CHART OF THE DAY

August 17, 2018

Spotlight on : 10-2 Yield Curve
Comparing Canada versus USA

For some time, we have been publishing Chart-of-the-Day reports on the 10-Year versus 2-Year yield curve ratio for U.S. Treasuries.

The latest report was published on August 17, 2018. You can access that report at the following link: <CTRL-CLICK> HERE

We explain the significance of the 10-2 yield curve ratios in those Chart-of-the-Day reports, particularly as a predictor of a potential forth-coming recession. When the ratio declines to reach 0.00x, or less, an imminent recession usually occurs.

This report compares and contrasts the 10-2 yields and ratios for the U.S. Treasuries and Government of Canada Bonds. The reporting period begins on May 1, 2018.

Table 1: USA and Canada 10-Year and 2-Year Sovereign Yields

The differences, or spreads, in the yields between the 10-year and the 2-year instruments are highly identical for the two countries, with some exceptions. Perhaps this is not unexpected.

DATE		USA		DATE		CANADA	
	10-YEAR	2-YEAR	DIFF		10-YEAR	2-YEAR	DIFF
4-May-18	2.95	2.51	0.44	4-May-18	2.32	1.91	0.41
11-May-18	2.97	2.54	0.43	11-May-18	2.40	1.97	0.43
18-May-18	3.06	2.55	0.51	18-May-18	2.52	2.06	0.46
25-May-18	2.93	2.48	0.45	25-May-18	2.41	1.99	0.42
1-Jun-18	2.89	2.47	0.42	1-Jun-18	2.33	1.90	0.43
8-Jun-18	2.93	2.50	0.43	8-Jun-18	2.27	1.90	0.37
15-Jun-18	2.91	2.52	0.39	15-Jun-18	2.21	1.85	0.36
22-Jun-18	2.90	2.56	0.34	22-Jun-18	2.14	1.82	0.32
29-Jun-18	2.85	2.52	0.33	29-Jun-18	2.13	1.85	0.28
6-Jul-18	2.82	2.53	0.29	6-Jul-18	2.14	1.91	0.23
13-Jul-18	2.83	2.59	0.24	13-Jul-18	2.16	1.94	0.22
20-Jul-18	2.89	2.60	0.29	20-Jul-18	2.11	1.93	0.18
3-Aug-18	2.95	2.63	0.32	3-Aug-18	2.36	2.08	0.28
10-Aug-18	2.87	2.61	0.26	10-Aug-18	2.33	2.11	0.22
17-Aug-18	2.87	2.61	0.26	17-Aug-18	2.25	2.08	0.17

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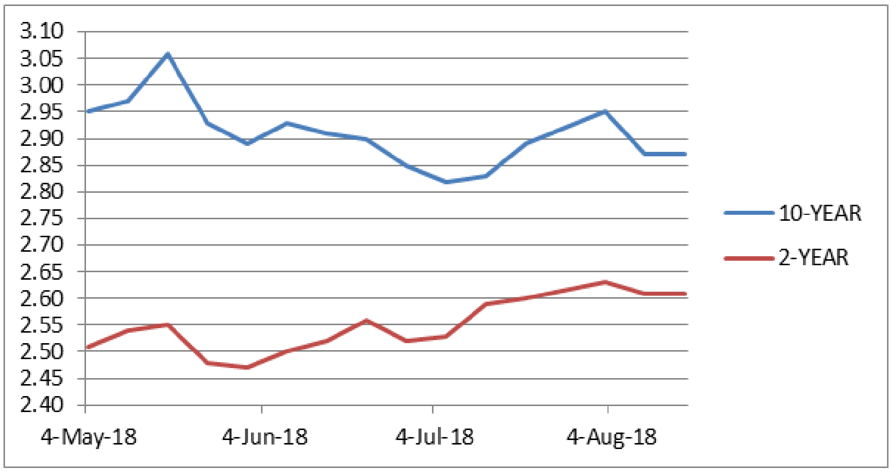
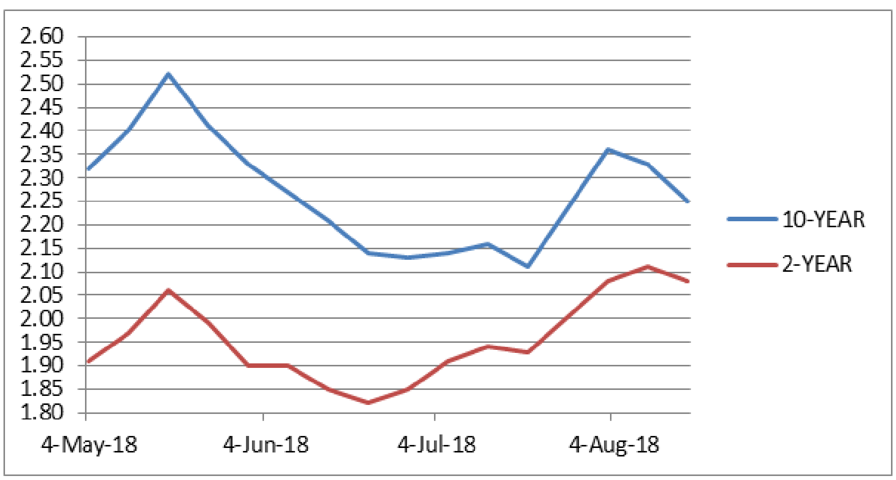
Chart 1: Graphs of USA and Canada 10-Year and 2-Year Sovereign Yields

