

# RECESSION BAROMETER

September 27, 2019

## Spotlight on : Yield Curve Ratios – Canada

### Recession Alert

eResearch put Canada on Recession Alert on August 8. Given that, historically, economic recessions have occurred some 15 to 20 months after an interest rate Inversion has occurred. That means a possible Economic Recession could ensue in Canada between November 2020 and April 2021.

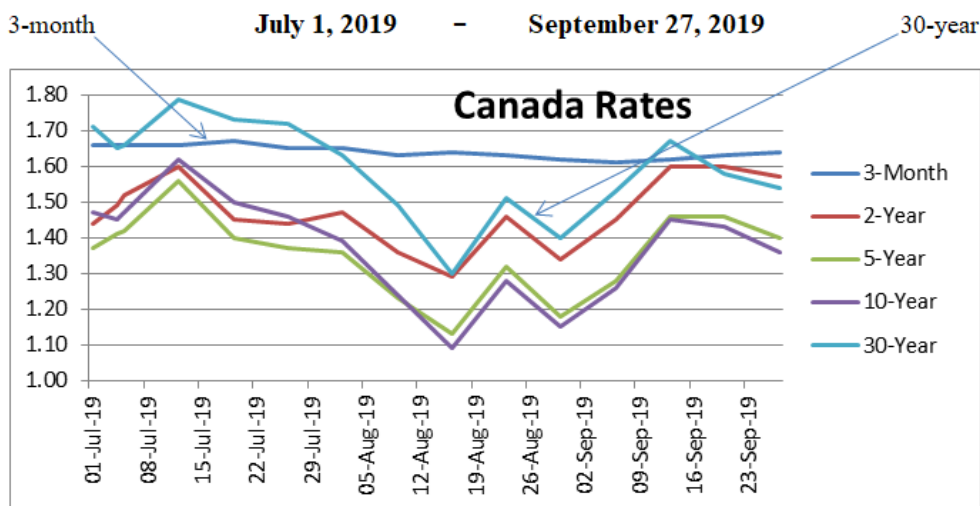
### Interest Rates: Various Maturities

Interest Rates see-sawed in Canada last week, but ended up well below the previous week’s closing level. Except for the 3-month rate, all of the other yield maturities that we monitor declined this past week.

Below, we show Canadian interest rates since July 1, 2019 (Q3/2019) for various maturities ranging from 3 months to 30 years.

The table on the next page shows the actual rates, on a weekly basis, in that time-frame.

