

RESEARCH BRIEF

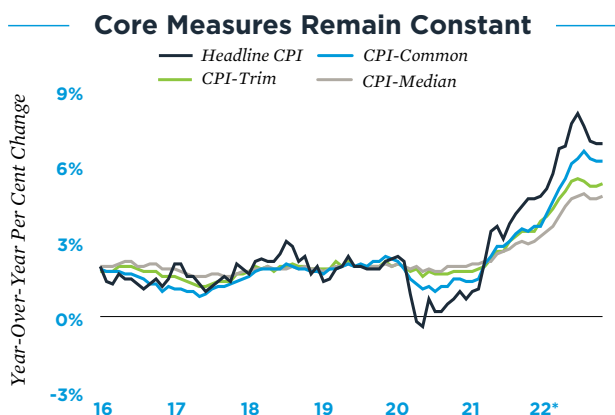
CANADA INFLATION

NOVEMBER 2022

Sticky Inflation Persists, Yet Magnitude of Interest Rate Hikes Likely to Soften

Price growth unchanged in October. Annual inflation remained at 6.9 per cent in October, down from the peak of 8.1 per cent in June. The Bank of Canada's core CPI indicators have also held firm, with CPI-common unchanged compared to September, and CPI-trim and CPI-median only up 10 basis points each. Nonetheless, it appears the three-month annualized measures of core inflation – which policymakers are now focusing on – have declined. These October figures suggest that elevated interest rates are cooling demand and causing price growth to soften. Stabilizing core measures also reinforce how easing supply chain bottlenecks are helping to lower shipping rates and commodity prices, which should continue to temper inflation over the coming months.

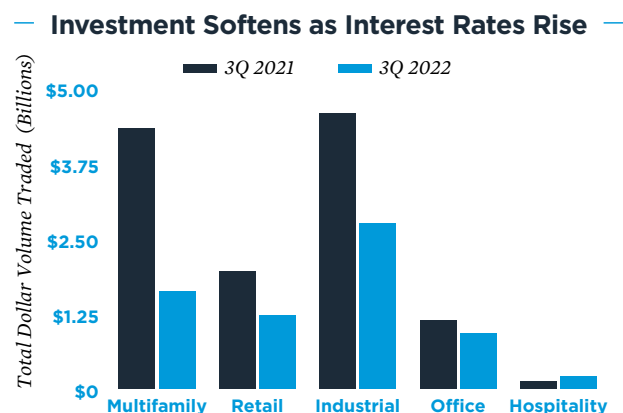
Mixed indicators for the Bank of Canada to consider. While inflation has been trending down since July, the BoC recently stated that in order for interest rate hikes to mitigate, it would have to see a rise in the unemployment rate. In October, however, the Canadian economy added 108,000 jobs, the second-largest gain this year, keeping the unemployment rate at 5.2 per cent. Given healthy employment, and with inflation still well above the BoC's target of 2 per cent, it is likely that the Bank will increase its overnight rate by an additional 25 basis points in December, bringing the overnight rate to 4.0 per cent. Nonetheless, with broad-based indicators beginning to soften and the Canadian economy showing signs of a potential recession, it is likely the BoC is nearing the end of its quantitative tightening program, with hikes anticipated to culminate early next year as inflation continues to moderate and unemployment rises, slightly.



Commercial Real Estate Outlook

Transaction market likely to remain quiet. While almost all commercial real estate asset types have healthy underlying fundamentals, investment activity has slowed in the second half of the year, and weakness will likely continue into the first part of 2023. Rising interest rates have caused many investors to take a wait-and-see approach in order to determine where interest rates stabilize and for uncertainty to mitigate. As a result, total dollar volume transacted in the third quarter relative to the same period last year was down between 20 percent and 60 percent across the office, retail, industrial and multifamily sectors. With interest rates expected to continue to rise for the remainder of the year and the early parts of 2023, investment activity may remain muted in the short term.

Hotels stay a top-performing asset. The hospitality industry suffered greatly at the onset of the pandemic. Nonetheless, since the removal of almost all pandemic-related restrictions, sector performance metrics have bounced back to historic levels. As of the end of the third quarter, key performance metrics – such as revenue per available room and the average daily rate – were up 11 per cent and 15 per cent, respectively, when compared to 2019. As a result of this strong income growth, which acts as a potential hedge against inflation, transaction volumes have remained healthy, with total dollar volume up 59 per cent when compared to the third quarter of last year. This trend is likely to continue in 2023, even in the face of economic uncertainty. The opportunity to purchase a hotel has been extremely limited, due to the current ownership profile, and investors are seeking inflation-resistant assets to help stabilize portfolios.



* Through October 2022

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



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