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Canadian CPI (June): Cementing a rate cut next week

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Consumer price index (% chg)	24:Q1	24:Q2	April	May	**June**
Year/year rate (unadjusted)	2.8	2.7	2.7	2.9	2.7
Monthly rate (unadjusted)	-	-	0.5	0.6	-0.1
Monthly rate (SA)	-	-	0.2	0.2	0.1
Three-month rate (SAAR)	-	-	2.3	2.8	2.0
CPI-trim (year/year rate)	3.2	2.9	2.8	2.9	2.9
CPI-median (year/year rate)	3.0	2.6	2.6	2.7	2.6

Source: Statistics Canada

- The inflation data for June gave the Bank of Canada what it needed in order to cut interest rates at next week's meeting. The headline CPI decelerated by two ticks to 2.7% y/y, in line with the consensus expectation. But more important for policymakers, their preferred measures of core inflation, CPI-trim and CPI-median both showed a monthly advance of 0.2% (seasonally adjusted), down from a 0.3% pace in the prior month. Other key core measures also improved, with CPIX decelerating to a 0.1% m/m pace, and CPI ex. mortgage interest costs at 1.9% y/y. This shows that the prior month's upside surprise in inflation was just a blip in a broader trend of disinflation as demand in the economy remains under pressure.

- The details of the report revealed that goods excluding the volatile food and energy categories fell sharply into deflation territory, with prices 0.5% below year-ago levels. That coincides with retail sales volumes per-capita being below year-ago levels for several months now and bloated inventory levels as a result of that.

- Some idiosyncratic factors were at play as usual, with the communications group rising strongly by 1.6% m/m SA, but policymakers will look past that as it's not demand driven. Travel tours prices, a category that's sensitive to exchange rate moves, fell sharply after a climb in the prior month, while health/personal care prices dropped after a surge in May.

- Mortgage interest costs didn't decelerate in June despite the BoC trimming rates in that month, with that component up by 0.8% m/m, the same pace as in May. However, as variable mortgage interest costs move down and shorter-term mortgages renew at lower interest rates, that component will ease off, with a partial offset coming from longer-term mortgages that were taken out at the lows of interest rates in 2020-21 that will still be renewing at higher interest rates versus that period. Rent, the highest-weighted component in the shelter sub-index eased off to 0.4% m/m SA, with the annual rate down slightly to 8.8% y/y. As population growth slows with the government restrictions tied to NPRs, and more people move into the homeownership market as interest rates fall, rents should continue to decelerate. Soon, the combination of fading MIC and a further gradual slowdown in rent will mean shelter will start to add material downward pressure on inflation.

- In six-month annualized terms, the Bank of Canada's preferred measures of CPI-trim and median are running only a hair above the 2% target. This report also leaves the average CPI for the quarter two ticks below the BoC's last published MPR forecast of 2.9%.

- On the surface, the demand-driven part of inflation appears to fading with only a few idiosyncratic pockets keeping inflation above target. In our view, the Bank of Canada can be comfortable gradually moving away from it's meeting-by-meeting and data-dependent strategy, and operate on something close to auto-pilot by trusting its forecasts which have been much more accurate over the past year. The economy is clearly in need of interest rate relief to ensure a soft landing with future headwinds such as large mortgage renewals and population growth that could cater. With headline inflation back within the target zone and the BOS survey showing firm's inflation expectations are edging down, any worries of upside risks to inflation or inflation being stuck above target is missing the mark.

Implications & actions

Re: Economic forecast — This report confirms that the weak demand backdrop is bringing inflation down towards target. In Q3, headline inflation should decelerate sharply on base effects, while we expect to see more measured progress in core measures, helped by an easing in mortgage interest costs. The BoC's latest round of business and consumer surveys showed that inflation expectations are easing off on balance, which will also provide the BoC with more comfort to continue to cut rates, and it's also looking like they will have to worry less about policy divergence with the Fed that is set to cut in September.

Re: Markets — There was little market reaction as a cut was almost fully priced in for July ahead of the data.