

RESEARCH BRIEF

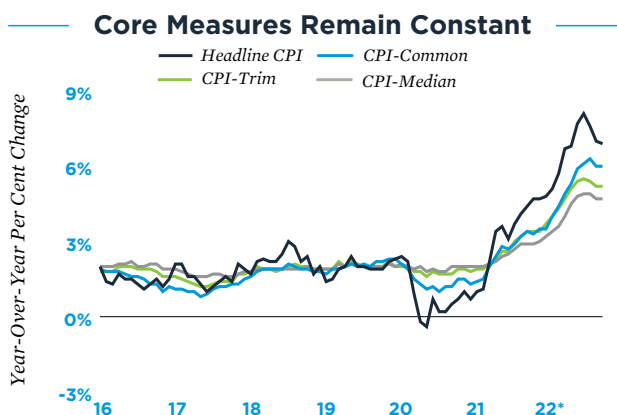
CANADA INFLATION

OCTOBER 2022

Price Growth Continues to Soften; Core Measures Unchanged From Last Month

Inflation remains high, but signs of moderation emerge. Annual price growth in September was 6.9 per cent, down 10 basis points when compared to August. While declining headline inflation is a positive outcome, the monthly drop failed to meet the consensus expectation. The 7.4 per cent month-over-month decrease in gas prices was largely offset by the sharp rise in food prices, which was a primary reason why overall inflation declined at a slower pace than anticipated. Regarding core CPI, annual growth rates in the Bank of Canada's three main indicators were unchanged from last month. Nonetheless, there are signs suggesting core inflation will likely trend downward in the near future as global shipping rates have fallen, commodity prices are down and supply chains are re-establishing. With headline inflation decreasing slower than the general consensus, and core measures running hot, it is likely the BoC will continue its hawkish approach to monetary policy later this month.

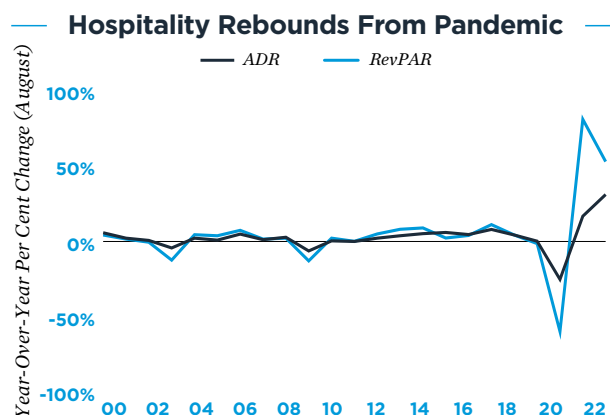
Bank of Canada likely to remain aggressive. With inflation still well above the target range of 2.0 per cent, it is likely the BoC will increase its overnight rate by an additional 50 to 75 basis points later this month. This will be the sixth rate hike this year, bringing the overnight rate to 3.75 per cent or 4.0 per cent. Mortgage rates will likely continue to trend upward as well, with both fixed and variable rates already eclipsing 5 per cent. Currently, fixed rates sit in the upper-5 per cent range, while variable rates are in the lower-5 per cent band. Nonetheless, with broad-based indicators suggesting a slowdown in core inflation in the upcoming months, the BoC is likely nearing the end of its quantitative tightening program.



Commercial Real Estate Outlook

Hospitality remains well positioned. Hard assets, such as real estate, tend to offer durable returns during periods of economic uncertainty. Hotels, specifically, may offer additional upside during times of rapid inflation, as room rates can be readjusted on a daily basis to keep pace with rising costs. While hotels struggled at the onset of the global health crisis, the current sentiment is sound, as fundamentals have recovered and revenue measures are at new highs. As of August, the average daily rate was 14.6 per cent above the level seen in 2019, and revenue per available room was up 11.2 per cent. While a possible recession on the horizon could lead to softer performance metrics, travel service prices have dropped at a much smaller pace than was expected. This suggests that people are still spending money on travel and hotels, even in the face of economic headwinds, such as elevated costs and rising debt service payments.

Investment activity to soften in the coming quarters. Looking beyond the hospitality sector, fundamentals for almost all commercial real estate property types are healthy, with some performing at all-time highs. These underlying factors will likely allow CRE to withstand an economic slowdown and provide durable returns. Nonetheless, with economic uncertainty and elevated borrowing costs, it is expected that investor sentiment will moderate. Some buyers will wait to see where interest rates stabilize, and sellers may come to terms with the new environment and realign expectations. However, once investors see more clarity, large volumes of capital currently on the sidelines waiting to take advantage of sound fundamentals will serve as a backstop to the transaction market.



* Through September

Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada



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