RESEARCH BRIEF
CANADA GDP

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Select Components of GDP Suggest a Turning Point in the Commercial Real Estate Sector

GDP inches forward. Canada's economy grew by a 1.0 per cent annualized rate in the third quarter. With interest rates holding in restrictive territory, GDP growth was down from the 2.2 per cent gain seen in the second quarter and below the Bank of Canada's estimate of a 1.5 per cent increase. As the Central Bank's overnight rate fell 125 basis points between June and November to 3.75 per cent, interest rate-sensitive sectors primarily drove economic expansion. Consumption surged by the strongest gain since the pandemic recovery at 3.6 per cent annualized, while residential investment also rose by 3.0 per cent – the first increase in four quarters. In contrast, GDP was hindered by inventories, which subtracted 130 basis points from overall growth. At the same time, non-residential structures and equipment investment fell by 11.3 per cent, which is not ideal given Canada's ongoing productivity challenges.

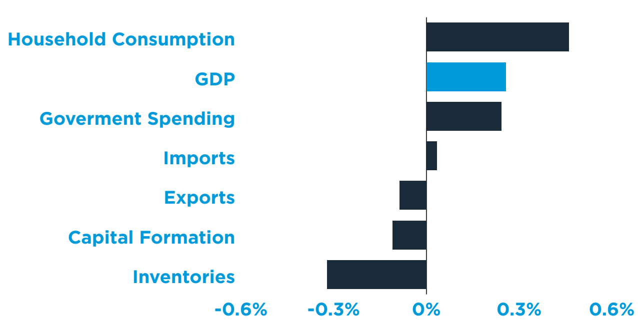
Possibility for an outsized rate cut lingers. Although preliminary estimates suggest that GDP growth will gain some momentum in the final quarter of the year – likely expanding by 1.6 per cent annualized – it is still expected to remain below the BoC's projection of a 2.0 per cent increase. Combined with weaker-than-expected growth in the third quarter and GDP per capita falling for the sixth-consecutive period, the probability of a 50-basis-point rate cut in December moved up slightly. Even so, money markets are still leaning towards a 25-basis-point rate reduction due to a number of factors. The recent surge in home sales, the uptick in inflationary pressure in October, and the sales tax holiday and minimum fiscal stimulus measures announced by the federal government support this possibility.

Commercial Real Estate Outlook

Surge in household spending a boon for CRE. The 3.6 per cent annualized gain in consumption supports an optimistic outlook for commercial real estate performance. Although record population growth is contributing to this increase, a less restrictive monetary environment is also playing a key role, which is set to continue aiding household spending in the quarters ahead. Under this setting, select property sectors, such as retail and industrial, stand to benefit. While limited property supply growth has maintained extremely tight fundamentals in Canada's retail sector despite cost pressures, a surge in construction has caused industrial performance to moderate. With interest rates now firmly trending down and consumption growing, however, Canada's industrial sector appears to be turning a corner. Preliminary estimates for the fourth quarter suggest that net absorption returned to positive territory. Coupled with a tapering development pipeline, the sector outlook is becoming more favourable. Both essential-based retail and industrial are likely to hold as preferred investment options over the coming year as a result.

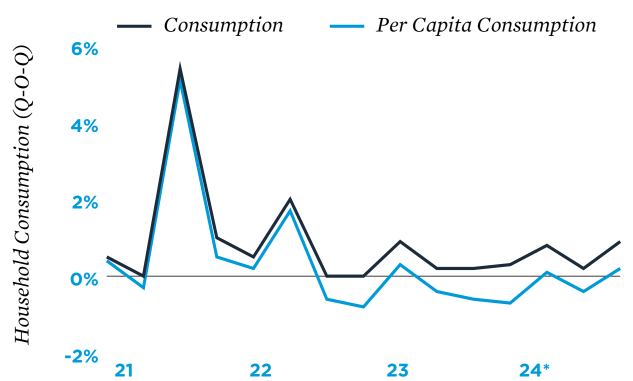
Investors to be aware of potential risks. While current forecasts suggest that GDP growth will gain momentum over the year ahead, some risks persist. Potential tariffs raised during the recent U.S. election would hinder overall economic growth, consequently impacting commercial real estate space demand. One sector most vulnerable to potential U.S. protectionist trade policies would be Canada's industrial properties, yet tapering development activity will help mitigate this risk. The sector's diverse tenant and industry mix could also help protect underlying fundamentals.

Consumption Drives Overall GDP Growth



Contributions to Per Cent Change in Real GDP

Per Capita Spending Back in Positive Territory



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Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Capital Economics; CoStar Group, Inc.; Statistics Canada