RESEARCH BRIEF
CANADA INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS
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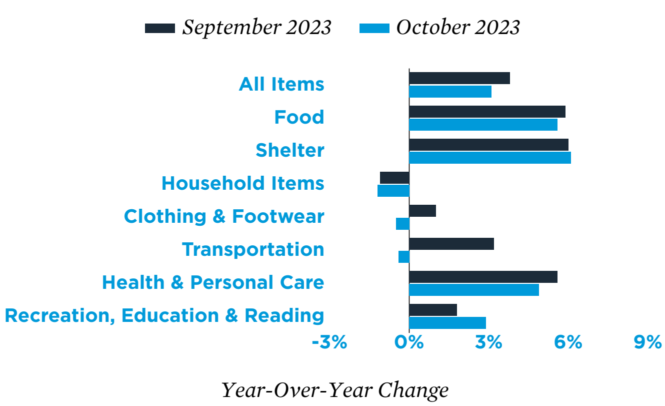
Inflation Takes a Significant Step Toward Bank of Canada's Target Range

Economy continues to show signs of cooling. Canada's headline inflation rate hit 3.1 per cent in October, down from the 3.8 per cent reading in September and just slightly above the Bank of Canada's target range of 1.0 to 3.0 per cent. Given favourable base-year effects, this drop was mainly driven by a 7.8 per cent fall in gasoline prices. Additionally, the Central Bank's preferred measures of core inflation — CPI-median and CPI-trim — reached their lowest levels since the end of 2021, sitting at 3.6 and 3.5 per cent, respectively. This brought the three-month annualized change to 3.0 per cent. Price pressures remained sticky for service inflation, however, which accelerated to an annual pace of 4.6 per cent, and was largely fueled by an 8.2 per cent jump in rental costs, as well as surging mortgage interest costs. Despite this, October's inflation measure was broadly welcomed, further supporting the belief that the Bank of Canada is done with its interest rate hiking cycle.

Central Bank to remain on sidelines. With inflation firmly trending down, the unemployment rate inching up, and Canada's economy contracting in the second quarter, money markets continue to price in an interest rate pause. In response to October's inflation reading, the market priced in a 90 per cent chance of a rate hold in December, with the likelihood of an interest rate cut by mid-2024 remaining essentially unchanged at 65 per cent. Additionally, with roughly 80 per cent of Canadians expected to face higher mortgage payments by the end of next year, the Central Bank is becoming increasingly concerned about Canada's housing market, further supporting the belief that the BoC's tightening cycle has reached its end.

Major Inflation Components Decelerate

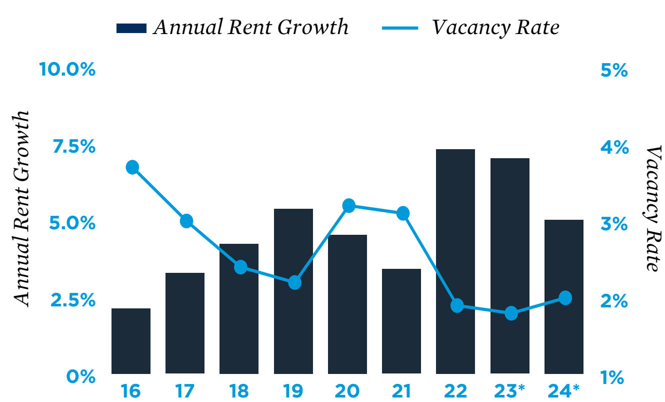


Commercial Real Estate Outlook

Housing imbalance fuels apartment rent growth. Canada's limited housing supply, coupled with robust demand drivers stemming from homeownership challenges, as well as record levels of immigration, have resulted in a housing supply-demand imbalance across the country. As a result, the nation's apartment rental vacancy rate has hovered around 2.0 per cent throughout 2023 — a near record low — which has caused rental inflation to remain elevated at 8.2 per cent as of October. Looking forward, robust apartment performance is likely to continue. Supply is expected to remain scare as it is estimated that Canada needs to build 5.8 million new homes by 2030 to reach affordability, which is well above the current rate of construction of 2.3 million. Canada's population is expected to keep growing at an above-average pace as the nation is set to welcome roughly 1.5 million new permanent residents over the next three years. Consequently, multifamily remains a preferred investment option, capturing 25 per cent of total dollar volume invested in commercial real estate over the past year ending in September.

Hotels continue to show strength. Travel tour inflation was one of the largest contributors to price growth in October, increasing 11.3 per cent year-over-year, resulting in healthy gains in hotel performance. As of September, hotel occupancy sat at 75 per cent, slightly above the pre-pandemic level. This is continuing to cause the average daily rate and revenue per available room to outpace inflation — growing 8.1 and 9.7 per cent, respectively. As a result, hotel sales activity has been limited as property owners want to benefit from the upswing in operating performance.

Multifamily Performance to Remain Robust



* Forecast

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

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