RESEARCH BRIEF
CANADA INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

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Easing Inflation Pressures Take a Slight Pause; Bank of Canada to Monitor Economy Closely

Inflation ticks down, but remains elevated. The consumer price index climbed 6.8 per cent year-over-year in November, down 10 basis points when compared to October. While the inflation reading was higher than the general consensus of 6.7 per cent, mainly a result of surging rental fees, slowing price growth is still a positive outcome. Regarding core measures, which remove the largest price changes in individual components, the indicators were relatively unchanged. CPI-trim remained at 5.3 per cent, while CPI-median inched up 10 basis points to 5.0 per cent. The three-month annualized rate for these core measures, a key indicator for the Bank of Canada, did increase as well. Nonetheless, while annual inflation did not drop as much as anticipated, broad-based indicators for future price deceleration still exist. Gas prices continue to decline, consumer demand is softening and supply chain headwinds are mitigating. Future price growth, as a result, is still expected to trend down over the coming months.

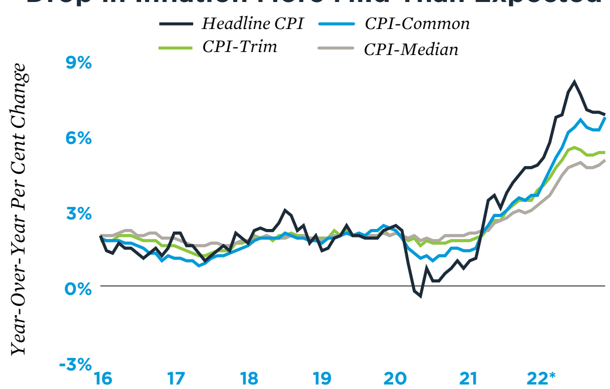
Interest rate uncertainty continues to loom. At the BoC's most recent monetary policy meeting, it stated it would evaluate upcoming macro indicators to determine future interest rate announcements. With November inflation higher than expected, it may result in the Bank remaining hawkish and increasing its overnight rate once again in January by 25 basis points. Nonetheless, the December CPI report and employment release, coupled with the Bank's next quarterly business and consumer surveys — released in mid-January — could still swing future monetary policy either way. The potential for the Bank to pause rate hikes is still a possibility.

Commercial Real Estate Outlook

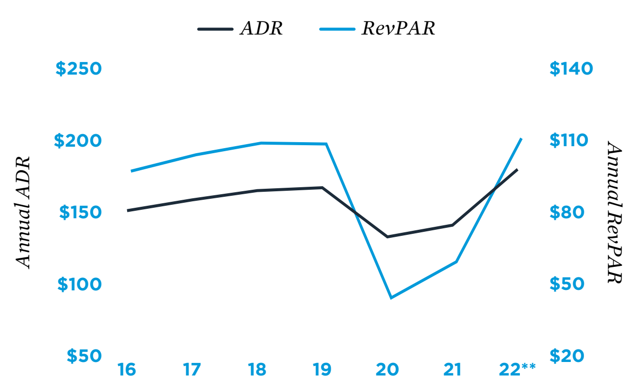
Transaction market softens. While almost all commercial real estate asset types have healthy underlying fundamentals, investment activity has slowed in the second half of the year. Rising interest rates have caused many investors to take a wait-and-see approach to determine where borrowing costs stabilize and price expectation gaps continue to exist between buyers and sellers. As a result, total dollar volume transacted in the third quarter relative to the same period last year was down between 20 per cent and 60 per cent across the office, retail, industrial and multifamily sectors. With interest rate uncertainty continuing to prevail heading in to the new year, investment activity will likely remain muted in the short term. Still, robust underlying fundamentals should act as a backstop. Once interest rates stabilize, positive investor sentiment is expected to build, creating cautious optimism toward Canada's commercial real estate sector heading into 2023.

Inflation-resistant assets show strength. Hotels suffered greatly at the onset of the pandemic. Since the removal of pandemic restrictions, however, sector performance bounced back to historic levels. This rebound was largely due to pent-up travel demand, which enabled operators to leverage high turnover to adjust daily rates at the pace of inflation. As a result, investor interest pushed transaction activity up 59 per cent year-over-year in the third quarter, despite economic headwinds. Looking forward, while performance is likely to normalize, growth is still expected. Elevated inflation will continue to benefit income metrics, while the return of corporate travel and a relatively strong U.S. dollar should generate steady demand.

Drop in Inflation More Mild Than Expected



Annual Revenue Trends



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* Through November; ** Through 3Q
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada