
Insured	5-Year	10-Year
October 2021	0.80 - 1.00	0.95 - 1.10
October 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

Highlighted transaction

Asset type Mixed Use Retail Office

Location Major Canadian City

Facility details A senior charge facility in the amount of \$25.5 million was arranged to assist with the acquisition for a five-year term and 25-year amortization. The structure included a formula reduction in the guarantee over time, subject to performance.

Intelligent debt financing solutions

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