RESEARCH BRIEF
CANADA MONETARY POLICY

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Central Bank Increases Policy Rate Again; Potential to be the Last Hike as Pressures Ease

Policy rate ticks up again. The Bank of Canada increased its overnight rate 25 basis points to 5.0 per cent at its July meeting. The Central Bank has now moved its policy rate up 475 basis points since March 2022 as inflation remains above the BoC's target of 2.0 per cent. In its announcement, the Bank stated stronger-than-expected consumption, a turnaround in the housing market, resilient employment growth, as well as sticky core inflation and still-elevated inflation expectations, as the main reasons to continue its monetary tightening cycle. While the BoC did state that it anticipates consumption to ease, along with the labour market, it remains concerned that progress toward the 2.0 per cent target could stall and remain stuck around 3.0 per cent. Despite these concerns, and limited forward guidance, the general consensus among economists is that this may be the final rate hike of this cycle, as the labour market is loosening, core inflation is declining and inflation expectations are normalizing. However, if inflation does not continue to trend down, further hikes remain a possibility.

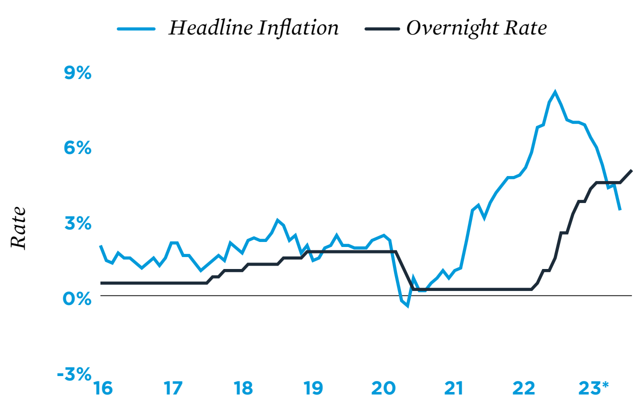
Housing momentum may stall. With the BoC's conditional interest rate pause in March, Canada's housing market began its recovery. As of May, the average price of a single-family home was up 5.0 per cent when compared to the February trough as some buyers returned from the sidelines when uncertainty began to abate. The resumption of the monetary tightening cycle by the BoC may cause monthly gains to ease as further rate hikes could cool buyer sentiment. Yet, with the sales-to-new listings ratio indicating a sellers market, and with limited housing supply, further price declines are unlikely.

Commercial Real Estate Outlook

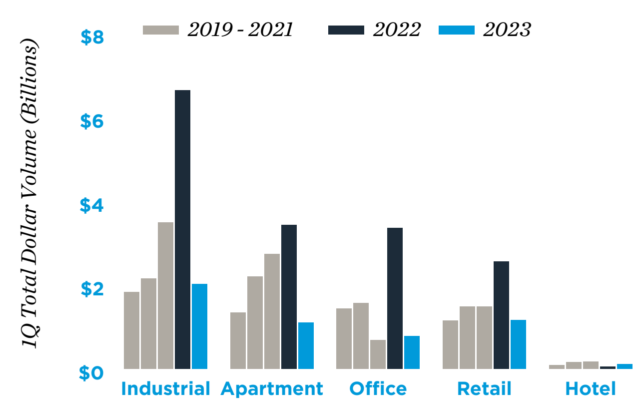
Optimism could build among CRE investors. With indicators and market sentiment suggesting that this may have been the BoC's final rate hike, positive investor sentiment will likely build in the commercial real estate investment community over the coming months. Price expectation gaps between buyers and sellers could mitigate as property underwriting becomes more clear and pricing begins to recalibrate. Underlying fundamentals across the property spectrum remain healthy, which supports a potential uptick in CRE transaction activity once financing costs show signs of stabilizing. This comes after roughly one year of muted sales activity as many market participants moved to the sidelines and took a wait-and-see-approach. Due to this, total dollar volume transacted fell roughly 70 per cent annually as of the end of the first quarter with rising interest rates curbing property returns, and thus buyer enthusiasm.

Select assets outperform. Hotels saw annual sales volumes rise 90 per cent as of the end of the first quarter. This was likely due to the daily turnover, allowing operators to realign revenues with rising costs more frequently. Coupled with pent-up travel demand, key income metrics like the average daily rate and revenue per available room increased roughly 20 per cent as of May when compared to the 2019 levels. Additionally, retail transaction volumes have also fared relatively well, down only 50 per cent annually as of the first quarter — which is better than the 70 per cent average seen across other asset types. This is especially true for grocery-anchored retail as the essential nature of the products offered creates stability, making it a preferred investment option in times of economic uncertainty.

Central Bank Continues Fight Against Inflation



Rising Borrowing Costs Curb Sales Volumes



*Overnight rate through July, Inflation through May

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