RESEARCH BRIEF
CANADA MONETARY POLICY

IPA INSTITUTIONAL PROPERTY ADVISORS
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Real Estate Markets Adjusting to Lower Rates as Central Bank Extends Its Easing Cycle

The Bank of Canada delivered its second rate cut. As inflation pressures continued to unwind, the BoC reduced interest rates by 25 basis points in July. With weak household spending and signs of slack in the labour market, the bank now expects inflation to ease further in the foreseeable future. While this decision was broadly in line with market expectations, the monetary authority struck a more dovish tone in the press conference. BoC governor Tiff Macklem emphasized that, with increasing excess supply in the economy, the downside risks of weaker-than-expected growth are becoming more concerning. This indicates that the bank has transitioned to supporting GDP growth so that inflation does not retract significantly. Looking ahead, if inflation continues on a downward trajectory, a cut at every policy meeting for the remainder of 2024 is possible.

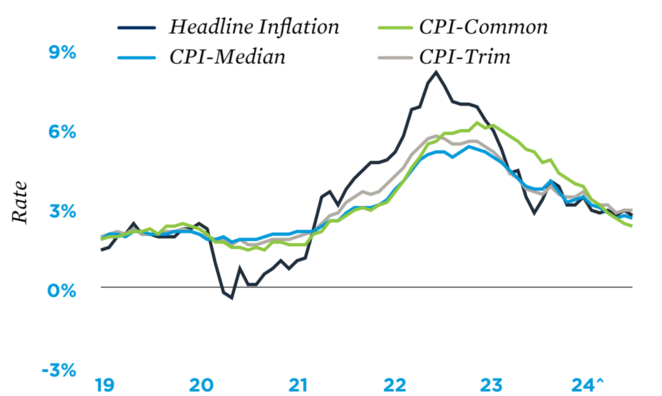
Investment activity likely to perk up. While a 4.5 per cent overnight rate remains in restrictive territory, the BoC's dovish forward guidance will likely boost investor sentiment. Some sidelined investment capital has already been redeployed for smaller-sized deals since the beginning of 2024, as buyers returned to the market in anticipation of easing financial conditions. As a result, metros such as Edmonton and Calgary saw a mild rise in total dollar volume transacted in select property types. With expectations that the overnight rate could drop below 4.0 per cent by year-end, investment activity may receive a more sizable boost for the remainder of 2024, particularly in sectors with healthy fundamentals.

Commercial Real Estate Outlook

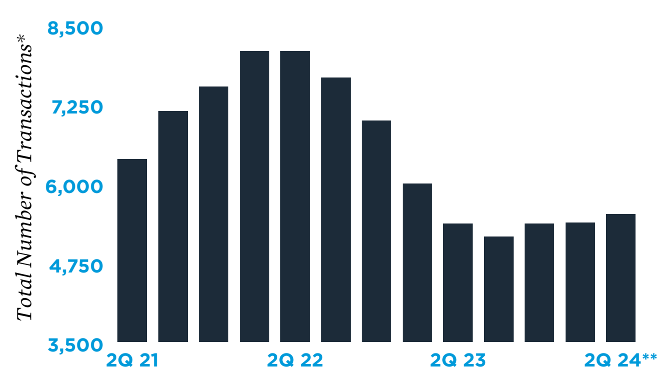
Lower borrowing costs to stimulate consumer spending. As Canada's recent change in immigration policy slows population growth – a major driver for private consumption – easing borrowing costs will likely take the baton to propel the next phase of consumption growth. With interest rates gradually declining to less restrictive levels, consumer spending is expected to recover toward the end of 2024 and well into 2025. This will benefit leasing activity in the retail sector, which witnessed weakening net absorption this year. Additionally, the upward momentum in consumer spending may also increase demand in the warehousing, transportation and manufacturing industries, supporting space needs in Canada's industrial sector. Consequently, the industrial vacancy rate could stabilize in 2025 after two years of increase.

Housing market reacting to lower interest rates. With further easing from the BoC appearing more assured, the single-family market will likely experience greater engagement from home buyers, facilitating a gradual transition from renting to homeownership. Coupled with a diminishing inflow of temporary residents expected over the coming year, this lower interest rate environment is expected to relieve some pressure on the multifamily market. However, despite significantly higher construction starts over the past few years, total apartment completions were lower than anticipated in the first half of 2024 due to construction delays. The still hefty demand and the lagging pace of new supply will maintain a low apartment vacancy rate, leading to further rent hikes this year.

BoC Cuts Rate Amid Broad Easing of Inflation



Sales Activity Gradually Gaining Momentum



*^ Through June; * Trailing 12-month sales for office, retail, hotel, multifamily and industrial properties; ** Preliminary estimate*
Sources: Altus Data Solutions; Bank of Canada; CMHC; Statistics Canada