RESEARCH BRIEF
CANADA MONETARY POLICY

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

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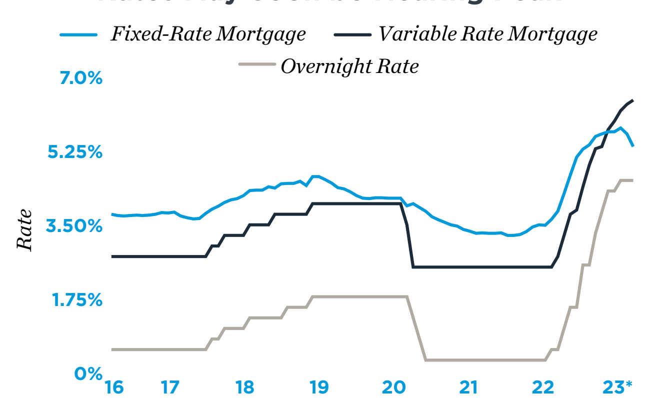
Bank of Canada Holds Policy Rate; Commercial Real Estate Investment Positioned to Benefit

Policy rate unchanged for the first time in over a year. After eight consecutive interest rate hikes, the Bank of Canada paused its monetary tightening cycle. In its announcement, the Bank stated that the latest developments have evolved broadly in line with expectations, as economic growth is softening and inflation continues to cool. As a result, the Governing Council decided to hold the overnight rate at 4.5 per cent, and will continue to assess economic developments and the impact of past interest rate increases. While the general consensus suggests that inflation should return to the target range of 1 to 3 per cent later this year, the central bank stated that it is prepared to increase the policy rate further if inflation persists. An extremely tight labour market, growth in China and the Russian-Ukraine War remain key sources of upside risk to inflation. Nonetheless, with encouraging CPI data, it seems unlikely that the BoC will be forced to resume raising rates. The consensus among major banks suggests that rates will plateau at 4.5 per cent and begin to drop in the fourth quarter or early next year.

Barriers to homeownership persist. Given the BoC's pause, variable mortgage rates have likely peaked at over 6 per cent, with fixed rates above 5 per cent. Consequently, housing affordability remains a challenge, even in the face of declining home values. Additionally, with interest rates showing signs of stabilizing, an uptick in sales activity is likely as potential buyers look to get ahead of the market. Home prices, as a result, could increase in the second half of this year, furthering long-term affordability challenges. Investment in rental development is needed to provide lower-cost housing options.

Rates May Soon be Nearing Peak

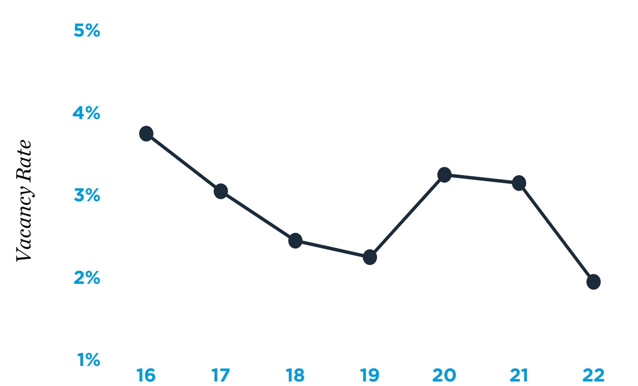


Commercial Real Estate Outlook

Investment activity set to benefit as uncertainty abates. In the first half of 2022, total dollar volume transacted rose by 70 per cent when compared to the same time period in 2021 as buyers took advantage of the low interest rate environment. Once borrowing costs increased, however, sales activity stalled as market participants moved to the sidelines and took a wait-and-see approach to determine where lending rates would stabilize. Now, with interest rates unchanged in March, positive investor sentiment should begin to build within the commercial real estate industry as the market fully absorbs this new, higher-cost investment climate. An uptick in transaction activity over the coming months is expected, as this large volume of waiting investment capital currently on the sidelines will likely be unlocked in order to take advantage of the sound underlying fundamentals for almost all property types.

Multifamily to benefit from interest rate stabilization. In 2022, national apartment vacancy fell 120 basis points to 1.9 per cent, causing rent growth to reach 7.3 per cent year-over-year, both of which were the largest changes on record. While elevated interest rates are slowing Canada's economy, the apartment rental sector is well-positioned as limited supply and prevailing demand should keep fundamentals healthy. Vacancy is forecast to continue on its downward trajectory, while rent growth is expected to reach 6 per cent annually in 2023. With interest rates showing signs of stabilization, investor enthusiasm is likely to build in order to capitalize on these healthy performance metrics, which should lend support to an uptick in transaction activity.

Apartment Vacancy Nears Historic Low



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