RESEARCH BRIEF
CANADA RETAIL SALES

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Economy Showing Resilience as Inflation Chips Away at Purchasing Power and Household Spending

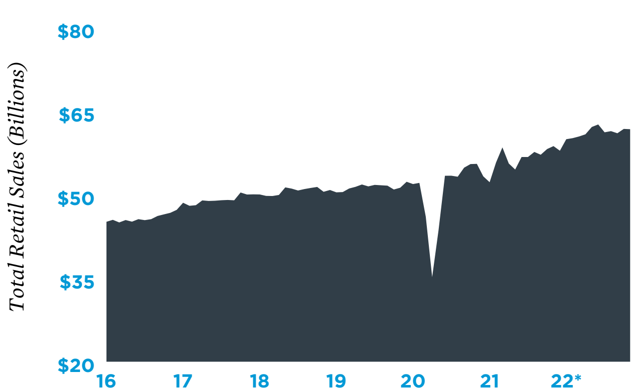
Retail sales return as estimates suggest strong end to the year. It appears as though the Canadian economy carried more momentum into 2023 than many anticipated. While retail sales declined 0.1 per cent month-over-month in November, preliminary estimates for December suggest that retail sales increased by 0.5 per cent. After accounting for inflation, this translates into an estimated 1.9 per cent month-over-month increase in total quantity traded. Nonetheless, with consumer confidence continuing to weaken, consumption is anticipated to slow over the coming months. While a recession remains a possible outcome, Canada's largest banks are now contemplating the idea of a potential soft landing, as many economists underestimated the resilience of the Canadian economy.

Rise in retail sales not likely to change Central Bank's outlook. The apparent resilience of the Canadian economy, shown through the estimated strength of December retail sales, is not likely to change the Bank of Canada's recently-hinted-at outlook of holding interest rates at 4.5 per cent, following this month's 25-basis-point increase. Investment activity, nonetheless, could remain sluggish until the rate plateau is fully absorbed by the market beyond the Bank's next policy meeting in March. Broad-based indicators, however, continue to suggest that inflationary pressures are softening. Consequently, the most likely outcome is that the Bank does hold its overnight rate at 4.5 per cent. Investor sentiment, as a result, could turn positive, and large volumes of capital that currently sit on the sidelines will then be unlocked as investors look to capitalize on sound underlying fundamentals for a wide range of property types.

Industrial sector to remain well-positioned. National industrial vacancy reached 1.1 per cent, while the average asking rent increased by roughly 20 per cent annually in 2022. These healthy underlying fundamentals stemmed from robust e-commerce-related demand brought on by the global health crisis, as well as limited available supply and a lack of new developments. While online spending has since slowed from 2020/2021 levels, e-commerce-related sales remain nearly 80 per cent above 2019 levels. Additionally, with the emergence of onshoring and the need to hold higher inventory levels, coupled with the slow return of domestic manufacturing, industrial demand is likely to persist over the coming year. Some risk factors are beginning to emerge, however, with rental rate growth possibly becoming unsustainable for some smaller tenants, which may slightly curb demand as economic headwinds persist.

Grocery-anchored retail a preferred investment option. In recent years, retail assets gained increased attention from the investment community, due to higher yields than other property types and sound fundamentals. Food-anchored retail plazas — as well as other single-tenant, non-discretionary retailers — were in high demand, due to the essential nature of the products offered and the well-covenanted tenants that tend to occupy these spaces. Looking forward, grocery-anchored retail should continue to be a popular asset among investors, as even in the face of economic headwinds, consumers need to purchase basic necessities like food. This is why grocery-related retail sales have shown more resilience in the current economic environment, resulting in positive investor sentiment.

Retail Sales Soften as Purchasing Power Erodes



E-Commerce Feels Impact of Rising Interest Rates

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