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Canadian CPI (Aug): Not just a gasoline-driven acceleration

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Consumer price index (% chg)	23:Q1	23:Q2	Jun	Jul	**Aug**
Year/year rate (unadjusted)	5.1	3.5	2.8	3.3	4.0
Monthly rate (unadjusted)	-	-	0.1	0.6	0.4
Monthly rate (SA)	-	-	0.3	0.6	0.6
Three-month rate (SAAR)	-	-	3.1	3.4	6.0
CPI-trim (year/year rate)	4.8	3.9	3.7	3.6	3.9
CPI-median (year/year rate)	4.8	4.0	3.9	3.9	4.1

Source: Statistics Canada

- Canadian inflation accelerated by more than expected in August, and even though higher prices at the pumps were a big factor behind the move they were not the only one. Core inflationary pressures remained stronger than the Bank of Canada would like to see, although we still suspect that evidence of a slowing economy and rising unemployment rate will give policymakers enough comfort that inflation will ease ahead without the need for further interest rate increases.
- The 4.0% y/y reading in headline inflation was a couple of tenths higher than the consensus expectation (3.8%) and the strongest reading since April. As well as gasoline prices, rising rents also contributed to the acceleration, with the year-over-year rate of rent inflation accelerating to 6.5%, from 5.5% in the prior month. While the year-over-year increase in mortgage interest costs accelerated only slightly relative to July, this area remained the largest contributor to the annual pace of inflation in August. Excluding mortgage interest costs, inflation would have been 3.2%.
- While there wasn't much good news within today's inflation report, there was evidence that inflationary pressures at grocery stores are easing, with food price inflation at stores easing to 6.9% y/y, from 8.5% in July. There was also some further weakness in prices for discretionary services such as air fares, travel tours and hotel prices, showing that households are likely becoming more price sensitive again following the surge in demand last year.
- Excluding food/energy, prices rose by a seasonally adjusted 0.3% m/m in August, following a 0.4% increase in the prior month, with that trend inconsistent with a 2% inflation target. Indeed, the three-month annualized rate accelerated to 3.6%, from 2.8% in the prior month. However, mortgage interest costs (MIC) have contributed to those strong monthly readings, and the three-month annualized pace excluding MIC as well was a fairly tame 2.4%.
- The Bank of Canada's preferred core measures of inflation also looked hotter than expected in August, with CPI-trim accelerating from 3.6%y/y to 3.9%y/y and CPI-median from 3.9% to 4.1%. Both of these measures also accelerated on a three-month annualized basis as well.

Implications & actions

Re: Economic forecast — In the near-term, inflation is more likely to accelerate slightly further than decelerate, given the further increase in oil prices seen so far in September. For the third quarter as a whole, inflation is likely to average around 3.8%, well ahead of the 3.3% forecast from the Bank of Canada's July MPR. While that's partly because the July projection was based on WTI oil prices of $75/bbl (well below current levels), underlying inflationary pressures are also firmer than the Bank was probably expecting, meaning that policymakers will face some tough decisions at upcoming meetings. If consumer spending remains sluggish and the unemployment rate continues to grind higher as we forecast, we still expect that the Bank will refrain from further interest rate hikes despite the strong current inflationary backdrop.

Re: Markets — Bond yields rose and the Canadian dollar continued to strengthen following today's data release as investors raised their expectations for further BoC interest rate hikes.