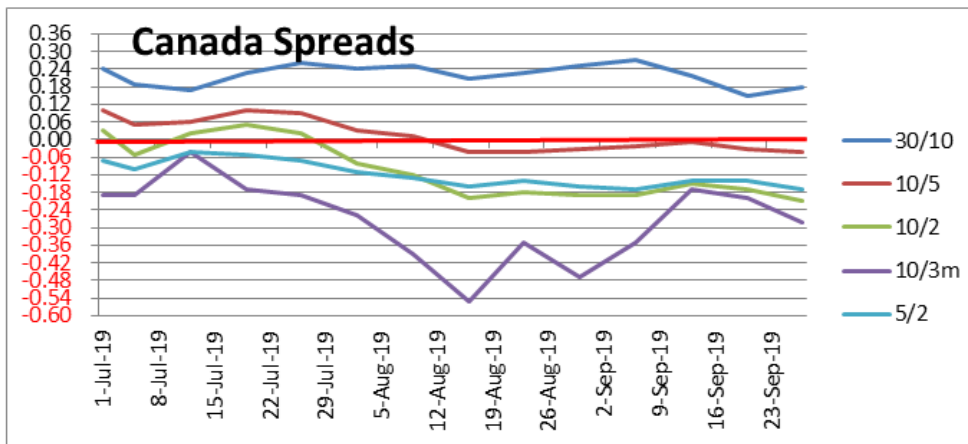
### Since July 1, 2019



Date	3-Month	2-Year	5-Year	10-Year	30-Year
01-Jul-19	1.66	1.44	1.37	1.47	1.71
04-Jul-19	1.66	1.49	1.41	1.45	1.65
05-Jul-19	1.66	1.52	1.42	1.47	1.66
12-Jul-19	1.66	1.60	1.56	1.62	1.79
19-Jul-19	1.67	1.45	1.40	1.50	1.73
26-Jul-19	1.65	1.44	1.37	1.46	1.72
02-Aug-19	1.65	1.47	1.36	1.39	1.63
09-Aug-19	1.63	1.36	1.23	1.24	1.49
16-Aug-19	1.64	1.29	1.13	1.09	1.30
23-Aug-19	1.63	1.46	1.32	1.28	1.51
30-Aug-19	1.62	1.34	1.18	1.15	1.40
06-Sep-19	1.61	1.45	1.28	1.26	1.53
13-Sep-19	1.62	1.60	1.46	1.45	1.67
20-Sep-19	1.63	1.60	1.46	1.43	1.58
27-Sep-19	1.64	1.57	1.40	1.36	1.54

The chart below shows the Spreads for selected maturities. The horizontal **Red** line marks the Inversion level. Only the 30-year/10-year Spread is not inverted. The 10-year/5-year Spread briefly flirted with leaving Inversion but it is slowly trending down again. The other three metrics continue to be inverted and are moving lower, albeit slowly.

July 1, 2019 - September 27, 2019



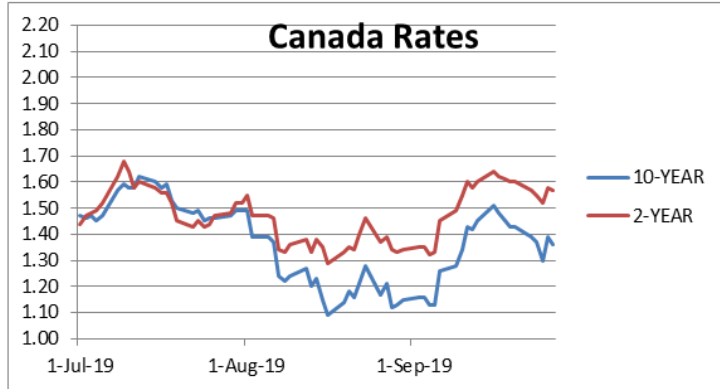
Here is the table for these Spreads:

Date	30/10	10/5	10/2	10/3m	5/2
1-Jul-19	0.24	0.10	0.03	-0.19	-0.07
5-Jul-19	0.19	0.05	-0.05	-0.19	-0.10
12-Jul-19	0.17	0.06	0.02	-0.04	-0.04
19-Jul-19	0.23	0.10	0.05	-0.17	-0.05
26-Jul-19	0.26	0.09	0.02	-0.19	-0.07
2-Aug-19	0.24	0.03	-0.08	-0.26	-0.11
9-Aug-19	0.25	0.01	-0.12	-0.39	-0.13
16-Aug-19	0.21	-0.04	-0.20	-0.55	-0.16
23-Aug-19	0.23	-0.04	-0.18	-0.35	-0.14
30-Aug-19	0.25	-0.03	-0.19	-0.47	-0.16
6-Sep-19	0.27	-0.02	-0.19	-0.35	-0.17
13-Sep-19	0.22	-0.01	-0.15	-0.17	-0.14
20-Sep-19	0.15	-0.03	-0.17	-0.20	-0.14
27-Sep-19	0.18	-0.04	-0.21	-0.28	-0.17

10-Year/2-Year Ratio

The 10-year/2-year yield curve ratio is the primary metric that we use for gauging the likelihood of an Economic Recession occurring in Canada. See Page 7 for explanation.

