RESEARCH BRIEF
CANADA MONETARY POLICY

IPA INSTITUTIONAL PROPERTY ADVISORS
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Further Interest Rate Certainty Emerges; Positive Investor Sentiment Likely to Build

Conditional pause continues. For the second straight month, the Bank of Canada held its policy rate at 4.5 per cent. While the Central Bank did state that GDP growth in the first quarter appeared to be stronger than forecast — due to a tight labour market and a healthy rise in exports — it still expects economic growth and inflation to moderate. As more households renew their mortgages at higher rates and restrictive monetary policy works its way through the economy more broadly, consumption should soften. Also, with recent turmoil in the U.S. banking sector tightening credit conditions further, international growth may stall over the coming months, causing Canada's exports to drop. Nonetheless, the Bank did state that it will continue to assess whether monetary policy is sufficiently restrictive to relieve price pressures and remains prepared to raise the overnight rate further if needed. However, recent data suggests that inflation will continue to cool, making an additional rate hike unlikely. A rate cut in early 2024 is now the more probable outcome.

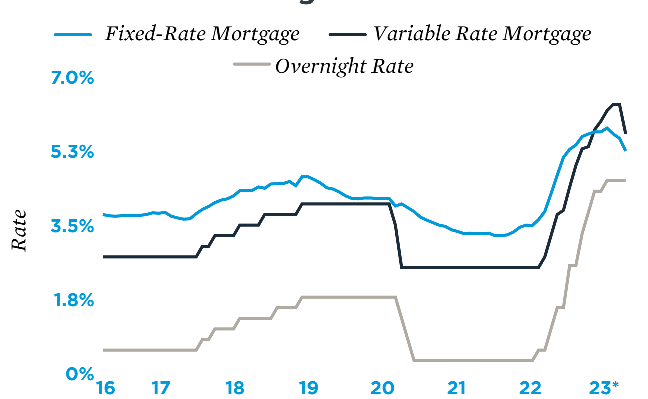
Housing market shows signs of stabilizing. With variable and fixed mortgage rates trending down since the BoC began its conditional pause in March, it appears home borrowing costs have peaked. As a result, early indicators suggest that Canada's housing market may be beginning to stabilize. New listings continue to trend down, while home prices in Toronto and Vancouver — Canada's two most expensive cities — edged up slightly in March for the first time since early 2022. With borrowing costs peaking, an uptick in sales activity is likely to continue as potential buyers look to get ahead of the market. Home prices may reach their trough sooner than expected.

Commercial Real Estate Outlook

Uncertainty to mitigate over the coming months. In the first half of 2022, total dollar volume transacted rose 70 per cent when compared to the same time period in 2021, as buyers locked in low financing costs and took advantage of robust fundamentals for almost all property types. Once borrowing costs began to rise, however, price expectation gaps began to emerge between buyers and sellers, causing sales activity to fall roughly 42 per cent annually in the second half of the year as market participants moved to the sidelines. Now, with the policy rate unchanged for two consecutive months, it is likely borrowing costs have peaked and positive investor sentiment should begin to build as the market absorbs this new, higher-cost investment climate. An uptick in transaction activity is expected, as a large volume of waiting investment capital currently on the sidelines will likely be unlocked in order to take advantage of the sound underlying fundamentals across the property spectrum.

Commercial real estate well positioned. With interest rates expected to remain elevated for the remainder of the year, almost all CRE property types are well positioned to weather a short-term economic slowdown. National vacancy for both multifamily and industrial were at all-time lows to end 2022, causing annual rent growth to reach historic levels. Looking ahead, growth is expected to remain healthy as limited supply and sustained demand persist within both sectors. Additionally, key income metrics in the hospitality sector have surpassed 2019 levels and will continue to benefit from the return of international travel. As a result, CRE should continue to generate positive investor enthusiasm, despite economic headwinds.

Borrowing Costs Peak



Rising Interest Rates Curb Investment

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