RESEARCH BRIEF
CANADA INFLATION

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

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Shelter and Energy Costs Send Inflation Higher; Investment Rebound to Stay on Course

Unexpected uptick in inflation. Canada's consumer price inflation surprised on the upside in April, with the 12-month growth rate reaching 4.4 per cent compared to the market consensus of 4.1 per cent. Following a 4.3 per cent increase recorded in March, this also marked the first month of price growth acceleration since inflation peaked in summer 2022. Mortgage interest costs and rent were the top upward contributors for this headline CPI increase, which grew at 28.5 per cent and 6.1 per cent year-over-year, respectively. Due to OPEC+ announcing oil production cuts, gasoline prices advanced 6.3 per cent month-over-month, which slowed the pace of decline in energy costs on an annual basis. Looking at the sequential trend, CPI-median and CPI-trim regained momentum on a three-month annualized basis as well, despite a continued 12-month decrease.

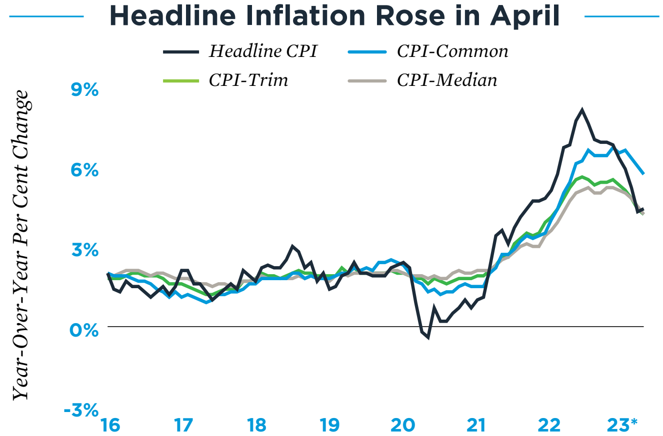
Central Bank to likely stay on the sidelines. While April's headline inflation outcome was not an encouraging sign, Canada's price growth on balance is still on a downward trajectory. Services inflation, which is mostly demand-driven, continued to soften. The spike in April's gasoline prices may also be short-lived as international oil prices appeared to have leveled off in the first half of May. While this uptick in headline inflation may increase the likelihood of future rate hikes, it is more probable that the BoC will continue to hold interest rates steady for the rest of 2023. For the Bank to change its current stance, it will likely need to see more evidence of a material shift in inflationary pressure from other economic indicators, including consumer spending and labour market conditions.

Commercial Real Estate Outlook

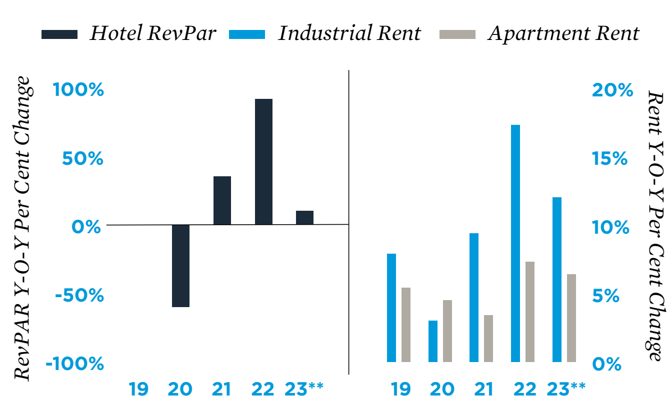
Investor sentiment remains cautiously optimistic. Before further signs of a more broad-based inflation acceleration prompts the BoC to change its stance, credit conditions should remain on a path of stabilization. This will allow buyer and seller expectations to rebalance, which should improve investment activity later this year. Investors who sat idle during the past four quarters will likely treat the coming months as an opportunity to re-enter the market in order to capitalize on sound CRE fundamentals — especially in the hospitality, industrial and multifamily sectors. Total dollar volume transacted will likely bottom out over the coming months. If inflationary pressure proves to be more stubborn, the BoC will stand ready to hike rates again. Investment volume may remain muted for longer than expected in that case.

Inflation-resistant sectors to see greater rebound in investment. In this economic cycle, hotel operators saw an immediate recovery in revenue amid skyrocketing travel demand after health restrictions were removed. Following several quarters of double-digit percentage increases, Canada's industrial rent is also expected to end 2023 nearly 50 per cent higher compared to the 2019 level. Due to an increase in immigration and demand spillover from the single-family market, the multifamily sector has also experienced record-high rent growth. Robust occupancy cost increases in these sectors have enabled property owners to better preserve their purchasing power. As inflation still remains elevated, these sectors will likely attract a larger share of capital once investment activity begins to improve.

Headline Inflation Rose in April



Canada Annual Rent Trend



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** Through April; **Forecast*
Sources: IPA Research Services; CoStar Group, Inc.; Statistics Canada