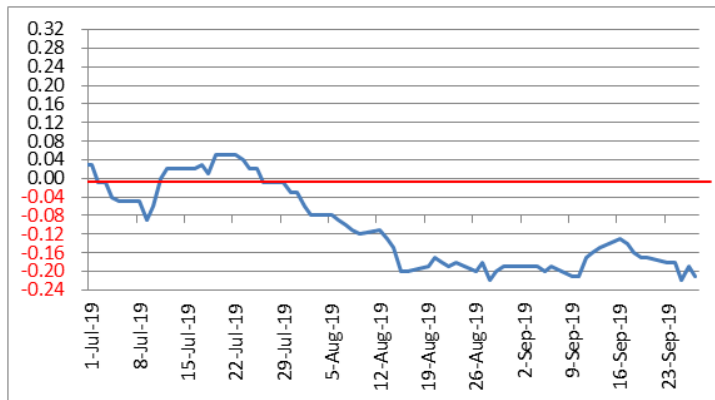
July 1, 2019 - September 27, 2019



**Observations:** On the above chart, Inversion occurs when the **Blue** line is below the **Red** line. As shown, this metric inverted in early July for 7 days and re-inverted on July 26 and has been inverted ever since.

July 1, 2019 - September 27, 2019

10-Year/2-Year CANADA SPREAD



**Observations:** The above chart shows that this metric is well inverted at the moment. The **Red** line marks the Inversion point.

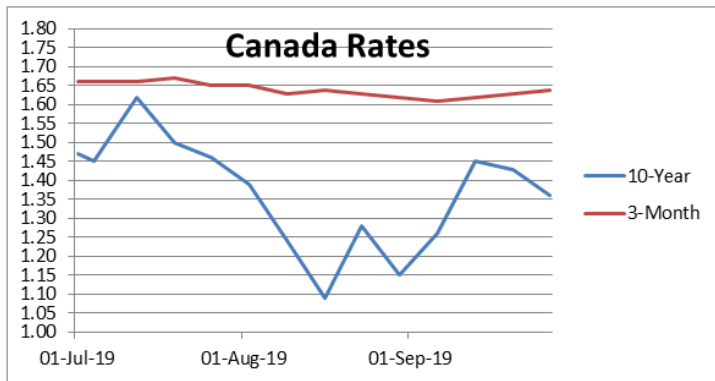
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10-Year/3-Month Ratio

The next metric features the yield comparison for 10-year versus 3-month maturities. Normally, one would expect that the longer-dated 10-year maturity would provide a return well above the very short-term 3-month maturity. It “ain’t” so at the present, nor has it been for quite a while.

July 1, 2019 - September 27, 2019

Canada Rates: 10-Year/3-Month

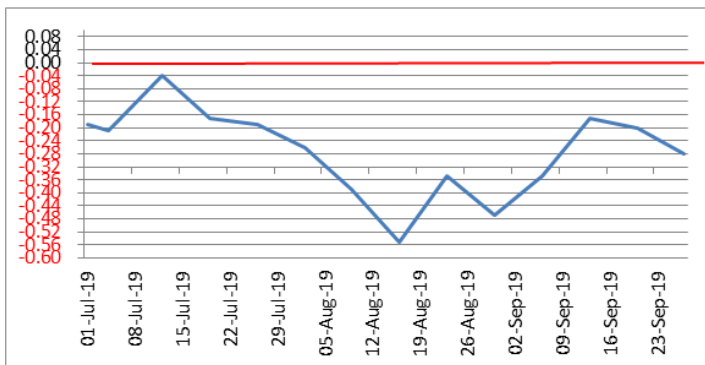


**Observations:** The 10-year interest rate (Blue line) started to decline rapidly beginning in mid-July and reached a nadir in mid-August. After staging a recovery that ran out of steam in mid-September, the 10-year interest rate has started to decline once again. As expected, the 3-month interest rate (Red line) has stayed fairly stable, ranging between 1.61% and 1.67%.

