THE MONTHLY MORTGAGE COMMENTARY

Debt & Structured Finance | Canada Research

MAY 2019

ONE STEP FORWARD AND TWO STEPS BACK

Positive developments over the month and recent events hint that the Canadian economy may be inching back towards stronger growth. The removal of steel and aluminum tariffs imposed by the U.S. at long last paves the way for the ratification of the CUSMA trade deal. The outlook for the Trans Mountain pipeline project got a lift as a B.C. court ruled that the province does not have the authority to restrict oil shipments for this critical federally-owned project. The Bank of Canada, while maintaining the current level of interest rates, cited “accumulating evidence” that the economic slowdown might be temporary and optimistically suggests a return to growth starting in Q2.

This optimism, however, is at odds with investor trading that is currently pricing in a nearly 80% probability of an interest rate cut over the next 12 months. In the U.S., further yield curve inversion is reinforcing the recession signal as 10-year Treasury yields fall below their 3-month counterparts. U.S. traders have fully priced in one interest rate cut in 2019, with the potential for another two more.

Ongoing escalation of the trade war between the U.S. and China has been the main driver of growing global pessimism. For Canada, Bloomberg economists estimate that 17% of our forecasted economic growth is exposed to the fight between the world’s two largest economies. The nature of the conflict has also evolved into a digital cold war of sorts with the U.S. attempting to ban major Chinese tech firms and China “weaponizing” its exports of rare earth minerals, a crucial element used in high-tech devices. Expectations for a resolution in the near term is fading as the U.S. administration claims it is “not ready” to negotiate a deal and China utilizes aggressive language that is reminiscent of its past pre-war warnings. As such, analysts are revising their outlooks and incorporating a protracted trade war as the new base case scenario.

If a full-blown trade war were to materialize, the resultant downturn and impact to the global economy could lead to the “radicalization” of monetary policies according to an AB Bernstein paper. The next recession or populist political pressure could lead to the implementation of even more debt to spur growth, the use of negative interest rates or helicopter money to directly inject cash into consumers’ wallets. At the same time, the questionable efficacy of central banks to rein in volatility alongside an increasingly riskier credit market is leaving corporate bond and commercial real estate credit spreads in a vulnerable state.

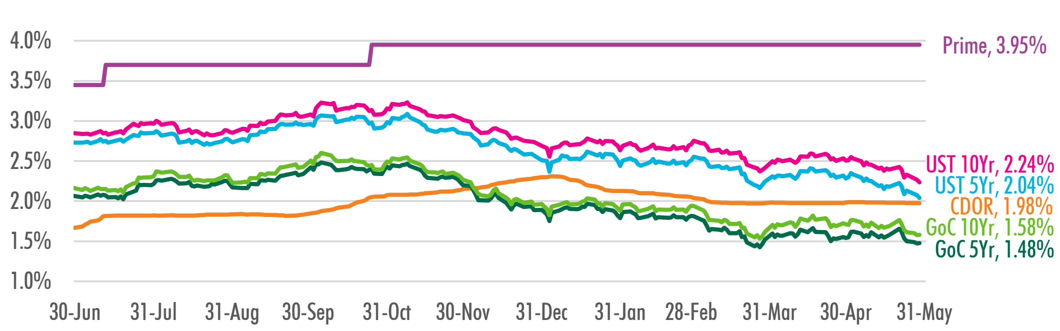
Key Indicator	Current	30 Days
5Yr Mortgage Spread	1.55-2.10%	
10Yr Mortgage Spread	1.70-2.30%	
5Yr CMB Spread	35 bps	0 bps
10Yr CMB Spread	44 bps	0 bps
USD/CAD	$0.7395	-0.46%
WTI Crude	US$58.81	-7.39%
S&P/TSX REIT Index	184.99	1.36%

Source: Thomson Reuters, May 29, 2019.

Economic Highlights:

- Employment gains surged to a monthly record of 106,500 jobs in April 2019 and the unemployment rate compressed to 5.7%.
- Retail sales grew for the second consecutive month by 1.1% in March 2019.
- Exports rose by 3.2% to $49.0 billion in March 2019, led by energy products.

Benchmark Yields



Source: Thomson Reuters, May 29, 2019.

ViewPoints:

- The Bond Market Is Trying To Tell Us Something (Worry)
- China Gears Up To Weaponize Rare Earths In Trade War
- Next Downturn Could See A ‘Radicalization’ Of The Policies Used During The Financial Crisis
- Pimco Warns That Central Banks Can’t Rescue The Bond Market

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