RESEARCH BRIEF
CANADA INFLATION

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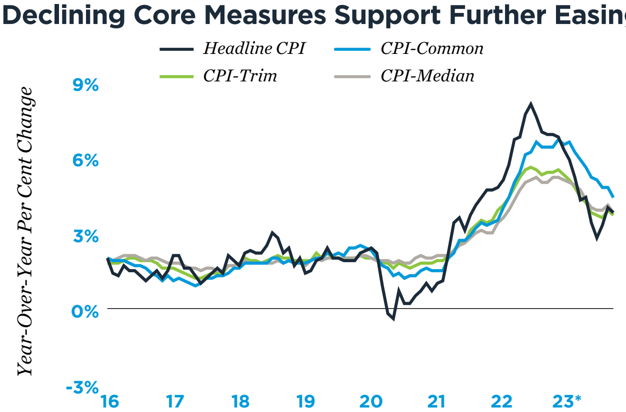
OCTOBER 2023

Larger-Than-Expected Fall in Inflation Supports an End to Interest Rate Hiking Cycle

Inflation cools after two consecutive monthly upticks. Headline inflation fell to 3.8 per cent in September, down from the 4.0 per cent reading witnessed in the previous month and below the consensus estimate of no change. This drop was largely due to declining core prices. The three-month annualized rate of CPI-median decelerated to 3.5 per cent from 4.4 per cent, while CPI-trim slowed to 3.8 per cent from 4.2 per cent. Furthermore, the Central Bank's old core measure, which excludes the eight most volatile components including mortgage interest costs, even declined by 0.1 per cent — the first monthly fall since July 2020. With inflation trending down once again, combined with Canada's economy contracting in the second quarter, easing consumer spending, unemployment inching up, and a weak showing in the recently released Business Outlook Survey, it appears excess demand in the economy is diminishing. This suggests that inflation should continue to decelerate in the quarters ahead, without the need for further interest rate hikes.

Fall in inflation to keep Bank of Canada on the sidelines. Following September's inflation reading, money markets and many economists now forecast interest rates to remain steady for the remainder of the year and into the early parts of 2024. Prior to the release, money markets were pricing in a roughly 43 per cent chance of an additional rate hike at the Central Bank's next policy meeting in October, which quickly fell to 15 per cent following the larger-than-expected fall in inflation. Now, it appears more likely than not that the BoC's next policy move will be an interest rate cut, which could occur as early as the second quarter of next year.

Declining Core Measures Support Further Easing

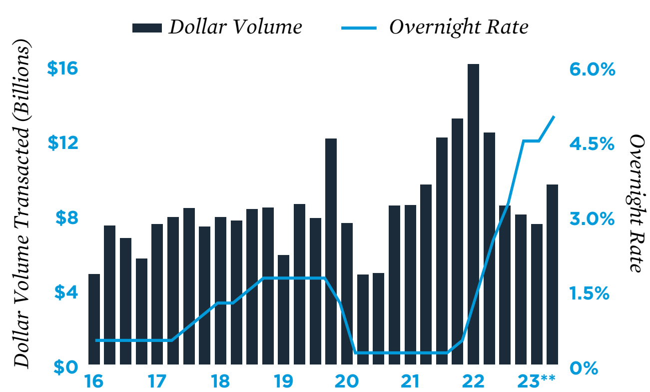


Commercial Real Estate Outlook

Capital markets uncertainty showing signs of abating. With borrowing costs showing early signs of stabilization in the second and third quarters, transaction activity appeared to gain momentum. On a quarter-over-quarter basis, total dollar volume transacted increased roughly 30 per cent in the second quarter compared to the first three months of the year. Although the BoC did hike its policy rate by a further 50 basis points in the third quarter, preliminary estimates suggest that quarterly dollar volume held up relatively stable, if not trending up once again. With interest rate uncertainty exhibiting signs of abating, clearer underwriting conditions emerged. This aided price recalibration and helped mitigate price expectation gaps between many buyers and sellers. As interest rates are expected to remain unchanged heading into the early parts of 2024, coupled with healthy underlying fundamentals across the property spectrum, commercial real estate transaction activity is likely to gain further momentum as large volumes of deployable investment capital look to re-enter the market.

Commercial real estate beats broad-based inflation. While inflation still remains above the BoC's target range, some property types are seeing annual rent growth outpace inflation. As of the third quarter, industrial rent growth hit 12.5 per cent, while apartment rent gains hit 7.3 per cent. Due to hotels' daily turnover, the property type has witnessed its average daily rate increase 11.2 per cent as of August. Select properties are seeing rent growth outpace the consumer price index again, resulting in a real positive impact to net operating income.

Interest Rate Stabilization to Aid Investment



* Through September; ** Dollar volume through 2Q, overnight rate through 3Q
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Capital Economics; CoStar Group, Inc.; Statistics Canada