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Canadian CPI (July): Still a bit hot around the collar

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Consumer price index (% chg)	23:Q1	23:Q2	May	Jun	Jul
Year/year rate (unadjusted)	5.1	3.5	3.4	2.8	3.3
Monthly rate (unadjusted)	-	-	0.4	0.1	0.6
Monthly rate (SA)	-	-	0.0	0.3	0.5
Three-month rate (SAAR)	-	-	3.1	3.1	3.1
CPI-trim (year/year rate)	4.8	3.9	3.8	3.7	3.6
CPI-median (year/year rate)	4.9	4.1	3.7	3.7	3.7

Source: Statistics Canada

- Inflation in July remained a bit too hot around the collar for the Bank of Canada's liking, with the recent slowing in growth and employment not yet having worked its way fully into price settings. The 12-month inflation rate accelerated to 3.3% y/y, from 2.8% in the prior month, leaving the pace well above the consensus expectation of 3.0%. While base effects tied to a large drop in gasoline prices from a year ago falling out of the calculation contributed to the acceleration along with higher energy prices in July, prices excluding food and energy rose by a strong 0.3% in seasonally-adjusted terms.
- The advance in the ex. food/energy group included a jump in shelter prices tied to higher mortgage interest costs that move mechanically with the overnight rate and bond yields, a reason why the BoC should be thinking about a pause. But the Bank's preferred core measures, CPI-trim and median, were still above target at 3.6% y/y and 3.7% y/y, respectively, and rose at a monthly pace of 0.3%. The leaves our forecast for a final 25bp hike from the BoC in September in place, although it's a close enough call that a downside surprise in the GDP data due before then could put the Bank on hold.
- A surge in electricity prices in Alberta also hit the headline rate, as heat waves supported demand and price caps were removed. However, the surge in demand and prices will likely fade by September as the weather cools. Oil prices have climbed in August on OPEC output restraint, and suggest that headline inflation could accelerate further from here. Food prices are proving to be stickier than expected, based on food commodity price indices and what's been seen south of the border. Food prices accelerated to 0.4% m/m SA, as grocery store price increases gained momentum and restaurant prices rose strongly.
- Excluding food and energy, prices accelerated to 0.34% m/m from 0.1% in June, on a seasonally-adjusted basis. Our preferred measure of core inflation, which excludes mortgage interest costs as well because these are being directly affected by BoC rate hikes, showed prices increased by 0.3% on the month, although the three-month annualized pace decelerated by a tick to only 1.5%. Some discretionary service categories saw prices rebound in July (recreation, education, reading), but that came after a decline in the prior month.

Implications & actions

Re: Economic forecast — The upside surprise in July inflation wasn't entirely attributable to higher energy prices and food prices, as core categories outside of mortgage interest costs also accelerated, and headline inflation is likely to increase further in August as base effects remain unfavorable. While we would argue for more patience, the BoC is likely on track for a final 25bp hike in September. But we expect the rise in the unemployment rate to continue ahead and prevent any further tightening thereafter, and we continue to view the Bank as overshooting and we therefore expect inflation to fall below the 2% target as early as the second half of 2024.

Re: Markets — Bond yields climbed sharply ahead of the release and remained steady around the release, while the loonie appreciated slightly, with the move limited by surprisingly strong news on US retail spending released alongside the Canadian CPI data.

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