# CANADA'S ECONOMY BEATING EXPECTATIONS

## CBRE DEBT COMMENTARY – MAR 2017

Recent stock market run-ups, which repeatedly reached historic highs, and the assertive increase in business optimism since the U.S. election have retreated somewhat of late. Is it possible that markets got ahead of themselves based on market-priming rhetoric and the Republican Party's seeming control of both Congress and the Senate right up to the canceled healthcare vote on March 24, 2017?

Markets are adjusting, albeit with some lag, to the eventual realities of the new Washington. Unfortunately, the rest of the world must watch and wait while the $17.9 trillion U.S. economy, the world's largest, figures out if this is just a speed bump on the road to sustained optimism and growth, or if this is the end of the honeymoon phase for financial markets.

With further ambitious policies on the horizon, the potential to elevate the U.S. economy beyond current expectations still exists. More favourable tax structures would leave corporations and individuals with extra cash to invest and spend, further propelling economic growth. Cross-border shopping and expansion would also positively impact Canadian cities. Deregulation will free companies to pursue more lucrative and profitable avenues of business. Boosts to infrastructure spending will add a surge in employment and lay the foundation for stronger long-term growth. Canada's natural resources will be a prime source of materials to facilitate the construction.

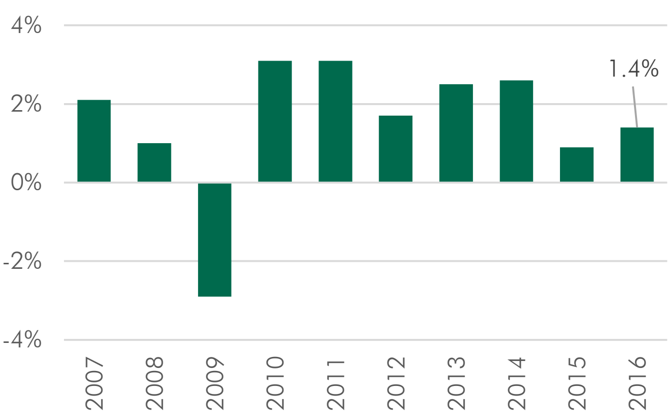
While factors abound feed pessimism surrounding the U.S. economy, the potential is even greater, and as always, Canada will stand to benefit as a result of our strong economic ties.

### Key Indicators, March 2017

| | | CURRENT | 2017 YTD | 2016 |
|---|---|---|---|---|
| Canada Yields | 30 Day CDOR | 0.88% | -5.6 bps | 0.4 bps |
| | CDN 5 Yr Bond | 1.11% | -1 bps | 38 bps |
| | CDN 10 Yr Bond | 1.63% | -9 bps | 23 bps |
| U.S. Yields | US 5 Yr Treasury | 1.96% | 3 bps | 19 bps |
| | US 10 Yr Treasury | 2.41% | -2 bps | 13 bps |
| Exchange Rate | CAD/USD | $0.7472 | 0.39% | 3.43% |
| REIT Index | S&P/TSX Capped REIT | 161.50 | 2.34% | 13.61% |
| Oil | WTI Crude | $48.37 | -9.96% | 30.59% |
| Mortgage Spreads | 5 Yr Range | 1.70% - 2.35% | | |
| | 10 Yr Range | 1.85% - 2.45% | | |

Source:. Thomson Reuters Eikon, March 2017

### Annual Real GDP Growth




Source: Statistics Canada, March 2017

### Forecast-Beating Results for Canada's Economy Under Grey Skies

Canada's economy surpassed all expectations with a slew of forecast-beating economic data released in early March 2017. Real GDP growth for Q4 2016 came in at an annualized +2.6%, stronger than the +2.0% forecasted and outperforming Q4 results in the U.S. Canadians, unfazed by the global turmoil and domestic weakness of the prior quarters, are continuing to spend more on both goods and services. The trade balance report for January marked the third consecutive trade surplus for Canada with a rise in both export values and volumes. Next, the jobs report for February surprised with the strongest full-time employment gains since May 2006. Manufacturing, wholesale trade, and retail sales all jumped more than expected to round out the data releases to date. Economists were surprised by the strong data and have since revised their Q1 2017 growth estimates upwards.

The ensemble of positive economic data brings renewed optimism for Canada's economic outlook, all while globalization seems to be in retreat, as global trade has barely grown when compared to overall economic output. Accordingly, the Bank of Canada cautions that there are still "significant uncertainties" which will need to be monitored for their potential adverse consequences. The uncertain future of trade policies with the U.S. could put up to 75% of Canadian exports at risk. Persistent economic slack in the form of below-optimal levels of inflation and weak wage growth signal room for improvement before full economic growth is reached. Rising record levels of household debt, now at 167.3% of disposable income, is also an ongoing concern for the financial stability of Canada.

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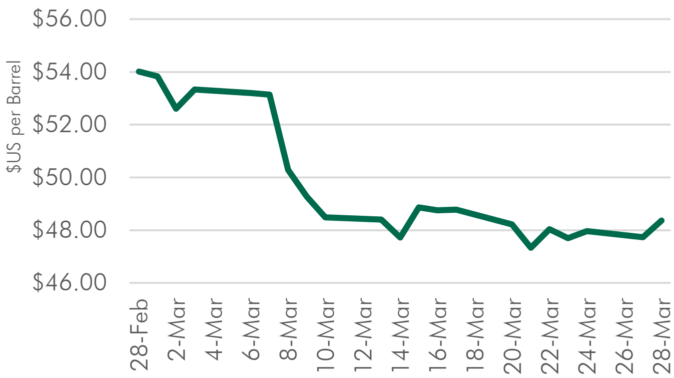
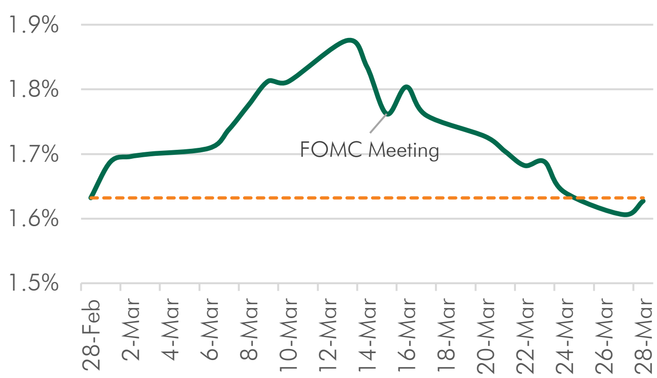
### WTI Crude Prices, March 2017



