OCTOBER 2017

Debt Market Monitor

National Debt Capital Markets Services

Inflation implications

U.S. Federal Reserve ("the Fed") Board leaders have frankly confirmed that they have no explanation why inflation does not have more momentum. Notwithstanding the apparently unachievable 2% inflation rate that the Fed has been focused on in order to continue to raise interest rates, board leaders have moved interest rates upwards and have given a clear indication that one more rate increase this year and potentially three more rate hikes in 2018 are on the table. Inflation is an important cog in the wheel to the increasing pattern for interest rates, especially when the Fed's sell-off of its $4.5-trillion portfolio is about to kick off – more supply and less demand could lead to suppress longer term interest rates. Raising-short term interest rates, which the Fed controls, does not have a direct linear impact on long-term interest rates, and creating an inverted yield curve where short-term rates exceed long term-rates is a recipe for disaster. If inflation were to be at the target rate of 2%, a smoother gradual increase in consumer prices would be reflected, thus providing a natural path for increased rates to keep inflation from rising beyond the desired level. Should inflation remain somewhat stagnant, coupled with the Fed raising short term interest rates and commencing their sell off of their portfolio; we could see market forces keep longer term rates low, with the possibility of short overtaking long term rates.

According to Bloomberg, board chair Janet Yellen is counting on the effect of full employment – which the U.S. is now at – to lead to greater inflation. The inflation rate may not presently be a primary concern; however, it is something that will be very closely watched. While the economy is currently running nicely, it is not out of the shadow cast by the great financial crisis and other geopolitical threats.

It is all well and good to say that you are going to raise rates and then do so; however, the lack of inflation brings the potential for deflation into the picture, and raising rates continually – without regard for inflation – could be like pouring gas on a fire. The personal consumption expenditures (PCE) price index can be affected by wide swings in food and energy prices, while the core PCE price index is a measure absent of food and energy costs. The annual rate of the core PCE-price-index inflation was only 1.4% in July. The accompanying -2.0% annual rate of consumer durable price deflation highlights the significant risk in pushing too hard on the monetary brakes. A cited Vanguard investment manager claimed that bond yields will be reined in by low price inflation stemming from demographic change, globalization and technological progress.

By wishing interest rates higher, Fed board leaders will have to cope with low inflation and low bond yields that could very well make the planned rate increases more difficult going forward.

Fiscal Snapshot

Bank of Canada Rate

	Bank Rate	Bank Prime Lending
September 2017	1.00	2.95
One month ago	1.00	2.95
One year ago	0.75	2.70

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
September 2017	1.79	2.10	2.47
One month ago	1.53	1.85	2.26
One year ago	0.62	1.00	1.66

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
September 2017	1.50 - 2.00	1.65 - 2.35
One year ago	1.75 - 2.00	1.90 - 2.25
Insured	**5-Year**	**10-Year**
September 2017	0.90 – 1.10	0.90 – 1.10
One year ago	1.00 - 1.20	1.05 - 1.25

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

NATIONAL DEBT CAPITAL MARKETS SERVICES

Highlighted Transaction

Asset Type	Suburban
Location	Major Canadian city
Facility Details	A senior charge in the amount of $9.7M, structured for a 5 year term, 25 year amortization at a competitive rate of interest, for acquisition purposes.

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

Norm Arychuk, Broker*
416.673.4006
norman.arychuk@avisonyoung.com

*Licence #: M09002260
Brokerage Licence #10637

Michael Ho, Mortgage Agent**
416.673.4012
michael.ho@avisonyoung.com

**Licence: # M15000834
Brokerage Licence #10637

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avisonyoung.com

Avison Young Commercial Real Estate (Ontario) Inc., Brokerage
18 York Street, Suite 400
Mailbox # 4
Toronto, Ontario, Canada M5J 2T8
416.955.0000

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