Economics

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Canadian CPI (Apr): Much ado about a decimal

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Consumer price index (% chg)	22:Q4	23:Q1	Jan	Feb	**Mar**
Year/year rate (unadjusted)	6.7	5.1	5.9	5.2	4.3
Monthly rate (unadjusted)	-	-	0.5	0.4	0.5
Monthly rate (SA)	-	-	0.3	0.1	0.1
Three-month rate (SAAR)	-	-	2.4	1.6	2.1
CPI-trim (year/year rate)	5.4	4.8	5.1	4.8	4.4
CPI-median (year/year rate)	5.3	4.9	5.1	4.9	4.6

Source: Statistics Canada

- Canada's inflation rate moved up only a single tick in April, but there will be much ado about a decimal when the desired and expected path is lower rather than higher. The 4.4% price gain from a year ago comes after a nearly halving of the CPI since last June, but will raise eyebrows given that we've yet to see the cooling in the labour market that the Bank of Canada deems as key to getting inflation all the way back to 2%. That's not likely to have the central bank opting to raise rates in June, but that is indeed a risk for its July meeting, at which it will release a revised economic outlook.
- For now, however, there are reasons why we'll still stick with our call that while rate cuts are nowhere in sight for 2023, the Bank has time to stay on hold and let prior hikes work their way into economic activity. The 0.7% price bump in April was a 0.6% increase seasonally adjusted, so there's no comfort in the headline. But a chunk of that came from gasoline prices, which saw their biggest jump since October, and one that seems likely to be reversed now that crude prices have again retreated. True, there's less reason to feel any comfort about what was a 0.5% seasonally adjusted increase in food prices in April, which don't yet appear to be joining in the moderation for food at home prices seen stateside.
- Elsewhere, the upside surprise versus our forecast was only a measly single decimal place, with the seasonally-adjusted climb in prices excluding food/energy coming in at 0.3% in April.. That's a tick hotter than we thought, but no faster than the March increase. The other measures of underlying inflation we look at were a mixed bag. The two BoC core measures, CPI trim and median, eased a few ticks on a 12-month basis, although at 4.2%, both are still too hot. Less encouraging is that CPI excluding food, energy and mortgage interest accelerated to a three month annualized pace of 3.4%, having been close to the Bank of Canada's 2% inflation target in the last half year or so.
- It's fair to say that the economy is still too heated to get inflation back to 2% that quickly. Sure, mortgage interest costs, up 28.5%, are a factor in the headline numbers, one that will cool off on its own once we're through a period of mortgage renewals at today's higher interest rates. But brisk inflation in rent and a broad range of services is being sustained by gains in household spending power tied to strong job creation and firming wages. Resistance to such price increases will only come when slower income growth forces Canadians to cut back on items with escalating prices.
- So the key question for monetary policy makers isn't whether current economic conditions will bring inflation down - they won't - but whether current interest rates will bring economic growth down enough to ease inflation. We still think so.

Implications & actions

Re: Economic forecast — The data were firmer than we expected for food and for prices excluding food/energy, leading to a higher headline gain. While that's a setback in terms of getting to 2%, we still see enough braking forces acting on economic growth, both in Canada and abroad, to turn the CPI in the right direction. But a lot of our forecast for no further rate hikes in Canada now rests on seeing labour market slack starting to open up, and we might have to revisit that forecast should that fail to be the case in upcoming months. The data do underscore our persistent warnings that chatter about rate cuts in 2023, not only in Canada but in the US, is misplaced. Both countries need to go through some economic pain to get inflation to 2%, as today's data reminded us, so rate cuts are off the table until we gone through a few weak quarters.

Re: Markets — Canadian 2-year yields were about 10 basis points higher after the CPI release, as markets added to risks of a further rate hike, and pushed back the timetable for any interest rate cuts, while the Canadian dollar was also a bit firmer.

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