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Canadian CPI (December): Ending the year on a sour note

by **Katherine Judge** katherine.judge@cibc.com

Consumer price index (% chg)	23:Q4	23:Q4	Oct	Nov	Dec
Year/year rate (unadjusted)	3.7	3.2	3.1	3.1	3.4
Monthly rate (unadjusted)	-	-	0.1	0.1	-0.3
Monthly rate (SA)	-	-	0.0	0.3	0.3
Three-month rate (SAAR)	-	-	3.1	1.5	2.3
CPI-trim (year/year rate)	3.7	3.6	3.5	3.5	3.7
CPI-median (year/year rate)	3.9	3.6	3.5	3.6	3.6

Source: Statistics Canada

- The acceleration in headline inflation to 3.4% from 3.1% in December was expected, as a steeper drop in gasoline prices from a year-ago fell out of the annual calculation. What wasn't expected was the lack of progress in the Bank of Canada's preferred core measures of inflation, CPI-trim and CPI-median. CPI-trim accelerated by two ticks to 3.7% and median remained at 3.6% (from an upwardly revised prior month reading that was previously 3.4%). Those measures also accelerated in three-month and six-month annualized change terms, suggesting that price pressures did not become more narrowly based. Excluding shelter shows more tame inflation, with services ex. shelter running at a 2.4% y/y pace, but the Bank of Canada will still need to see more progress before considering rate cuts, and we continue to look for the first cut in June.
- Seasonally-adjusted monthly prices rose by 0.3%. That included a 7.7% SA jump in airfares, which reflected strong demand for travel during the holiday season. Car prices also jumped, as 2024 models became available, but that will likely be a one-off impact, as we expect demand for durable goods to deteriorate ahead. Food price inflation picked up, with grocery store prices up 0.5% SA m/m, and restaurant prices up by 0.6% SA m/m. Strong inflation in food (+5.0% y/y) is likely keeping inflation expectations elevated, as consumer expectations are tied closely to things that are purchased on a regular basis.
- Core goods inflation (ex. food and energy) is running at 2.2% y/y, while services ex. shelter inflation is running at 2.4% y/y. CPIX, a core measure of inflation that excludes the eight most volatile components and indirect taxes, eased to 2.66% from 2.80%. While these readings are still above the 2% target, they are all substantially lower than the 4-5% ranges that were seen earlier in the year, and are better indicators of underlying inflationary progress than the Bank's stated preferred measures at the moment given structurally higher housings costs and the inclusion of mortgage interest costs. The Bank of Canada is fully aware of that and we suspect they could gradually give weight to a broader suite of measures of underlying inflation.

Implications & actions

Re: Economic forecast — Headline inflation likely won't fall into the Bank of Canada's target range for a few months, but the key to our call for the Bank to start cutting interest rates in June will be further progress in core measures, particularly excluding shelter costs, which are being impacted directly by the Bank of Canada's previous interest rate hikes. Sluggish economic growth and the deterioration in the labour market should leave underlying core measures on a decelerating track ahead.

Re: Markets — Bond yields climbed following the upside surprise in CPI-trim and median, although the market is still pricing in too high of a chance of rate cuts in H1 in our view.

CIBC Capital Markets – PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 – Bloomberg @ CIBC