RESEARCH BRIEF
CANADA INFLATION

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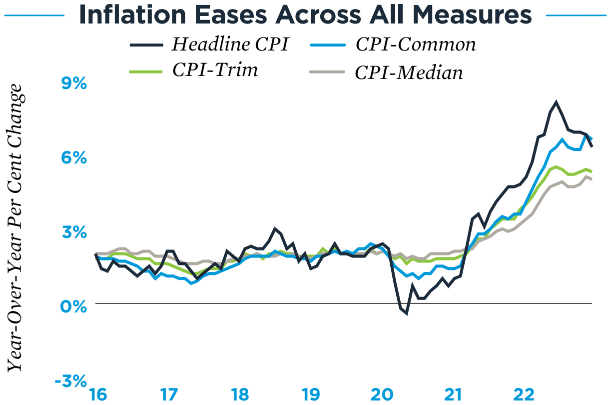
Inflation Continues to Ease; Central Bank Policy Decision Looms as Investors Monitor Closely

Largest monthly drop in inflation since pandemic. Canada's consumer price index decreased 0.6 per cent month-over-month in December, reaching 6.3 per cent annually. This decline beat the general consensus and was mainly caused by the 13 per cent month-over-month drop in gasoline prices. Nonetheless, the Bank of Canada's primary measures for core inflation — CPI-trim and CPI-median — both edged down, causing them to reach 5.3 per cent and 5.0 per cent, respectively. Furthermore, the three-month annualized rate of these core measures, a key indicator for the central bank, now sits at 3.0 per cent, which is within the BoC's target range. Annual price growth, as a result, is expected to ease further over the coming months as broad-based indicators continue to show promising signs of future price deceleration.

Bank of Canada likely nearing the end of its tightening program. Headline inflation is still running above the BoC's target range, and the labour market remains extremely tight. Consequently, it appears an additional 25-basis-point interest rate hike is likely, despite the BoC hinting at a potential pause at its final meeting of 2022. Nonetheless, it is still expected that the current monetary tightening cycle is nearing an end. Inflation pressures have shown persistent signs of slowing as commodity prices continue to decline and supply chain disruptions ease. As a result, the general market consensus suggests one final 25-basis-point hike, which will then likely mark the end of the Bank's tightening cycle. Further interest rate hikes beyond that point, however, remain a possibility if macroeconomic indicators do not show further signs of easing inflationary pressures.

Inflation Eases Across All Measures

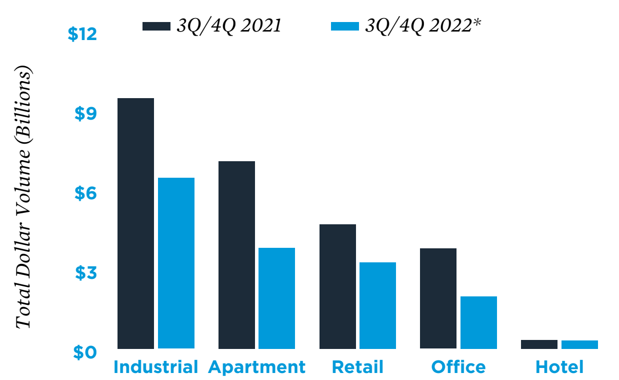


Commercial Real Estate Outlook

Uncertainty likely to abate soon. Investment activity in the first half of 2022 was robust for almost all property types, due to sound fundamentals and healthy tenant demand. Rising interest rates, however, curbed investor enthusiasm, and transaction activity slowed notably in the second half of the year. Total dollar volume traded was down 35 per cent when compared to the prior period, as many investors were taking a wait-and-see approach to determine where borrowing costs stabilize, which is still continuing now. However, with inflation continuing to trend down, interest rate uncertainty is likely to dissipate over the next quarter. While the general consensus calls for an additional interest rate hike in January, once the Bank pauses, positive investor sentiment is expected to build as buyers look to benefit from sound underlying performance metrics.

Select assets provide inflation resistance. Despite inflation beginning to ease, some property types are favoured in times of rapid price acceleration. This is specifically true for hotels, which can reset room rates on a daily basis, due to the asset's high turnover rate. In turn, hotel owners are able to align revenues with increasing costs. As a result, investment activity in the second half of 2022 remained relatively unchanged compared to 2021, despite heightened borrowing costs. This also holds true for multifamily properties in markets without rent control, as rents can be adjusted to market value annually, helping owners balance revenue with rising input costs. Consequently, rental apartments in Alberta, a non-rent controlled province, witnessed total dollar volume transacted increase by nearly 14 per cent in 2022 when compared to the prior year.

Rising Borrowing Costs Hinder Investment



* Preliminary Estimate

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