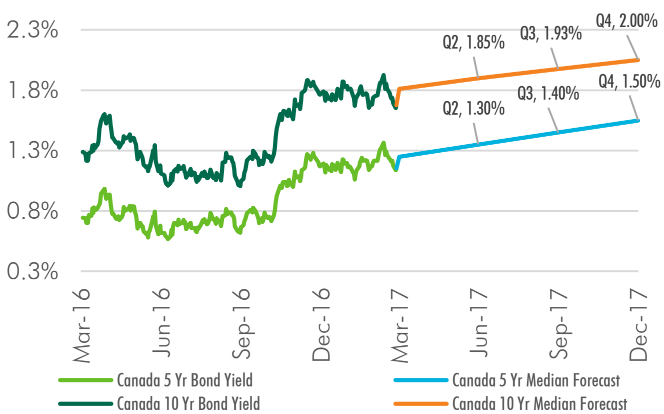

Source: Thomson Reuters Eikon, March 2017

### Canada 10 Year Bond Yields




Source:. Thomson Reuters Eikon, March 2017

### Canada Bond Yield Forecasts




Source:. Thomson Reuters Eikon, March 2017

### Oil Below $50/Barrel on U.S. Oversupply

The price of oil came off their post-OPEC meeting rally to currently trade below $50 a barrel again. This was a result of new record-high levels of crude inventory reached in the U.S., as oil production ramped up south of the border. According to Baker Hughes, U.S. oil producers have added 196 oil rigs since the OPEC production cut agreement, almost double the 102 oil rigs Canada added during the same period. The drag on oil prices coincided with another international oil giant, Royal Dutch Shell, withdrawing from their higher cost Alberta oil sands projects and selling most of their assets in the region. OPEC's response will be closely watched in the coming weeks, in particular whether the group will agree to extend their current production cuts that are scheduled to wind-up in June. Support for stronger oil prices will play a pivotal role in Alberta's finances, as their recently released budget relies on higher oil to return its ballooning deficit to balance by 2024.

### Bond Yields Reach 21-Month High Only to Fall Flat

On March 1st, the Bank of Canada announced that the Policy Interest Rate will remain at 0.50%. While noting that recent economic data may have been stronger than expected, the central bank quoted weak inflation and high levels of uncertainty as the basis for holding rates steady. Instead of a quiet month for bond yields, due to Canada's inextricable link to the U.S. economy, GoC yields rose in tandem with U.S. Treasuries as the March 15th FOMC meeting neared. Strong economic data propelled odds of a U.S. interest rate hike to nearly 100% leading up to the meeting. Investors even began pricing in the probability of a more aggressive rate hike schedule for 2017, which lifted the Canada 10 Year Bond Yield to a 21-month high of 1.88%, up 24 bps since last month. But when the FOMC raised interest rates as expected, they also reconfirmed their original three rate hike schedule for 2017, contrary to market expectations for four. As a result, bond yields actually fell after the announcement. Shortly afterwards, doubts on the success of the Trump administration's pro-corporate policies led to a selloff in stock markets as investors fled into bonds, pushing the 10 Year Bond Yields further down to 1.63% as of March 28th.

As the U.S. continues to raise interest rates in 2017, Canadian bond yields are expected to follow suit. The median forecast for the Canada 10 Year Bond Yield is expected to reach 2.00% by the end of the year. This is potentially a worrying sign for fixed-rate commercial mortgages as the cost of borrowing rises with bond yields. Variable-rate mortgages on the other hand, will show less change as they are closely tied to the Bank of Canada's Policy Interest Rate, which is not expected to rise until early 2018.

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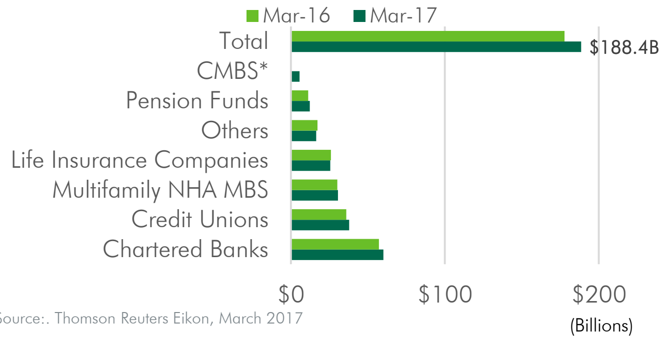
### Canadian Commercial Mortgage Market




Source:. Thomson Reuters Eikon, March 2017

### Commercial Mortgage Market Grows 6.0% YoY

According to the most recently available data, Canada's commercial mortgage market is estimated to have grown 6.0% year-over-year in March, totaling approximately $188.4 billion. The growth is led primarily by Chartered Banks and Credit Unions, together adding $4.7 billion in commercial mortgages to their balance sheets from last year. Life Insurance and Other Financials continued to lose market share and held $1.3 billion less in commercial mortgages year-over-year.

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