RESEARCH BRIEF
CANADA INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS
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Cooling Inflation Provides Optimism For Commercial Real Estate Investment

Price growth decelerates for eighth straight month. Canada's annual inflation rate reached 5.2 per cent in February, below the market consensus of 5.4 per cent. This measure was down from 5.9 per cent in January, which was the largest monthly drop since April 2020, and is nearly 300 basis points below the June 2022 peak of 8.1 per cent. Although core price pressures remained elevated, with the three-month annualized rate sitting at 3.5 per cent, the fall in headline inflation suggests that annual price growth will average 5.2 per cent this quarter, which is below the Bank of Canada's forecast of 5.4 per cent. As a result, the Central Bank's monetary tightening program is balancing supply and demand at a faster pace than originally expected. This provides further support toward the belief that interest rates have reached their peak and that additional hikes are unlikely, despite an extremely tight labour market.

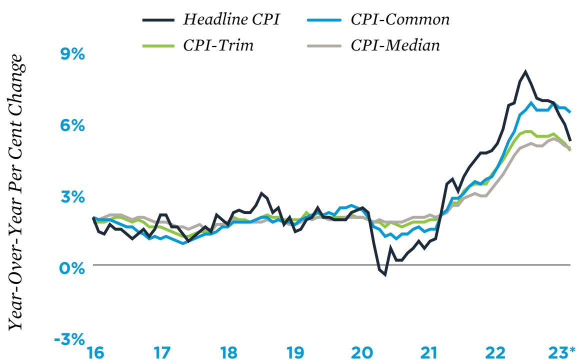
Fears in the Financial Sector another reason to maintain pause. With inflation cooling faster than expected, coupled with turmoil in the global banking sector, there is little chance that the Bank of Canada will be forced to resume its interest rate hiking cycle in the coming months. Consequently, the Central Bank is likely to hold its policy rate at 4.5 per cent before cutting it in the latter part of 2023. However, the BoC will likely push back against the new market-implied view that it could begin cutting interest rates before the summer. Underlying inflationary pressures, such as a tight labour market, the Russian-Ukraine War and the reopening of China, continue to present further inflationary risks. A rate cut, however, is now the more likely outcome, although not until the end of 2023.

Commercial Real Estate Outlook

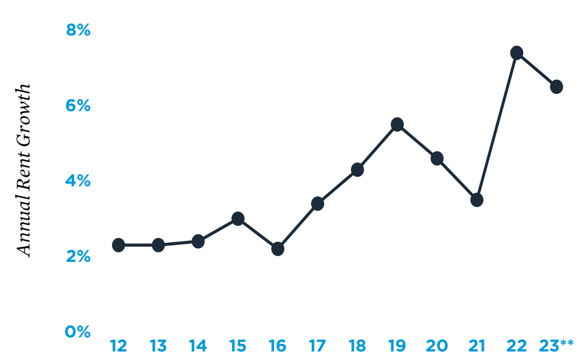
Positive sentiment to improve amid slowing inflation. Investment activity in the first half of 2022 was robust for almost all property types. Rising interest rates, however, curbed investor enthusiasm, and transaction activity slowed notably in the second half of the year. Total dollar volume traded was down 35 per cent when compared to the prior period, as many investors took a wait-and-see approach to determine where borrowing costs would stabilize. While many market participants remain on the sidelines today, interest rate uncertainty is beginning to abate, with inflation cooling and the BoC pausing rate hikes at its most recent meeting. As a result, transaction activity could experience an uptick as buyers and sellers begin to absorb this new, higher-cost investment environment. Additionally, with markets now implying an interest rate cut before the end of 2023, many buyers may deploy investment capital currently on the sidelines in order to get ahead of the market and to capitalize on sound fundamentals for almost all property types.

Inflation-resistant assets well positioned. Properties with relatively high turnover, like apartments and hotels, offer a potential inflation hedge as they can more easily realign revenues with costs. As a result, in 2022, multifamily saw annual rent growth surpass 7.0 per cent. Meanwhile, hotels saw key income metrics like the average daily rate and revenue per available room eclipse 2019 levels by 15 per cent and 12 per cent, respectively. Looking forward, further growth is expected for both property types as historic immigration will continue to drive apartment demand, while pent-up travel demand and the return of international tourism should aid hotels.

Inflation Eases Across All Measures



Multifamily Rent Growth Reached Historic Level



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