RESEARCH BRIEF
CANADA INFLATION

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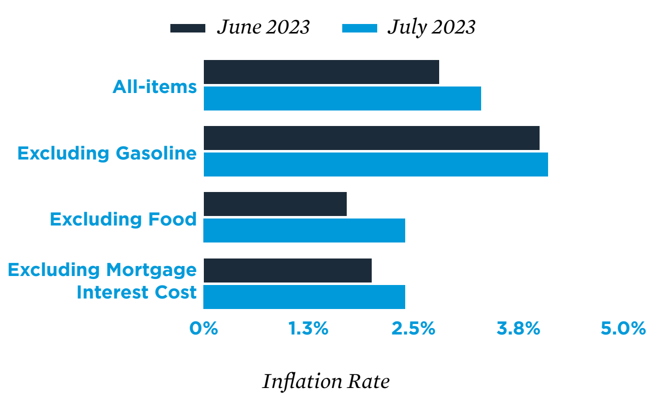
Mixed Signals for Bank of Canada to Consider as Inflation Trends up Once Again

Inflation ticks up amid base-year effect. In July, annual inflation increased to 3.3 per cent. This was above the Bank of Canada's target range, as well as the consensus estimate of 3.0 per cent. July's CPI acceleration was mainly attributed to a base-year effect in gasoline prices as the impact of the Russian-Ukraine war is no longer impacting the 12-month movement in energy inflation. Nonetheless, the BoC's preferred measure, the three-month annualized average of CPI-trim and CPI-median, fell to 3.5 per cent, down from 3.9 per cent in June. Also, the BoC's "supercore" inflation, which measures price pressures stemming from services — excluding shelter and energy — eased to 4.2 per cent from 4.8 per cent on a three-month annualized basis. While declining core inflation provides some evidence of broader price easing, the larger-than-expected increase in headline inflation raises the risk of a further rate hike.

Mixed indicators for the Central Bank to consider. With the BoC stating that it might raise rates again if data surprised to the upside, a possibility for a further interest rate hike still remains. As core inflation trends down, along with an easing labour market and stagnating retail sales suggesting further price easing ahead, money markets are still pricing in an interest rate pause next month. Additionally, with second quarter GDP likely to indicate slower-than-expected growth, coupled with elevated borrowing costs continuing to eat into households' real disposable income, further price softening is likely to occur over the coming months. This may be enough to convince the BoC to return to the sidelines and hold its policy rate at 5.0 per cent.

Reaching Inflation Target Remains a Challenge

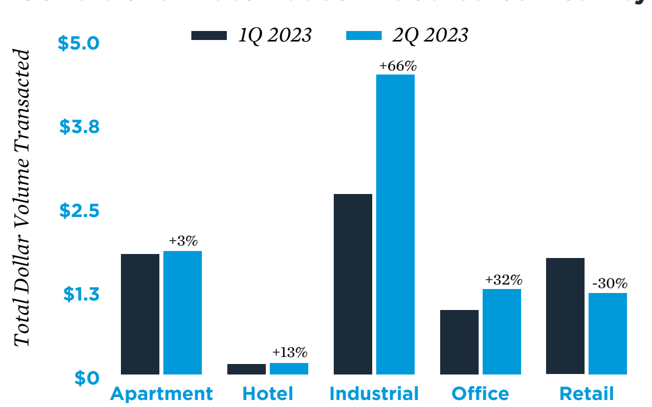


Commercial Real Estate Outlook

Commercial real estate investors to gain confidence. With money markets still pricing in an over 60 per cent chance of an interest rate pause at the BoC's September meeting, positive investor sentiment is likely to build over the final quarter of the year. As interest rate uncertainty is expected to abate, clearer underwriting conditions should aid price recalibration, which will likely support an uptick in transaction activity. Many market participants are anticipated to emerge from the sidelines with large volumes of deployable investment capital looking to take advantage of healthy underlying fundamentals across the property spectrum. This was already witnessed earlier in the year when the BoC paused interest rate hikes in March. Total dollar volume transacted in the second quarter rose roughly 20 per cent when compared to the first quarter, after rising borrowing costs curbed buyer enthusiasm over the past year. When compared to the prior period, total dollar volume transacted over the trailing 12 months was down roughly 40 per cent.

Hotels a top performer. The hotel sector tends to be more inflation-resistant as daily turnover allows operators to increase room rates in order to align with rising costs on a more frequent basis. Due to rapid inflation over the past year, coupled with pent-up travel demand, hotels recovered from their pandemic lows at a rapid pace. As of June, occupancy rates have returned to pre-pandemic levels, and key income metrics — such as the average daily rate and revenue per available room — were up 21.7 and 20.7 per cent, respectively. This was further highlighted in July's inflation numbers, as traveler accommodation prices increased 4.2 per cent annually.

Conditional Rate Pause Aided Sales Activity



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