RESEARCH BRIEF
CANADA INFLATION

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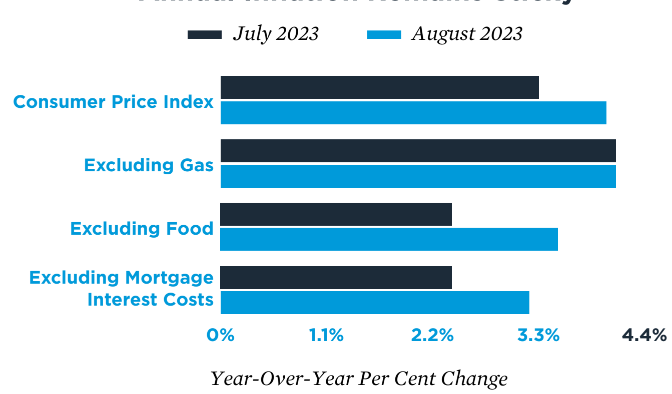
Interest Rate Uncertainty Continues to Loom as Inflation Edges up for Second Straight Month

Further price growth raises risk of additional rate hike. Canada's annual inflation rate jumped to 4.0 per cent in August. This was up from 3.3 per cent seen in July and above the consensus estimate of 3.8 per cent. Higher gasoline prices and unfavourable base-year effects for energy prices were largely to blame for the overall acceleration. However, with both of the Bank of Canada's preferred measures of core inflation — CPI-trim and CPI-median — increasing 0.4 per cent monthly, the three-month annualized rate hit its highest level in over a year at 4.5 per cent. Underlying price pressures remained sticky, which provides further risk toward an additional interest rate hike. With headline and core inflation now sitting at or above 4.0 per cent, mortgage interest costs can no longer be blamed for keeping inflation elevated, as this component added a little more than a 1.0 percentage point to the headline rate.

Bank of Canada expected inflation uptick. While annual price growth accelerated in August, this shift may not be enough to prompt the BoC to increase its overnight rate further. The Central Bank acknowledged at its September policy meeting that it expected inflation to rise in the short term. Canada's economy is also showing signs that the 475 basis points of cumulative rate increases so far are beginning to have an impact. The nation's GDP contracted in the second quarter, while the unemployment rate has risen 50 basis points since April. As a result, money markets are pricing in a roughly 60 percent chance of an interest rate hold at the BoC's next policy meeting in October; however, the likelihood of an additional rate hike by year-end has increased.

Annual Inflation Remains Sticky

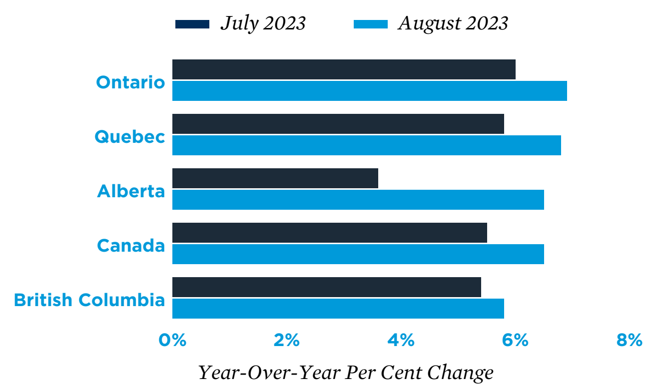


Commercial Real Estate Outlook

Short-term uncertainty to remain amid inflation uptick. August's inflation reading increases the likelihood of a further interest rate hike. This is likely to cause uncertainty to persist within the commercial real estate investment landscape over the short-term. However, money markets and economists expect a more likely chance than not of an interest rate hold at the Central Bank's next policy meeting. Borrowing costs are still forecast to stabilize heading into 2024, which will create clearer underwriting conditions and aid price recalibration. As a result, commercial real estate transaction activity is likely to gain momentum in the early parts of next year as large volumes of deployable investment capital are ready to take advantage of healthy fundamentals across the property spectrum.

Shelter prices accelerate, led by rent growth. With Canada witnessing historic population growth over the past year amid record levels of immigration, along with rising interest rates creating additional barriers to homeownership, apartment rental demand has increased drastically. On top of strong demand tailwinds, elevated financing costs have curbed development activity. Investment in residential building construction was down 25 per cent year-over-year as of July, and building permitting, which captures future development intentions, was down 8.5 per cent annually. Canada's housing supply-demand imbalance has increased significantly over the past year. The national multifamily vacancy rate sits below 2.0 per cent, which has caused rental inflation to reach 6.5 per cent as of August. As a result, apartments remain a top-performing asset and are capturing a large share of investment dollars.

Market Imbalance Drives Annual Rent Growth



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