RESEARCH BRIEF
CANADA INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS
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Hotels and Apartments: How Inflation Impacts Key Sectors

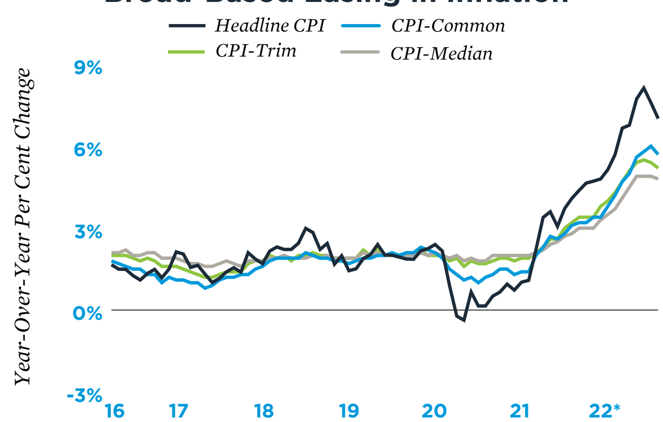
Broad-based easing in inflationary pressure. Headline and core inflation fell more than expected in August, recording the second consecutive softening in price growth. The headline rate declined by 60 basis points to 7.0 per cent, and the three core inflation measures followed, with an average decrease of 20 basis points, still well above the Bank of Canada's 2.0 per cent target. While food prices reached a new high, lower gasoline costs caused by increased global oil production, coupled with a moderation in shelter price growth, continued to drive down inflation. If this trend continues, further easing is likely to be expected, as the third quarter Canadian Survey on Business Conditions suggests that increasing prices from the supply side have reached the peak. Additionally, late summer consumer demand has also leveled off, pointing to lower demand-driven pressures on inflation in the fall.

Slower price growth may bring smaller interest rake hikes. The reduced inflationary pressure will likely offer the Bank of Canada some flexibility for its near-term interest rate decisions. After the 75-basis-point rate increase in September, the Bank may see this softer inflation as an encouraging sign. If price growth continues on its downward trajectory, there is increased likelihood that the BoC will announce smaller rate hikes at its policy meetings in the near future.

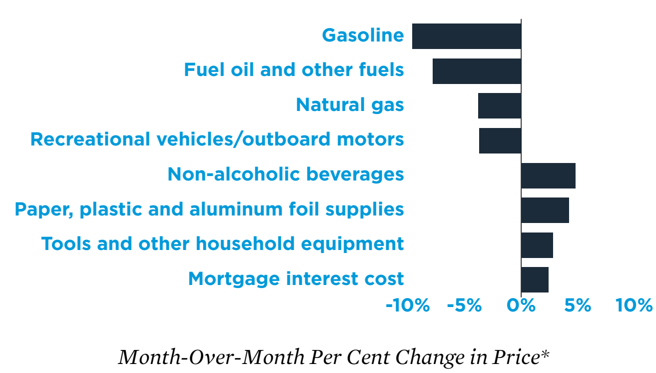
Hospitality sector favoured as hotel revenues hold up. Throughout the summer, pent-up consumer demand, combined with soaring oil prices, pushed travel costs well above pre-pandemic levels. Airfare and hotel rates from June to August increased by an average of 21 per cent relative to the same period in 2019, far exceeding the price growth in most other categories. Hotels' ability to adjust daily rates frequently has allowed operators to keep up with the evolving market during high inflation. Now as oil prices have retracted, the subsequent softening of transportation costs will likely continue to bode well for hotelier in the near term, as travelers may be more willing to spend on hotel room nights. This trend was reflected in the marginal 0.1 per cent month-over-month decrease in hotel rates compared to a much larger decline of 2.5 per cent in airfare. Furthermore, the removal of all remaining pandemic-related border and quarantine restrictions should further help the travel sector recover and boost hotel demand. As a result, hotel rates are likely to hold up for a relatively longer period of time, while inflationary pressures begin to recede at a faster pace elsewhere. This will support revenues, and in turn benefit investors in the hospitality sector.

Multifamily continues to offer inflation resistance. Still-elevated inflation suggests that the BoC will keep raising interest rates, albeit at a less aggressive pace. As a result, home mortgage rates will likely continue to climb, further increasing debt servicing costs and hindering affordability in the single-family market, despite six consecutive months of home price drops. This will redirect additional housing demand toward apartments, supplementing organic demand drivers and a preference for housing flexibility, particularly in a time of economic uncertainty. Multifamily investor sentiment will be strengthened by the sector's inflation-resistant nature and positive long-term outlook, as supply constraints in both the single-family and apartment rental markets will keep underlying fundamentals robust going forward.

Broad-Based Easing in Inflation



Decline in Energy Prices Drives Down Inflation



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** Through August*
Sources: IPA Research Services; Royal Bank of Canada; Statistics Canada; The Canadian Real Estate Association