RESEARCH BRIEF
CANADA RETAIL SALES

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Retail Sales Show Signs of Moderation, Prompting Careful Consideration of Benchmark Rate

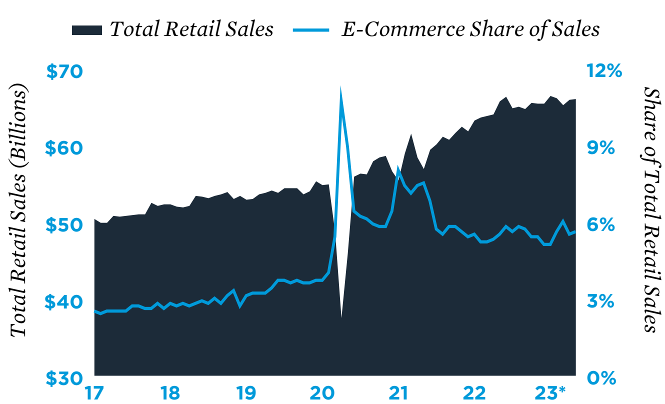
Retail sales inch up at slower than expected pace. Retail sales ticked up slightly in May, increasing 0.2 per cent month-over-month, which, after accounting for inflation, translated into a 0.1 per cent gain. While positive growth continued to suggest that households are absorbing higher borrowing costs better than expected, May's reading was well below the preliminary estimate of 0.5 per cent. Retail sales were up only 0.5 per cent on an annual basis — the weakest showing since the onset of the global health crisis — which may suggest further easing ahead. The latest preliminary numbers imply that retail sales were unchanged in June. This calls into question the Bank of Canada's claim that there is persistent excess demand in the economy. Consequently, an interest rate pause is becoming more likely as consumption continues to ease and headline inflation fell by more than expected in June. Commercial real estate investment activity may trend up over the coming months as a result.

Online shopping regains momentum. In May, e-commerce-related spending rebounded, increasing 2.1 per cent monthly. As a share of total sales, online shopping tracked up as well, accounting for 5.6 per cent. This is down from the 2020 peak of 11.0 per cent, but remains well-above the pre-pandemic average of 3.0 per cent. E-commerce- related space demand is likely to continue to lend support toward Canada's industrial sector. While year-end vacancy is forecast to edge up slightly due to an influx of new supply set to enter the market, it is likely to remain below 2.0 per cent, aiding further double-digit annual rent growth.

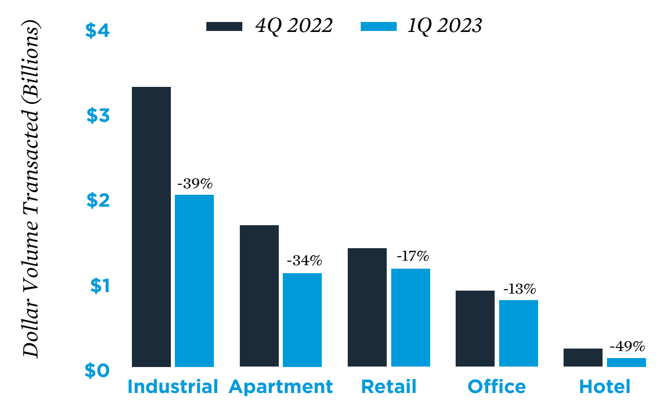
Recent data hints toward interest rate pause. With retail sales showing signs of moderating, coupled with easing labour market conditions and inflation falling back within the BoC's target range, the possibility of further rate hikes is becoming less likely. Price expectation gaps between buyers and sellers may mitigate over the coming months as borrowing costs stabilize and provide clearer underwriting conditions, aiding price recalibration. These factors and healthy underlying fundamentals for almost all property types support the possibility of an uptick in transaction activity. Earlier this year when the BoC paused its rate hiking cycle and uncertainty began to abate, some property types and markets saw an uptick in sales volumes. It is likely this trend regains momentum as many sidelined buyers with large volumes of deployable investment capital look to re-enter the market in order to take advantage of robust property performance.

Retail properties a preferred investment vehicle. With retail offering one of the highest cap rates among property types, hovering around 6.5 per cent — along with rising sales in essential categories like food and beverage — single-tenant, food-related retail remains a preferred investment option. This is due to the property type offering stability, with annual food and beverage sales rising for 13 consecutive months, along with the asset type typically being leased by tenants with strong corporate covenants. Total dollar volume transacted as of the end of the first quarter was down only 17 per cent compared to the final quarter of 2022, which is better than the 34 per cent average seen across all other property types.

Retail Sales Trend Up, but Show Signs of Easing



Retail Investment Volume More Stable



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