RESEARCH BRIEF
CANADA RETAIL SALES

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Emerging Cracks in Retail Sales Support a Pause in Bank of Canada's Rate Hiking Cycle

Retail sales stagnate as higher interest rates are slowly absorbed. In June, retail sales grew 0.1 per cent month-over-month. Robust population growth, coupled with a relatively healthy labour market and elevated savings, has helped the economy absorb rising borrowing costs better than expected. However, the underlying data continues to point to further weakness ahead. After adjusting for inflation, retail sales edged down 0.2 per cent month-over-month in June. Core retail sales — which exclude gasoline, as well as motor vehicle and parts dealers — were down 0.9 per cent. While a slowdown in consumption will likely cause economic growth to soften, it indicates that the Bank of Canada's interest rate hiking cycle is beginning to impact the broader economy. This may be enough to force the Central Bank back to the sidelines at its September meeting as underlying inflationary pressures continue to ease.

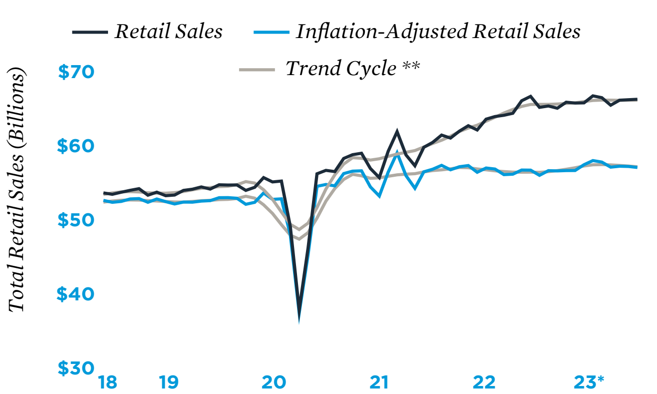
Easing retail sales support potential interest rate pause. With inflation-adjusted retail sales down 0.4 per cent since the end of 2022, it is becoming increasingly hard for the BoC to justify its view that the economy continues to operate in a position of excess demand. Along with the unemployment rate rising for three consecutive months, the probability of an interest rate pause has increased. As a result, commercial real estate transaction activity is likely to gain momentum heading into 2024. This was already highlighted in the second quarter, when the BoC first paused rate hikes in March, as total dollar volume transacted increased across all major metros and was up 18 per cent nationally when compared to the first three months of the year.

Commercial Real Estate Outlook

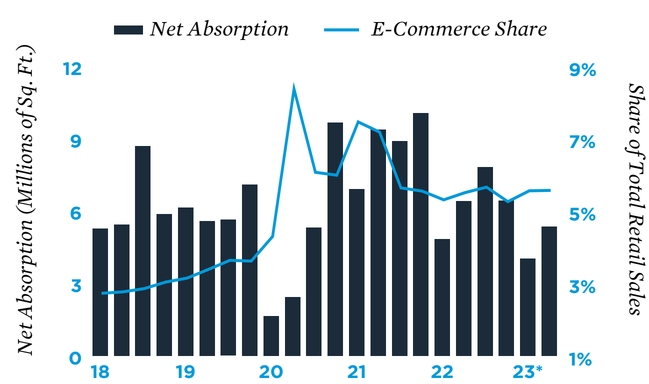
Industrial sector sees most investment. The national industrial vacancy rate was 1.4 per cent as of the second quarter. Robust demand from e-commerce-related activity supported healthy fundamentals over the past few years. Online spending as a share of total retail sales was well-above the pre-pandemic average. While vacancy is expected to edge up as leasing softens and an influx of new supply enters the market, the percentage of available space is still forecast to end the year sub-2 per cent. Emerging demand drivers in the manufacturing sector are also providing an optimistic long-term outlook. This was supported by the third consecutive monthly rise in motor vehicle and part sales in June, as well as the 2.4 per cent annual rise in real manufacturing sales. Additionally, construction investment in manufacturing facilities was 60 per cent above the level seen in the early parts of 2022. In the second quarter, total dollar volume transacted for industrial properties rose 55 per cent when compared to the first three months of the year and accounted for 52 per cent of all dollar volume.

Essential retail mitigates investor risk in times of uncertainty. Grocery-anchored retail is continuing to generate investor attention, despite a modest 0.4 per cent month-over-month drop in grocery-related spending. This property type tends to house tenants that offer essential products, such as supermarkets, banks, pharmacies and doctor's offices, which typically generate more stable sales in times of economic uncertainty. Grocery-related spending in Canada has seen monthly gains in five of the first six months of 2023, while annual sales have trended up for 13 consecutive months.

Retail Sales Ease Amid Rising Interest Rates



E-Commerce Drove National Industrial Demand



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* Through June; ** Smoothed version of seasonally-adjusted time series
Sources: IPA Research Services; Altus Data Solutions; Capital Economics; CoStar Group, Inc.; Statistics Canada