RESEARCH BRIEF
CANADA MONETARY POLICY

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

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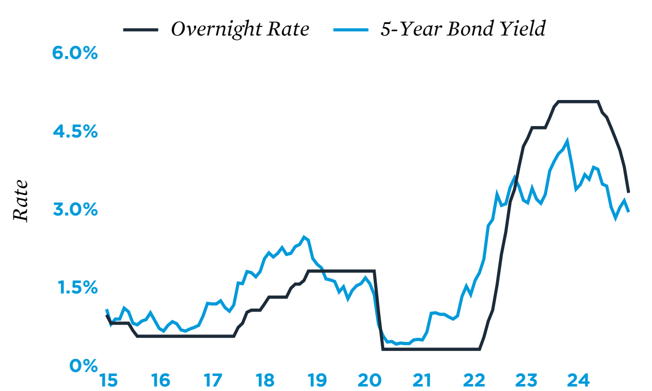
Second-Consecutive Outsized Rate Cut to Spark Further Optimism in CRE Sector

Monetary easing cycle continues at fast pace. For the second-consecutive meeting, Canada's central bank lowered its overnight rate by 50 basis points, bringing it to 3.25 per cent. This is down 175 basis points from the peak reading of 5.0 per cent in June, as a weakening economy supports the need for a less restrictive monetary environment. As to why they enacted another outsized rate cut, the Bank of Canada cited slower than expected GDP growth in the third quarter, at-target inflation, a fast-rising unemployment rate and recent policy changes set to curb population growth as their main reasons. Other federal and provincial policies – including a temporary suspension of GST on some products, the potential one-time payment to consumers and changes to mortgage rules – were also mentioned by Canada's monetary authority. However, the Bank stated they plan to look through some of these temporary effects and focus on underlying trends to guide them on future policy decisions.

Bank likely to return to a more gradual pace of easing. Despite the BoC cutting its policy rate by another 50 basis points, accompanying communications were more hawkish, with the Bank anticipating a more gradual approach going forwards. While this may be due to the policy rate now being within the defined neutral range, it could also be because the central bank has observed green shoots emerging in Canada's economy, noting that consumer spending and housing activity both picked up in the third quarter. Nevertheless, further rate cuts are still expected. Money markets suggest a roughly 65 per cent chance of a 25-basis-point cut in January, while economists see a terminal rate in the 2.25 per cent to 2.50 per cent range.

Cost of Capital Beginning to Improve

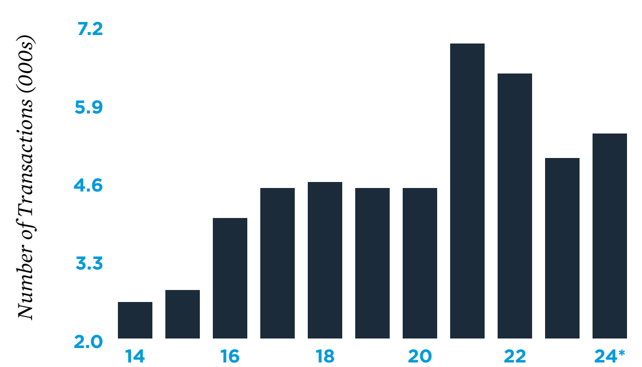


Commercial Real Estate Outlook

Momentum set to grow in CRE industry. The Bank of Canada's ongoing easing cycle has been welcomed news for commercial real estate investors. This trend is especially true for those who tend to base financing around shorter-term money, such as developers. A falling overnight rate could act as a tailwind for CRE construction over the coming year as a result. On the transaction side, a lower policy rate is poised to fuel positive investor sentiment; however, bond markets have mostly priced in these movements already. This is one reason why longer-term money, such as 5- and 10-year yields, held relatively unchanged following the policy announcement and are largely stabilizing around their expected values. Regardless, this stabilization and an expected uptick in economic growth amid lower borrowing costs should fuel investor confidence over the coming year, which is likely to spur greater investor activity. This spark in activity has already been seen, as the total number of sales jumped 13 per cent over the past yearlong period ended September.

Select sectors benefit more from falling borrowing costs. With financing costs having now been trending down since June, more interest rate-sensitive sectors have begun to benefit. In the third quarter, household consumption surged by 3.6 per cent annualized, which could act as a tailwind for both industrial and retail property space demand over the coming year. Additionally, residential investment rose 3.0 per cent, while home sales reached their highest level in October since early 2022, jumping 7.7 per cent monthly. Combined with a diminishing construction pipeline, the industrial, retail and residential sectors maintain a positive outlook.

Investment Activity Could be Turning Corner



* Trailing 12 months through 3Q
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Canadian Real Estate Association; Capital Economics; CoStar Group, Inc.; Statistics Canada

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