RESEARCH BRIEF
CANADA INDUSTRIAL

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

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Industrial Sector Continues to Face Challenges as Manufacturing Slack Drags On

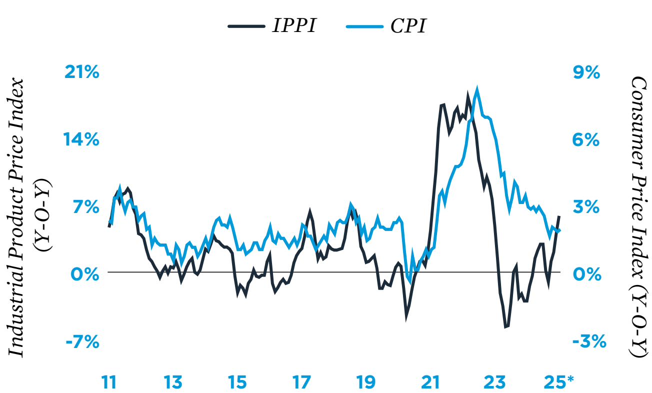
Manufacturing demand stays weak despite strong headlines. Sales of manufactured goods rose 1.7 per cent month over month in January, driven by an 11.1 per cent rebound in motor vehicle sales and a 4.7 per cent lift in petroleum and coal product sales. Yet much of this strength is due to seasonal fluctuations – such as the resumption of auto sector operations after planned winter shutdowns in December – and higher prices boosting energy product sales. Excluding these seasonal and price factors, real sales fell short in January compared with the same month last year, down 2.1 per cent year over year. This ongoing weakness, coupled with declining manufacturing output, has persisted since early 2024, coinciding with Canada's slackening productivity growth.

Risk of reflation rising as producer prices rise. Since October 2024, increases in the Industrial Product Price Index (IPPI) – which measures price movements for products sold by manufacturers – have driven a significant portion of the growth in nominal manufacturing sales. While the IPPI historically tracks consumer price inflation, the two measures have diverged in recent months, indicating that price pressures have yet to be passed on to consumers. As this widening gap squeezes profit margins, however, sustained increases in the IPPI – now more likely amid trade tensions – could lead to re-accelerating price growth at the consumer level. Inflation data in the coming months will therefore be crucial. It will indicate whether the rise in producer prices transmits to consumer prices – an important factor in the Bank of Canada's policy deliberations.

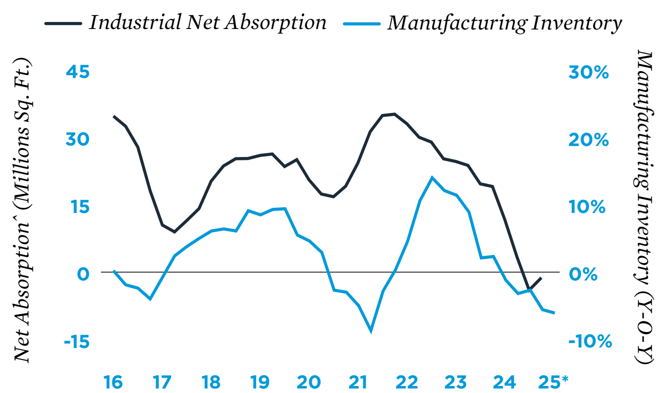
Industrial space demand under pressure amid destocking. At the end of 2024, inflation-adjusted inventory fell to its lowest level in nearly three years, signaling that companies have been optimizing stock to avoid holding excess unsold goods. This trend broadly aligns with industrial space demand, where net absorption dropped to a multi-year low in late 2024. Looking ahead, producers may further cut production while clearing inventory, as manufacturing sales are likely to bear the brunt of weakening external demand while uncertainties surrounding trade tensions grow. This could keep net absorption muted for an extended period, pushing the industrial vacancy rate above our previous projections. Should trade tensions persist, the rate will likely exceed 4.0 per cent by the end of 2025.

Industrial construction to remain soft this year. Responding to elevated construction costs, industrial property developers have become increasingly reactive to demand strength when assessing project feasibility. As signs of softening demand emerged between late 2023 and early 2024, developers moved quickly to scale back construction. Nationally, the under-construction pipeline in the fourth quarter of 2024 was down nearly 60 per cent from its post-pandemic peak. This trend was most evident in Alberta and Quebec, where declines from the peak reached 87 per cent and 77 per cent, respectively. With expectations of a demand recovery amid falling interest rates now clouded by uncertainties and recession fears, developers are likely to remain on the sidelines, awaiting greater clarity on economic and political conditions before launching new projects.

Producer and Consumer Prices Diverging



Industrial Demand Declining Amid Destocking



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** Price indexes, inventory through Jan. 2025; Net absorption through 4Q 2024; ^4Q trailing sum*
Sources: IPA Research Services; Altus Data Solutions; Statistics Canada