RESEARCH BRIEF
CANADA MONETARY POLICY

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Interest Rate Hiking Cycle Appears to be Over After Eight Consecutive Increases

Bank of Canada now expects to pause. Canada's central bank increased its overnight rate by 25 basis points in January, citing stronger than expected economic momentum to end 2022 as its reason. Consequently, the policy rate now sits at 4.5 per cent. The BoC, however, accompanied its smaller rate hike with new guidance that it intends to hold the overnight rate at its current level, while it assesses the impact of the cumulative interest rate increases so far. As a result, it is widely expected that the central bank has reached the end of its monetary tightening cycle, as broad-based indicators suggest that annual price growth will continue to soften and return to the Bank's target range of 1 per cent to 3 per cent. Nonetheless, the pause in interest rate increases is conditional on the outlook evolving as expected and inflationary pressures continuing to ease.

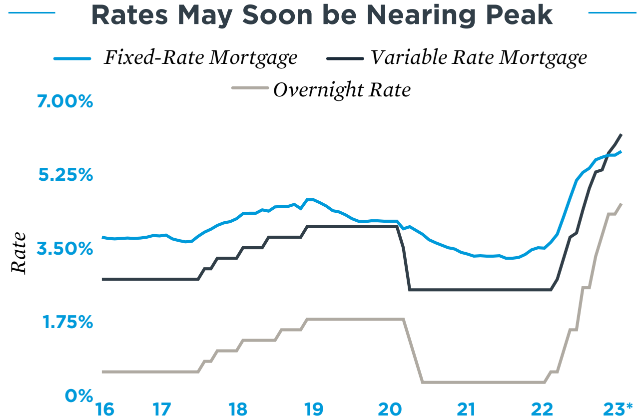
Barriers to homeownership persist. Despite potentially nearing a peak with a pause by the BoC, variable mortgage rates have eclipsed 6 per cent, with fixed rates not far behind. Consequently, housing affordability has become an even greater challenge, causing purchasing activity to remain muted and housing prices to decline. Buying appetite, however, is showing early signs of reaching an inflection point, with sales activity increasing in December. Purchasing activity will likely strengthen further over the coming months as interest rates are now expected to stabilize, with variable rate mortgages attractive to those who want to get ahead of the market. Nonetheless, with still-elevated housing prices and higher debt servicing costs, barriers to homeownership continue to stymie many potential buyers, furthering the need for purpose-built rentals.

Commercial Real Estate Outlook

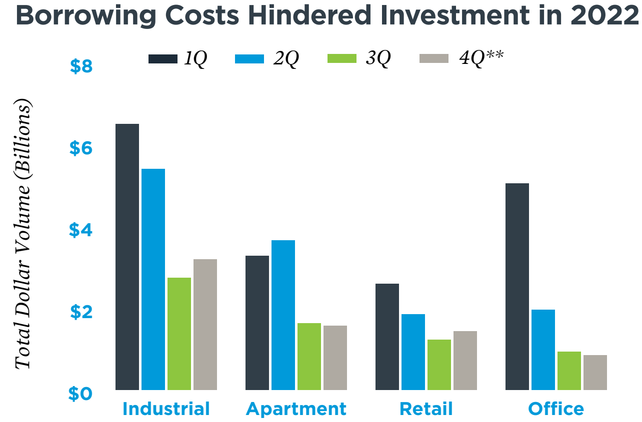
Multifamily sector poised to weather a slowdown. Ending 2022, Canada's multifamily sector was one of the nation's top-performing asset types. National vacancy hovered around 2.0 per cent, helping annual rent growth to reach 8 per cent. While elevated interest rates are slowing Canada's economy, the apartment sector is well-positioned as limited supply and prevailing demand should keep fundamentals healthy. Despite a softening in single-family housing prices, many potential buyers continue to be redirected to the rental market, as ownership remains a challenge for a sizable share of Canadians. Additionally, Canada is expected to reach historic immigration levels in 2023, further increasing apartment demand. Consequently, vacancy is forecast to continue on its downward trajectory, while rent growth is expected to reach 5 per cent annually.

Sales activity may soon revert. In the first half of 2022, total dollar volume transacted increased by 70 per cent when compared to the same period in 2021. Once borrowing costs began to rise, however, transaction activity stalled as many buyers took a wait-and-see approach. Looking forward, it is now likely that interest rate uncertainty should abate over the coming months as the Bank's monetary tightening cycle appears to have reached its end. Positive investor sentiment, as a result, is likely to build once the rate plateau is fully absorbed by the market, beyond the Bank's next policy meeting in March. Consequently, transaction activity will likely begin to gain momentum as investors gain more clarity. Large volumes of capital, which are currently on the sidelines, will then likely be unlocked in order to capitalize on sound underlying fundamentals.

Rates May Soon be Nearing Peak



Borrowing Costs Hindered Investment in 2022



** Through January; ** Preliminary Estimate*
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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