RESEARCH BRIEF
CANADA GROSS DOMESTIC PRODUCT

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Gross Domestic Product Surpasses Expectation, but Economic Growth Hits Pause

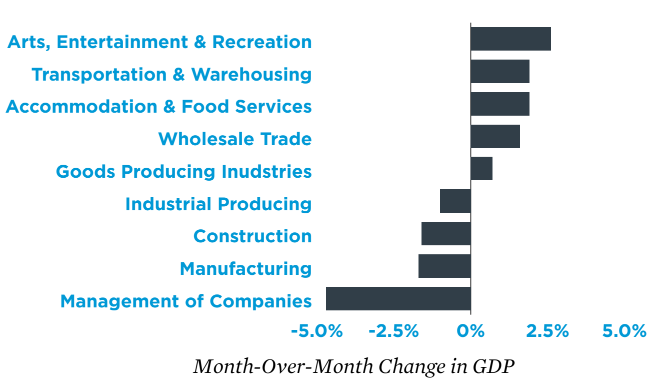
Gross domestic product maintains stability. Economists expected the Canadian economy to contract by 0.2 per cent month-over-month in May, due to rapidly increasing interest rates and falling residential real estate prices. However, this was not the case as GDP held steady. Despite the lack of economic expansion, this outcome is better than what many anticipated, especially when compared to the U.S., which has experienced economic contraction for two straight quarters. The most sizable drops in Canadian GDP seen in May were in office and industrial using real estate sectors, while the largest gains were realized in hospitality and retail using real estate industries.

Industrial CRE using sectors take the largest hit. Manufacturing, industrial production and the construction industries saw some of the largest decreases in GDP throughout May. Still prevalent supply chain headwinds in the global economy, together with the residential real estate slowdown, induced by rising interest rates, has caused activity to moderate. These factors may result in the cooling of some segments of industrial CRE demand, in turn eroding market momentum. However, with supply chains slowly re-establishing and companies reverting to onshoring, these effects are anticipated to be temporary. On the other hand, one of the largest gains in May GDP was in the transportation and warehousing sector, an industry heavily reliant on warehouse and distribution facilities. This uptick is continuing to be fueled by the online shopping boom stimulated during the health crisis and the increase in onshoring. As a result, investor sentiment should remain positive, as the national vacancy rate is 60 basis points below its pre-pandemic level, and the average rent is up 15 per cent since the end of 2019.

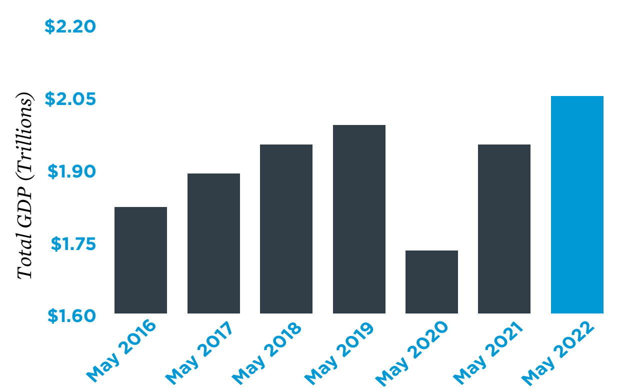
Office using sector impacted by higher interest rates. The office market was slowly beginning its recovery in the second half of 2021 and the early parts of 2022, as companies were beginning to implement return-to-office strategies. The technology sector was driving this recovery with increasing office space demand. However, tech companies have been facing headwinds in recent months, resulting in widespread layoffs. Other heavy-using office sectors, such as the financial service industry, are also feeling the effects of rising interest rates, specifically in their residential service branches and mergers and acquisitions departments, again reducing the need for office footprints. This is resulting in demand beginning to slow once again. Vacancy is currently 350 basis points above the level seen at the end of 2019, yet average rental rates have increased by 3.5 per cent in that two and a half year period, a mild pace relative to inflation.

Hospitality and retail industries show some of the strongest gains. Arts, entertainment and recreation, accommodation and food services, and wholesale trade have shown the strongest growth in May. These gains bode well for the hospitality and retail sectors, as pent-up demand and increased savings resulting from the health crisis are fueling demand in both of these industries, creating strong fundamentals for these properties. Hospitality has seen average daily rates return to the historic highs seen in August 2019, and revenue per available room is only 10 per cent below that same period. Additionally, retail sales remained strong in May, increasing by 2.2 per cent month-over-month to a total sale value of $62.2 billion, while at the same time seeing vacancy shrink and average rents rise, resulting in a favourable investment climate.

Canada GDP - Most Impacted Sectors



Canada GDP



* Through May
Sources: IPA Research Services;
Bank of Canada; Capital Economics; StatCan; CoStar Group Inc.; Altus Data Solutions