Here is the Spread chart for the 10-year/3-month metric.

July 1, 2019 - September 27, 2019

Canada Spread: 10-Year/3-Month



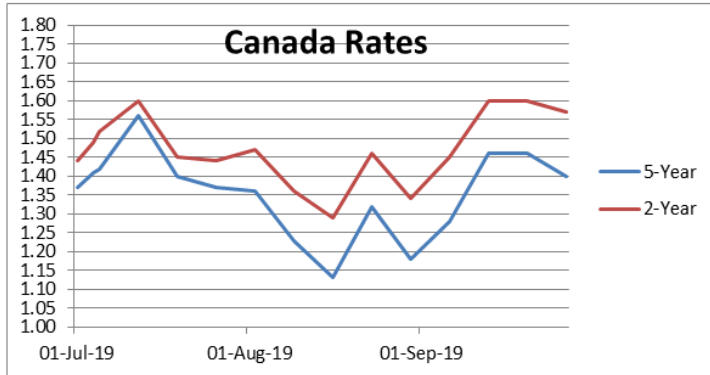
**Observations:** The Spread (Blue line) pretty much follows the experience of the 10-year interest rate metric, which is not surprising given that the 3-month interest rate metric has stayed relatively stable since the beginning of July.

### 5-Year/2-Year Ratio

The other key interest rate comparison that we monitor is the 5-year/2-year relationship. The 5-year is important as it generally provides the data for the decision-making of the chartered banks in determining mortgage rates.

July 1, 2019 - September 27, 2019

Canada Rates: 5-Year/2-Year

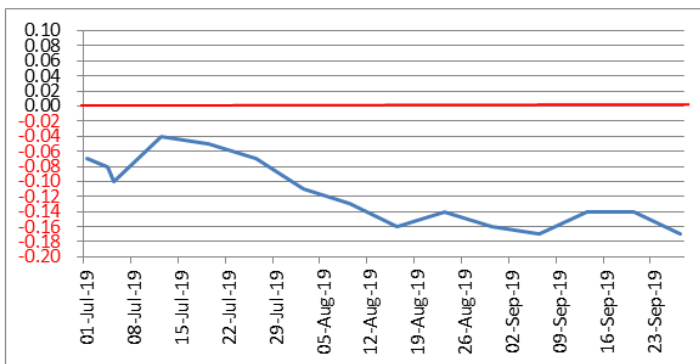


**Observations:** The 5-year/2-year yield curve ratio has been continuously inverted for some time, reflecting the market’s belief that the authorities will lower short-term rates. The Bank of Canada has maintained short-term interest rates despite much of the rest of the financial universe lowering domestic rates. The Fed has dropped rates twice recently yet the 2-year metric has not declined significantly in that country.

Here is the Spread for this metric in Canada.

