AVISON YOUNG

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Debt Market Monitor

Debt Capital Markets Services

How inflation impacts interest rates

The last meeting of the U.S. Federal Reserve Open Market Committee (FOMC) resulted in no interest-rate hike, as most expected. In its policy statement, the committee reaffirmed patience as the theme and that it would end its balance sheet reduction in September – by up to $50 billion per month. The FOMC offered no substantive explanation why its position changed from hawkish in late 2018 to dovish in early 2019. There are a few reasons that appear to have influenced the FOMC's forward view and actions – essentially a 180-degree about-face. The current U.S. administration has had a direct effect on the FOMC's membership through its appointments, thus entrenching the more desired dovishness. Next, the Federal Reserve (the Fed) saw considerable tightening of credit markets late in 2018, coupled with a long government shutdown.

In the latter half of 2018, U.S. core inflation unexpectedly stopped its upward trend toward the Fed's 2% target. Decreasing unemployment was expected to drive inflation higher – which it did not. Lastly, the Fed indicated that there was concern over the increasing potential for trade disputes and slowing growth in Europe and emerging markets. Accordingly, the Fed had to reconsider its previously announced plan of three interest-rate hikes for 2019.

What is so magical about 2% inflation and why is the Fed so focused on that number? The Fed has a dual mandate – maximum employment and stable prices. The 2% inflation target is based upon the Personal Consumption Expenditures Index (PCE) – which includes food and energy prices – and not the Consumer Price Index (CPI). The PCE has remained below 2% for the past 10 years. Given the recent strength of the economy and high level of employment, the low inflation experienced over the past decade is somewhat surprising.

Meanwhile, the bond market is wreaking havoc with investors and economists alike. In late March, the spread between two- and 10-year U.S. treasuries disappeared. In Canada, the 10-year bond yield was less than the overnight rate for the first time since 2008. In Germany, 10-year government debt was commanding a premium price.

The combined effects of all these factors now appears to have turned the focus from interest-rate increases to potential decreases during 2019.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
March 2019	2.00	3.95
February 2019	2.00	3.95
March 2018	1.50	3.45

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
March 2019	1.52	1.62	1.90
February 2019	1.82	1.94	2.19
March 2018	1.98	2.11	2.25

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
March 2019	1.65 - 2.00	1.70 - 2.00
March 2018	1.60 - 2.00	1.65 - 2.00
Insured	**5-Year**	**10-Year**
March 2019	0.90 - 1.10	0.85 - 1.10
March 2018	0.80 - 1.10	0.85 - 1.10

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

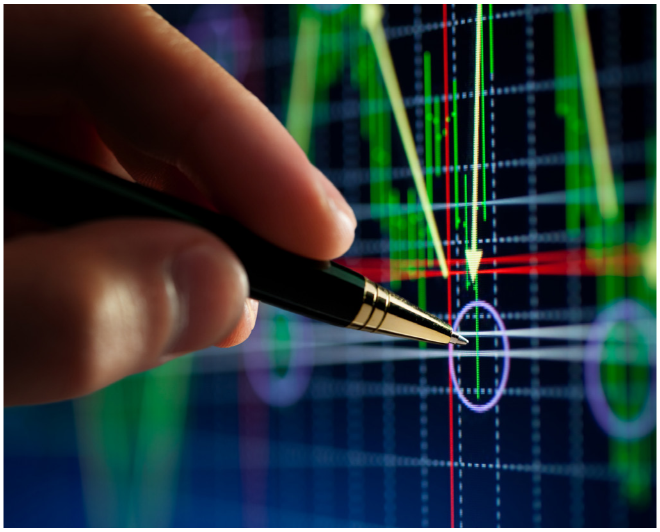
Source(s): Bank of Canada

Highlighted Transaction

Asset Type	Medical Office
Location	Major Canadian city
Facility Details	A short term bridge facility was arranged to facilitate the acquisition and repositioning of the asset, for $8.1M representing 100% of the purchase price.

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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