RESEARCH BRIEF
CANADA INFLATION

IPA | INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

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Annual Inflation Hovers Just Above Target Range, While Easing Takes a Temporary Pause

Inflation unchanged from previous month. Annual price growth hit 3.1 per cent in November, matching October's reading. The Bank of Canada's preferred measures of core inflation — CPI-trim and CPI-median — also held stable at 3.5 and 3.4 per cent, respectively. This unchanged reading was partially fueled by a 10 per cent monthly jump in travel tour prices, which alone pushed up the CPI by 0.2 per cent monthly. However, this pause in easing inflation is likely to be temporary, as historically large monthly moves in travel-related costs are swiftly reversed. Inflationary pressures are likely to ease further over the coming months. Excess demand in the economy is largely gone, with GDP contracting and consumption re-balancing in the third quarter. Canada's unemployment rate has also increased 80 basis points year-to-date as of November, suggesting wage growth is primed to cool. As a result, it is still likely that the BoC's next move will be an interest rate cut.

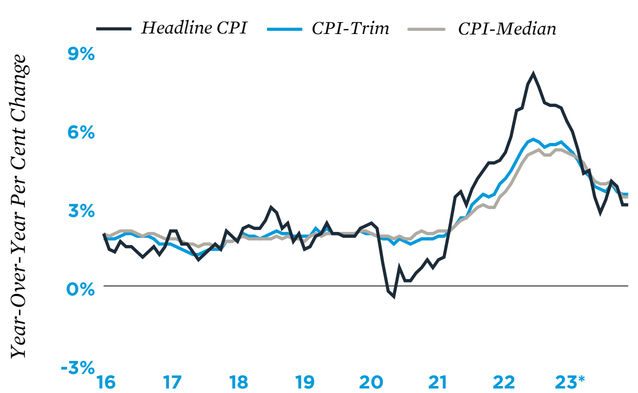
Timing of rate cuts pushed back. The market consensus was that inflation would fall in November. Given annual price growth remaining unchanged, this has pushed back expectations of a rate decrease as soon as March of next year. The Central Bank has stated it needs to see further downward movement in core inflation before considering rate cuts. Despite this, money markets continued to price in an interest rate cut as early as April, so any delays are unlikely to be long-lived. Underlying pressures are continuing to ease, and inflation is still below the BoC's forecast. The monetary authority has also stated that inflation could be volatile in the coming months, indicating that the Central Bank is willing to be patient.

Commercial Real Estate Outlook

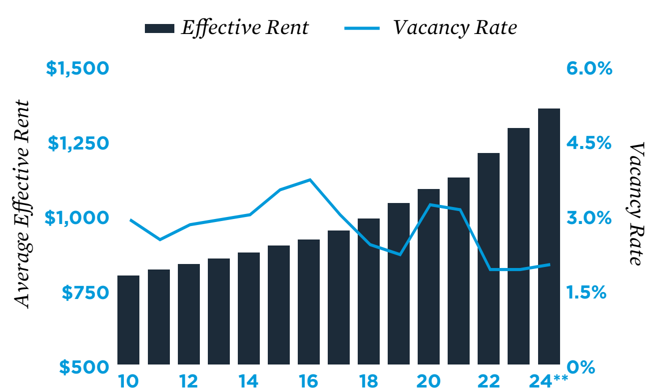
Stabilizing financing conditions support investment uptick. Despite inflation holding, positive investor sentiment is likely to build in the early parts of next year. The BoC has now held its overnight rate at 5.0 per cent for three consecutive policy announcements, while bond yields have fallen significantly over the past two months. Both Canada's five- and ten-year bond rates are down by over 100 basis points as of December. Given these improving financing conditions, price expectation gaps between buyers and sellers are set to mitigate as uncertainty abates and underwriting becomes less challenging. Coupled with healthy fundamentals across most properties, as well as record levels of deployable investment capital, sales activity is likely to gain momentum over the course of next year. This holds especially true for industrial, multifamily and essential-based retail as these assets continue to witness healthy demand, making financing capital relatively more available.

Shelter costs driving inflation. Housing-related expenses continued to be a primary driver of inflation in November. Mortgage interest costs were up 30 per cent annually, while rental inflation sat at 7.4 per cent. If removed, the three-month annualized rate of inflation would sit at roughly 2.0 per cent, the BoC's target. Given these housing-related costs creating affordability challenges within Canada's housing market, coupled with historic population growth witnessed over the past year, further apartment rentals are needed as demand is significantly outpacing supply. This is one reason why the federal government recently announced the Enhanced GST Rental Rebate in a bid to kickstart multifamily construction.

Easing Inflation Takes a Temporary Pause



Multifamily Performance to Sustain



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

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