Again, as expected, the trends in Canada and the USA are similar. As shown in both graphs, the differential between the 10-year yields and the 2-year yields is narrowing.

USA



CANADA

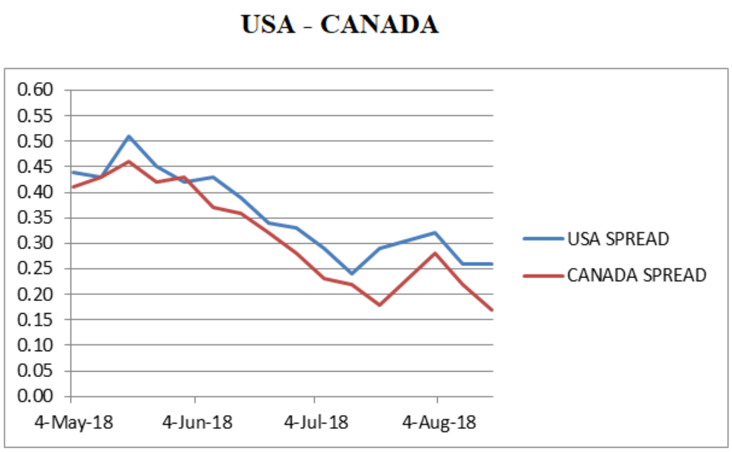


More importantly, because the recession predictor is forecast by the ratio of the 10-year to the 2-year, and not the absolute values of each, the next table and chart show what is currently happening.

Table 2 and Chart 2: Differences in 10-Year/2-Year Yield Curves

The tables are only for the last 14 weeks, but they show a discerning trend lower. The **blue** line represents the spread between 10-year U.S. Treasuries and 2-Year U.S. Treasuries. Similarly, for Canada, the spread is shown by the **red** line. It has dipped lower recently while the U.S. spread has levelled off.

	USA SPREAD	CANADA SPREAD
4-May-18	0.44	0.41
11-May-18	0.43	0.43
18-May-18	0.51	0.46
25-May-18	0.45	0.42
1-Jun-18	0.42	0.43
8-Jun-18	0.43	0.37
15-Jun-18	0.39	0.36
22-Jun-18	0.34	0.32
29-Jun-18	0.33	0.28
6-Jul-18	0.29	0.23
13-Jul-18	0.24	0.22
20-Jul-18	0.29	0.18
3-Aug-18	0.32	0.28
10-Aug-18	0.26	0.22
17-Aug-18	0.26	0.17



A declining spread that goes negative (or inverts), i.e., goes to 0.00x or lower, signifies slowing economic growth and, even, the likelihood of a recession.

For clarity, a negative or inverted yield curve indicates that long-term debt instruments have a lower yield than short-term debt instruments, given that these debt instruments are of the same or similar credit quality.

Historically, inversions of the yield curve have preceded many U.S. recessions. Thus, the yield curve is considered an important barometer for predicting turning points in the business cycle.

COMMENT: *The significant drop in the Canadian spread in the last two weeks likely heralds the latest increase in inflation. As inflation rachets up, the Bank of Canada will likely resort to raising rates sooner than later. Although the U.S. economy will always be the more important determinant of a North American recession, it is plausible that Canada could enter into a recessionary phase before the USA. Historically, in anticipation of the economy weakening, the stock market begins a protracted decline, with hard evidence of a recession coming later. Similarly, an inverted yield curve also precedes a recession, but the lead time is much shorter. Despite the current discouraging down-trend that is occurring, economic growth in both the United States and Canada still continues positively and, therefore, the possibility of a near-term recession in North America seems remote or, at this point, seems remote at least for 2018. However, 2019 is another matter.*

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