RESEARCH BRIEF
CANADA INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS
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Headline Inflation Falls Below Target, Yet Some Underlying Price Pressures Remain

CPI report offers mixed results. Inflation rose 1.9 per cent year over year in November, down from the 2.0 per cent reading in October. With the cost of capital now firmly trending down since June, mortgage interest costs were one of the largest contributors to November's price deceleration. The impact from Black Friday discounts also put some downwards pressure on the headline number. However, some underlying price pressures continued to persist. Not only did the Bank of Canada's preferred measures of core inflation – CPI-median and CPI-trim – hold stable at 2.6 per cent and 2.7 per cent, respectively, but the three-month annualized rate for the average of the two is now up to 3.3 per cent. Looking ahead, inflation is likely to be more volatile due to the two-month federal tax break on some goods and services that went into effect in December. Still, with headline inflation sitting at target since August, the central bank is likely to keep lowering its policy rate over the coming months, albeit at a more measured pace.

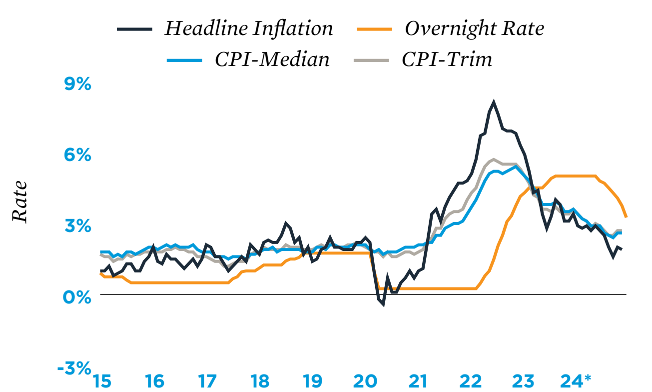
Markets becoming more cautious. Investor bets on upcoming rate decisions did not move following November's inflation release. Money markets continue to price in a roughly 55 per cent chance of a 25-basis-point cut in January. The slightly more hawkish tone from the Bank of Canada at its recent policy announcement, coupled with some reemerging inflationary pressures, a pick up in the housing sector and a surge in third quarter consumption, have led money markets to begin paring back future rate cut expectations. Nevertheless, interest rates are anticipated to continue edging lower, with a terminal rate in the 2.25 per cent to 2.50 per cent range.

Commercial Real Estate Outlook

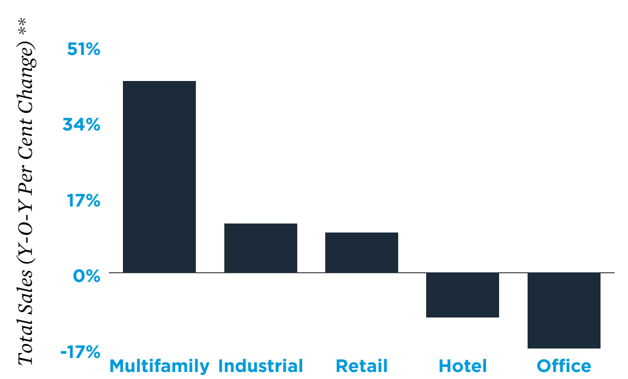
Inflation report highlights CRE investor preferences. Prices for food purchased from stores eased slightly from 2.7 per cent year over year in October to 2.6 per cent in November. Despite this, grocery prices remained elevated and were up 19.6 per cent compared with November 2021. While some of this increase has been driven by supply-side factors, underlying demand amid ongoing cost pressures and restrictive interest rates forced many consumers to redirect spending to more essential products. As a result, necessity-based, grocery-anchored retail has become a preferred investment option, with retail property transactions tied for the second-largest share among major commercial property types over the past year ended September. Similarly, given elevated homeownership costs, historic population growth and limited supply, rental inflation has also stayed elevated. In November, prices for rent accelerated 40 basis points to 7.7 per cent. With vacancy forecast to remain below equilibrium, apartments will also continue to generate positive investor sentiment. Over the past year ended September, the total number of multifamily transactions jumped 43 per cent.

Hotel prices surge amid high-profile concerts. The 6.7 per cent fall in travel services inflation broadly highlights the normalization happening within Canada's hospitality sector. After three years of outsized gains in key revenue metrics coming out of the pandemic, both the average daily rate and revenue per available room are forecast to moderate by the end of 2024. November did see a 8.7 per cent increase in traveler accommodation inflation, however, driven by a 11 per cent jump in Ontario amid six Taylor Swift concerts.

Headline Inflation Holding at Target



Preferred Assets See Annual Increase in Sales



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** Inflation through November, overnight rate through December; ** Trailing 12 months through 3Q*
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada