RESEARCH BRIEF

CANADA GROSS DOMESTIC PRODUCT

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GDP Growth Beats Expectations, Outlook Softening; CRE Remains Well-Positioned

Economic growth continues for fifth consecutive quarter. GDP rose 0.7 per cent in the third quarter, translating into a 2.9 per cent annualized gain, beating the general consensus of 1.5 per cent. Exports, specifically oil, as well as business investment in inventories, fueled economic expansion. These drivers, however, were moderated by declines in housing investment and household spending. Rising borrowing costs and elevated inflation are slowing the housing market and prompting consumers to tighten budgets. While the economy performed better than expected, further moderation in GDP growth is anticipated in the coming quarters. Commercial real estate, however, remains well-positioned to weather a short-term economic slowdown, as robust underlying fundamentals exist for almost all asset types. Additionally, muted investment activity may also be nearing its final stage as more broad-based indicators hint toward a softening in interest rate hikes.

Bank of Canada may be nearing the end of its tightening cycle. With broad-based indicators like shipping rates, commodity prices and supply chain bottlenecks all declining, it is likely that inflation will continue to trend down over the coming months. Moderating price acceleration, coupled with softening economic expansion and declining wage growth, may cause the Bank of Canada to shift down to a smaller 25-basis-point hike next month. Such a move would suggest the bank's tightening cycle could be nearing an end. Real estate investor sentiment, as a result, could potentially see an uptick in the second half of 2023 as investors are currently taking a wait-and-see approach to determine where interest rates stabilize.

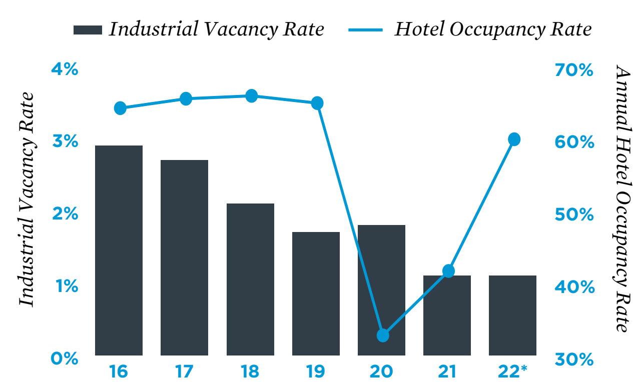
GDP Growth Continues to Moderate

Commercial Real Estate Outlook

Inventory investment bodes well for industrial sector. One main economic driver in the third quarter was investment in inventories. This is likely a byproduct of deglobalization and the rising presence of onshoring, where companies hold elevated stocks of just-in-case inventories to mitigate supply chain risks brought on by the global health crisis. Industrial demand, as a result, has reached historic levels, with the national vacancy rate declining to 1.1 per cent and the average asking rent increasing by nearly 20 per cent annually as of the end of the third quarter. While it is likely retailers begin to burn through just-in-case inventory with a potential recession on the horizon, these levels will still remain elevated compared to pre-pandemic times, when market conditions were already extremely tight. These robust metrics suggest the industrial market could withstand a slowdown in demand, as limited availability and the lack of new developments act as a backstop during an economic slowdown.

Hospitality sector continues to advance. The accommodation and food service industry expanded by 7.0 per cent, annualized in the third quarter. While consumers have been faced with elevated borrowing costs, heightened inflation and lower real disposable income, pent-up travel demand has prevailed in the face of economic headwinds. Hotels, as a result, continue to remain a top-performing asset as income metrics, such as revenue per available room and the average daily rate, are both up 16 per cent when compared to pre-pandemic levels. Despite ongoing economic headwinds, hotel performance metrics are expected to continue to improve in 2023 as both corporate and group travel are set to return to 2019 levels.

Fundamentals Trend in Positive Direction



*Through 3Q

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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