RESEARCH BRIEF
CANADA MONETARY POLICY

IPA | INSTITUTIONAL PROPERTY ADVISORS
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DECEMBER 2022

Bank of Canada Softens Language; Monetary Tightening May Be At or Nearing Its End

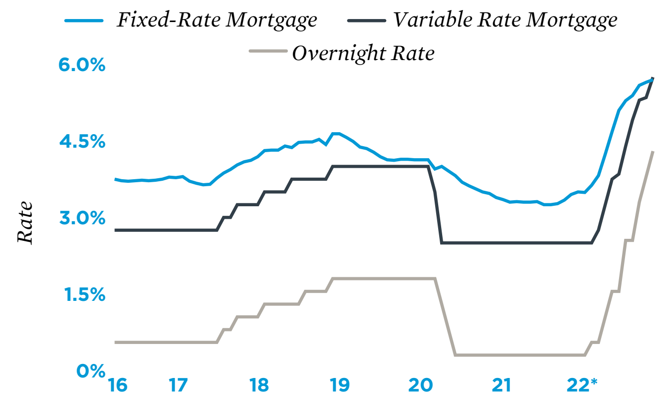
Central bank outlook turns dovish. The Bank of Canada raised its overnight rate by 50 basis points in December, bringing it to 4.25 per cent. While inflation has softened, annual price growth remains well above the target of 2.0 per cent. GDP growth also beat expectations in the third quarter, signaling that the economy continued to operate with excess demand. Nonetheless, in its announcement, the BoC stated that there is evidence of tighter monetary policy restraining domestic demand, as consumption has eased and home sales are retreating. The three-month rates of change in core inflation have also dropped, which is an early indicator that price pressures may be losing momentum. Correspondingly, the BoC transitioned to more dovish language, contemplating whether additional policy rate hikes are needed to bring supply and demand back into balance. This differs from previous announcements, where it firmly stated that the rate will need to rise further. While one additional 25-basis-point hike remains a possibility in January amid a still-tight labour market, the Bank may be at the end of its monetary tightening cycle.

Housing correction could soon be over. Both fixed and variable rate mortgages are approaching 6.0 per cent and will likely rise further, given this most recent uptick in the overnight rate. Consequently, housing affordability has become an even greater challenge, causing purchasing activity to remain muted. Buying appetite, however, could be hitting an inflection point, as mortgage rates should plateau once the BoC halts interest rate hikes. Purchasing activity will likely strengthen as this plays out, with variable rate mortgages attractive to those who want to get ahead of other buyers and expect borrowing costs to fall in the latter part of 2023. Nonetheless, with still-elevated housing prices, barriers to homeownership persist, furthering the need for purpose-built rentals as a less costly housing solution.

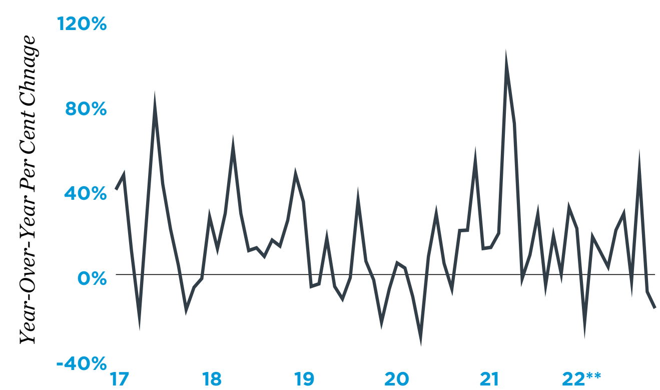
Elevated borrowing costs hinder development. With housing affordability a challenge, purpose-built rentals are needed. Heightened interest rates, however, are curbing construction activity, with builders questioning the feasibility of upcoming projects as firms cannot receive financing when minimum requirements are not being met. This slowdown in development will further amplify the supply and demand imbalance that exists in Canada's housing market. Over the long term, this will likely result in additional affordability obstacles, as robust population growth — fueled by immigration — will cause sustained housing demand. Further action is needed from local authorities to increase purpose-built rental supply.

Investors continue to take a wait-and-see approach. While the general consensus suggests that borrowing costs could soon plateau, investor enthusiasm remains muted as the recent interest rate hike allows uncertainty to prevail within the transaction market. Many commercial property buyers are currently waiting to determine where interest rates will stabilize, and many sellers have not yet come to terms with the lower price environment, creating a price expectation gap between market participants. If — as many indicators suggest — borrowing costs are nearing their peak, expectations should realign, allowing for positive investment sentiment to build. Transaction volumes, as a result, could switch course and trend upward in mid- to late-2023, as investors look to capitalize on sound property performance metrics for almost all asset types.

Rates Continue to Trend Upward For Now



Value of Multifamily Building Permits Drops



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