July 1, 2019 - September 27, 2019

Canada Spread: 5-Year/2-Year

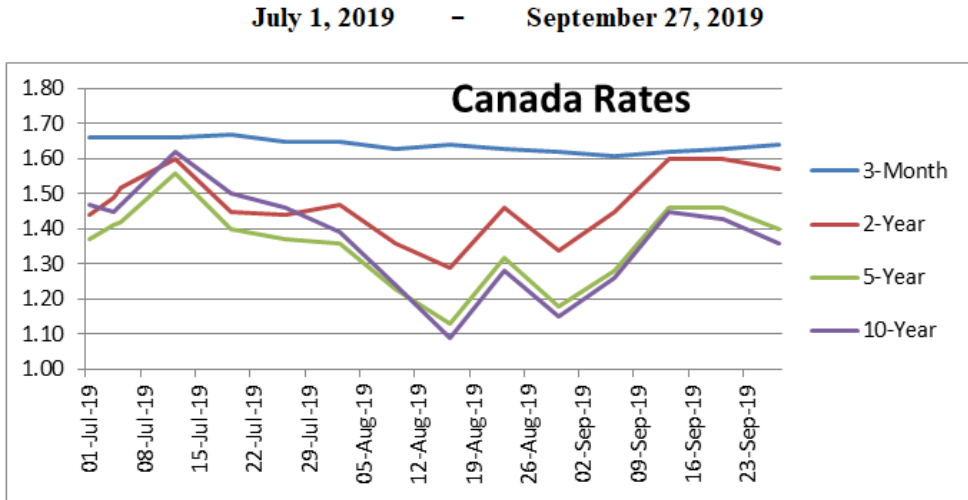


**Observations:** The Spread is steepening.

Let us look at these three metrics together.

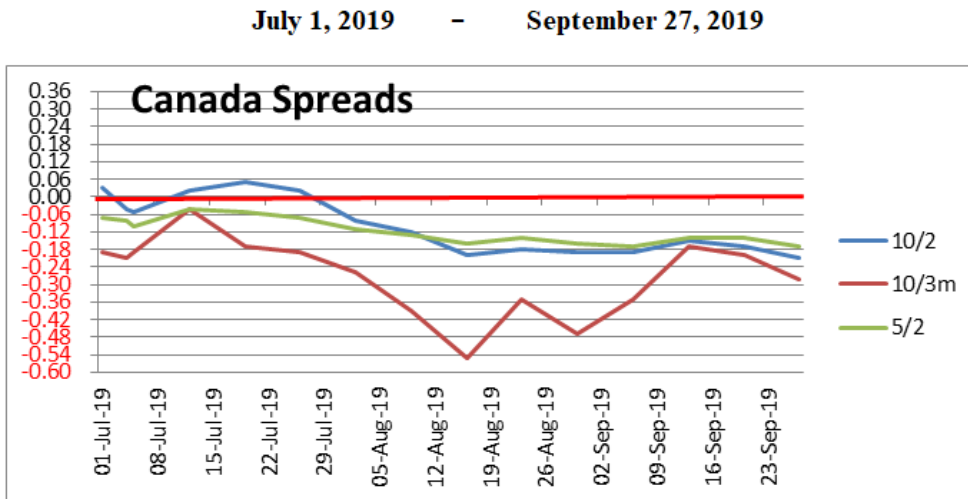
Three Key Interest Rate and Spread Metrics

The chart below shows the rates described above since July 1, 2019.



**Observations:** The normal order for these various interest rate maturities in terms of the level of interest rates would be, top to bottom on the chart, 10-year, 5-year, 2-year, and 3-month. The chart shows that it is exactly the opposite. The market is clearly signalling that something is amiss in the Canadian interest rate spectrum. This gives credence to our Count-Down to a possible Economic Recession.

The following chart shows and compares the Spreads for the three yield curve ratios.



**Observations:** All three yield curve ratios are inverted and are steepening. They have all been inverted since the last week in July. Despite still positive economic signs in Canada, these Inversions are significant. Something has to give.

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## Recession Barometer: Canada

In Canada, we have already started our Count-Down to a possible recession. This was based on the 10-year/2-year Government of Canada bonds exhibiting Inversion for ten consecutive business days, which it did on August 8. (Our alternative criterion is that the 10/2 must be inverted for 20 out of 30 consecutive business days, and this has also occurred.)

Further, two other key metrics, the 10-year/3-month and the 5-year/2-year yield curve ratios, are both inverted and have been for two straight months. This gives strong support to our forecast.

### Forecasting the Commencement of a Recession in Canada

Using *e* Research  
criteria, an  
inversion in  
Canada occurred  
on August 8, 2019

Historically, a  
recession begins  
15 to 20 months  
hence

**Inversion  
Occurred**  
August 8, 2019

**Inversion  
+15 Months**  
**November/2020**

**Inversion  
+20 Months**  
**April/2021**

Source: eResearch

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Bob Weir, CFA: Contributing Analyst

See the Disclaimer below.

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