

RESEARCH BRIEF

CANADA INFLATION

JANUARY 2024

Inflation Inches Up Amid Base-Year Effects; Central Bank's Next Move Still Likely a Rate Cut

Inflation remains sticky. Headline inflation matched market expectations in December with a reading of 3.4 per cent, up from 3.1 per cent witnessed in November. The headline acceleration was solely a result of a base-year effect where gasoline prices fell more on a monthly basis in December 2022 than they did in December 2023. When excluding gasoline, inflation slowed from 3.6 per cent in November to 3.5 per cent in December. On a monthly basis, headline CPI fell 0.3 per cent as lower month-over-month price decreases in travel tours and gasoline contributed to this decline. Regarding the Bank of Canada's preferred measures of core inflation – CPI-trim and CPI-median – both rose by 0.4 per cent monthly, which caused the average three-month annualized rate to jump back up to 3.6 per cent. Consequently, this raises the risk that the Bank of Canada will need to keep interest rates higher for longer.

Next move still likely to be an interest rate cut. The recently released Business Outlook Survey indicated that fewer businesses are planning larger-than-normal price increases over the coming year. The survey also suggested that labour shortages are no longer firms' biggest concern, which could alleviate wage pressures. Additionally, as past rate hikes are still being absorbed, economic growth will likely remain sluggish over the coming quarters, further curbing inflationary pressures and preventing the need for additional rate hikes. However, with wage growth remaining elevated in December, combined with sticky core-inflation, the BoC is likely to remain hawkish at its next policy meeting. These factors provide risk to the market implied view that interest rates will fall as early as April.

Money Markets Pricing in April Rate Cut

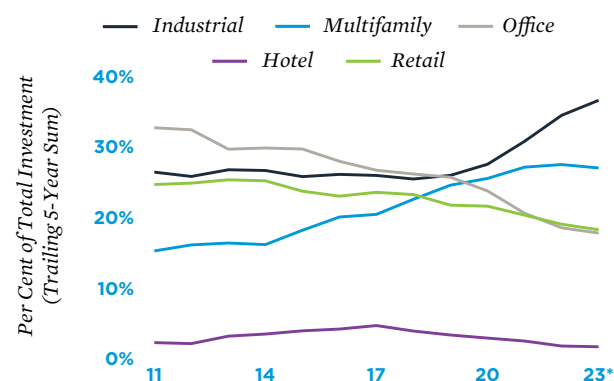
Meeting Date	Expected Target Rate	Probability of Cut	Probability of No Change	Probability of Hike
Jan 24	4.95%	19.2%	80.8%	0%
Mar 6	4.91%	31.7%	68.3%	0%
Apr 10	4.76%	74.7%	25.3%	0%
June 5	4.52%	98.7%	1.3%	0%
July 24	4.28%	100%	0%	0%
Sept 4	4.10%	100%	0%	0%
Oct 23	3.90%	100%	0%	0%
Dec 11	3.80%	100%	0%	0%

Commercial Real Estate Outlook

Rental inflation sees uptick to end the year. Rent prices continued to climb in December, rising 7.7 per cent year-over-year. This uptick was largely fueled by the higher interest rate environment. Elevated borrowing costs create barriers to homeownership – which redirects housing demand toward the rental sector – and slows construction activity. Furthermore, Canada's population grew at a record setting pace of 3.2 per cent annually as of the end of the third quarter of 2023. Consequently, Canada's housing supply-demand imbalance is growing, which pushed the national apartment vacancy rate to sub 2 per cent in 2023 and supported elevated annual rent growth. As a result, apartment rentals were a preferred investment option over the course of last year and accounted for roughly 25 per cent of total dollar volume transacted among major commercial property types, only trailing industrial's 40 per cent share.

Positive investor sentiment to build. With borrowing costs likely to fall as early as the second quarter, commercial real estate transaction activity could slowly gain momentum. When interest rates stabilized over the final quarter of last year, total dollar volume saw a slight uptick when compared to the prior quarter as more certainty returned to the market. As a result, select property types are likely to capture investor attention over the coming quarters as uncertainty abates further. Given still-tight vacancy, industrial assets are set to continue to generate positive investor enthusiasm. Additionally, both multifamily and essential-based retail will likely attract a large share of investment dollars as these assets play an important role in servicing communities seeing historic population growth.

Select Assets Shine Among Investment Options



* Through 3Q; Expected target rate based off swap market, probabilities based off current policy rate
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Capital Economics; CMHC; CoStar Group, Inc.; Refinitiv Eikon; Statistics Canada