RESEARCH BRIEF
CANADA INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS
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Tariffs Not Yet Fully Realized, While New Supply Impacts Rental Rates

Inflation eases, but pressures too high for comfort. Canada's headline inflation rate held at 1.7 per cent in May. While there were concerns that tariffs and countermeasures would raise prices, the removal of the consumer carbon tax has pulled the cost of gasoline down, keeping the headline rate below target. Meanwhile, both core inflation measures – CPI-median and CPI-trim – eased to 3.0 per cent. A smaller 0.21 per cent monthly rise on average for these core indicators also brought the three-month annualized rate down to 3.0 per cent. At the same time, past interest rate cuts have eased mortgage costs, helping to keep shelter inflation at 3.0 per cent. Nevertheless, despite some positive signs, underlying price pressures are elevated and with only early indicators of tariff implications pulling through into hard data, the Bank of Canada remains in an uncertain position.

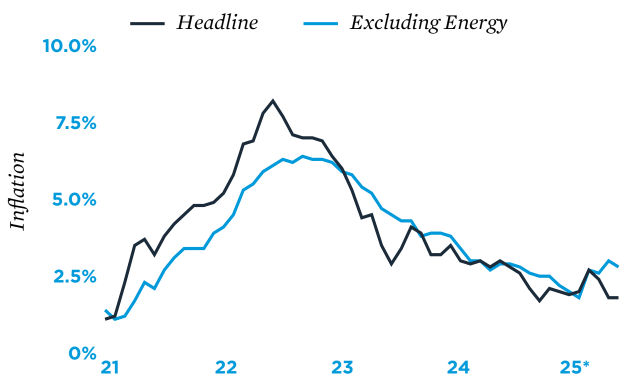
Interest rate path becoming more cloudy. Canada's central bank has maintained its key overnight rate at 2.75 per cent for two consecutive meetings, citing tariff uncertainties and inflationary pressures. While more clarity is beginning to form surrounding trade policy, as Canada and the United States appear to be closing in on an agreement, past tariffs are just starting to pull through into economic data. At the same time, if the relatively limited levies are removed in the coming month, the Bank of Canada will have more information to help guide future policy decisions. Money markets are pricing in a more likely chance of hold at the July meeting. Nevertheless, some major banks are still expecting further cuts amid a slowing economy. Yet, the pace, timing and terminal rate forecasts are now becoming less clear.

Commercial Real Estate Outlook

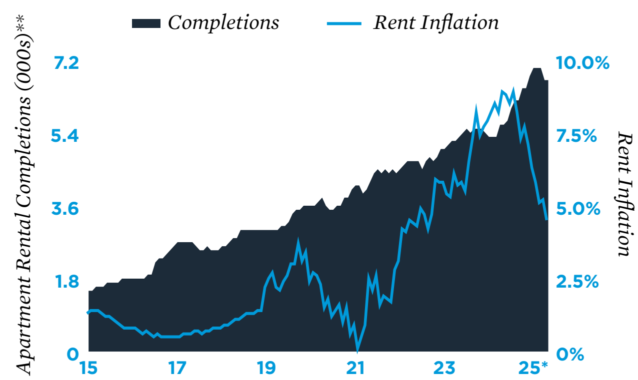
Rental inflation coming down. Shelter inflation has largely been pulled down by lower mortgage interest costs, yet rent growth has also been cooling. In May, rent inflation dropped 70 basis points to 4.5 per cent, down from a peak of 8.9 per cent in the same month last year. This easing has mainly been seen in Ontario – with rent inflation down to 3.0 per cent – as Toronto has seen both an influx of new purpose-built rental supply, but also for-owned condo inventory. At the same time, affordability challenges are straining renters' budgets and new builds are taking longer to absorb. Better development economics is also aiding rent costs in Alberta. After the province lead in rent inflation last year at a peak of 16 per cent amid record population growth, the level moderated to 3.4 per cent year-over-year this May as historic supply growth formed

Hotel sector showing some recalibration. Travel accommodation inflation fell 2.2 per cent in May and airfares also dropped 10.1 per cent, continuing a trend largely seen over the past year. This could reflect a pullback in travel spending amid economic risks and U.S. boycotts, which are now beginning to show in hotel performance. The national occupancy rate has begun to stabilize, with forecasts suggesting a slight fall by year-end. The average daily rate and revenue per available room are also expected to follow suit. Nevertheless, Canada's hotel industry has some opportunities to capture more domestic travellers who are avoiding the U.S. As a result, key hotel performance metrics will not be drastically impacted and will continue to hold well-above 2019 levels.

Carbon Take Removal Tames Headline Rate



Supply is Key to Easing National Rent Growth



*Through May; ** Trailing-12-month average
Sources: IPA Research Services; Altus Data Solutions; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada