RESEARCH BRIEF
CANADA INFLATION

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

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Inflation is Easing at a Faster Pace than the Bank of Canada Anticipated

Inflation decelerates and beats expectation. Canada's consumer price index rose 2.8 per cent year over year in February, down from the 2.9 per cent reading in January and below the market consensus of a reacceleration to 3.1 per cent. The three-month annualized rate is now down to just 1.3 per cent as it appears past rate hikes are reining in consumer spending and continuing to drive prices lower. February's drop was headlined by a deceleration in cellular and Internet services as well as food purchased from stores, but weakness in inflationary pressures was broad-based. When stripping out the most volatile components, the Bank of Canada's preferred measures of core inflation also moderated. CPI-trim and CPI-median rose by just 0.1 per cent monthly, bringing the average three-month annualized rates of core inflation to 2.2 per cent, hitting a level below 3.0 per cent for the first time since April 2021.

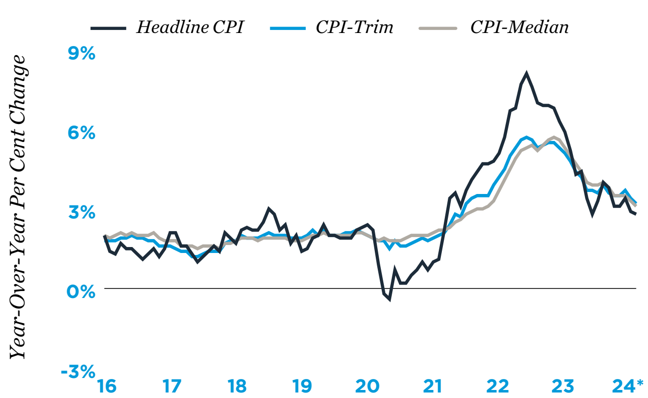
Likelihood of a June interest rate cut increases. With inflation remaining within the Bank of Canada's target range for two consecutive months, coupled with below-potential GDP growth witnessed in the final quarter of last year and an easing labour market, a midyear rate cut is becoming increasingly likely. Immediately following February's inflation release, bond yields fell and the Canadian dollar depreciated, suggesting that investors are increasing their bets for a June rate cut. According to interest rate swap markets, investors are now penciling in a roughly 60-70 per cent chance of a June rate cut — which is up from 45 per cent just prior to the release — and an 85 per cent chance of a July cut. Money markets are pricing in a total reduction of 75 basis points by the end of this year.

Commercial Real Estate Outlook

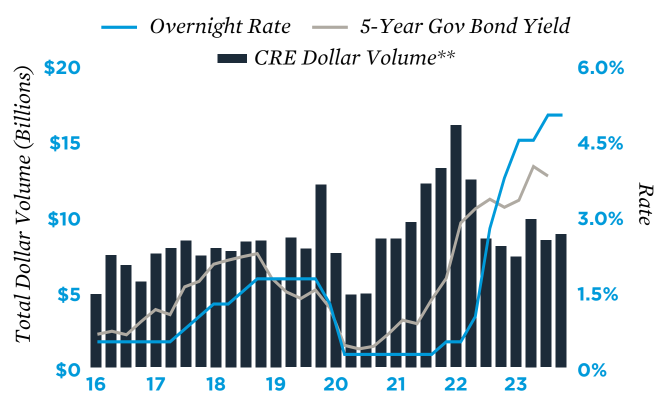
Stabilizing financial conditions aid investor sentiment. The BoC's overnight rate has sat at 5.0 per cent since July 2023. Coupled with softening economic data, bond yields have largely been trending down since October, with the five-year rate dropping roughly 85 basis points as of the end of February. This has pushed fixed-rate mortgages down and has caused variable rates to stabilize, which has aided underwriting and price recalibration. Mortgage spreads are also tightening for preferred products, making financing slightly more attainable. As a result, positive investor sentiment is building. In the final three months of last year, dollar volume sold rose 5.2 per cent quarter over quarter, translating into a 10 per cent year-over-year gain. This trend is likely to continue — especially for preferred assets such as industrial and anchored-retail — as borrowing costs are largely expected to fall over the second half of 2024 and financing capital remains more available for these select property types.

Housing costs accelerate. Shelter inflation continued to apply upward pressure on headline CPI in February. While mortgage interest costs were still up 26.3 per cent year-over-year, ownership inflation held flat. As a result, this uptick in shelter inflation can largely be attributed to the 8.2 per cent annual gain in rental rates. While this surge in rental prices partially reflects robust demand amid historic population growth and a healthy labour market, it also reflects Canada's lack of housing supply. Canada's population grew by a record level of 1.3 million people last year, which was met by an increase of fewer than 200,000 new housing units. Consequently, more supply is needed to address rapidly rising housing costs across the nation.

February Sees Broad-Based Easing in Inflation



Positive Investor Sentiment Poised to Grow



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** Through February; ** Includes apartment, retail, office and industrial sales $1 million and greater*
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada