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Pushing back on cost-push inflation

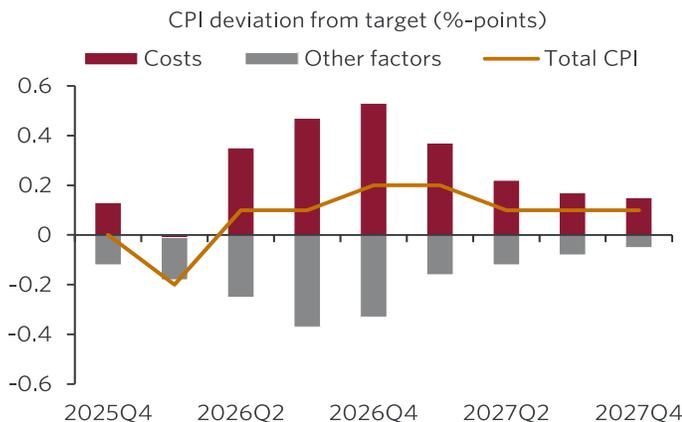
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Dictionaries that pick a “word of the year” have diverged in 2025, but if there were a Bank of Canada choice, it might be “carefully”. That’s been its oft-repeated adjective for how it has been proceeding with interest rate cuts this year. While recognizing the softness in demand, the Bank has been only cautiously adding further stimulus in 2025 due to concerns over cost-push risks to inflation. It’s cited the fallout from rejigging global supply chains in the wake of US tariffs, higher prices goods imported from the US that incur tariffs on inputs, and earlier in the year, a hit from Canada’s own retaliatory tariffs.

Those Canadian tariffs have been significantly eased, but the Bank’s October forecast retained concerns over cost-push inflation ahead. A chart in that month’s Monetary Policy Report (MPR) put all of the upside for CPI ahead from that factor, as collectively, the other factors they allowed for, most notably the output gap, leaned the other way (Chart 1).

But the MPR presents few details on how the “cost” factor was estimated, and concedes that those tied to trade are “difficult to predict”. So herein we take a deeper dive into cost-push inflation risks in Canada, and while they are indeed challenging to predict, the evidence suggests that they won’t represent a serious risk for an acceleration in inflation.

Chart 1: BoC inflation forecast upside is all due to costs



Source:

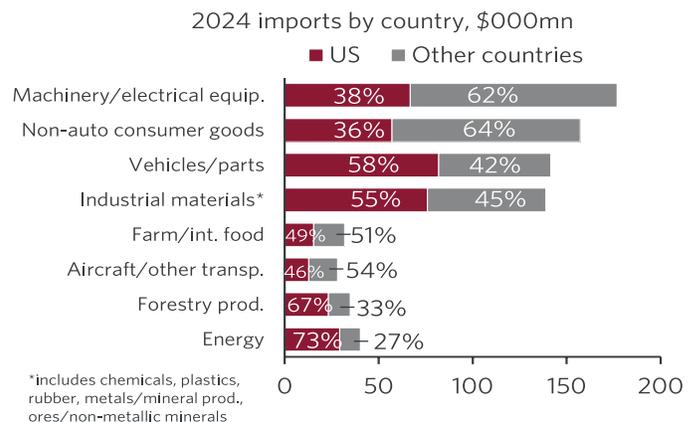
The global scene: Nothing too scary

There are two avenues through which cost-driven inflation could hit Canadian consumers and lift inflation expectations: those that impact prices for imported consumer goods, and those that raise domestic production costs. Within imports, tariffs and supply chains will have divergent implications for imports from the US, and those from the rest of the world, so we consider them separately.

Note that while Canada’s exports are heavily tilted toward the US market, our import mix isn’t as dominated by American products, particularly when one looks at finished goods in the CPI basket, rather than intermediate or industrial products (Chart 2). Within consumer goods, the US still accounts for a majority of our automotive imports. Energy imports are tilted to the US, but gasoline prices will be impacted by global pricing trends for crude oil and are therefore linked to the state of the world economy. For finished non-auto consumer goods, roughly two thirds of our 2024 imports came outside the US.

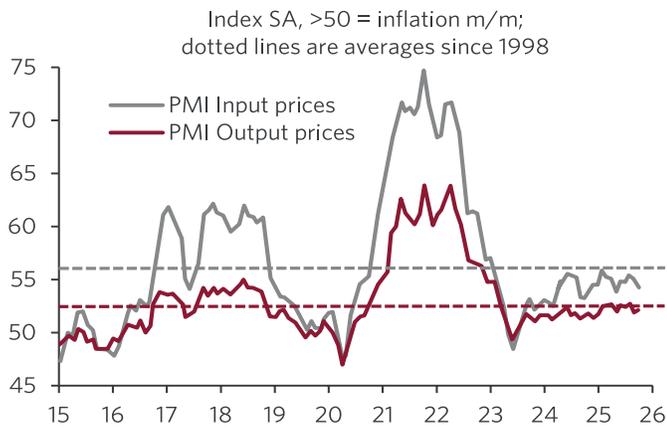
The challenges facing non-US economies these days suggest that there isn’t anything very scary about the inflation outlook for imports sourced in Europe, Asia or Latin America. US tariffs

Chart 2: Non-auto consumer goods imports sourced mainly from non-US countries



Source: StatCan, CIBC

Chart 3: Price increases for global manufacturers are tame

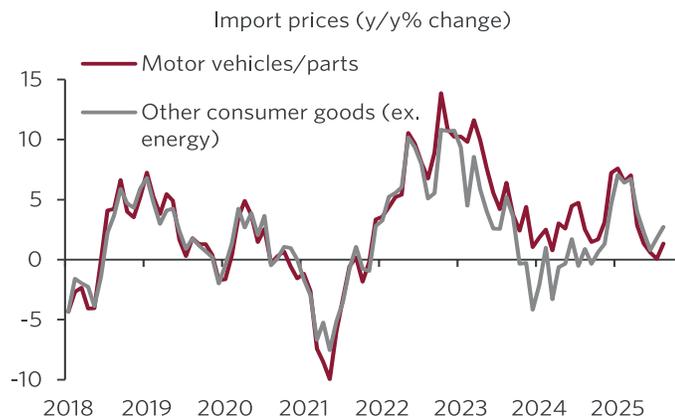


Source: S&P Global Market Intelligence

have posed a headwind for global manufacturing activity, with the global PMI recovering but not beyond its average level. That rebound has been skewed towards goods tied to AI capital spending, rather than consumer goods. That in turn has meant that, despite somewhat elevated levels for input prices, the global PMI for output prices remains at tame levels by historical standards (Chart 3). Consistent with that, a non-US global PPI index, weighted to shares of Canadian imports, showed roughly zero annual inflation in the latest data.

US production costs are indeed rising in some sectors, including those impacted by input tariffs. But for core finished consumer goods, US PPI inflation has been running in the 2.0% to 2.5% over the course of 2025. Energy goods prices have been generally tame, while food has been the exception, with finished consumer foods averaging nearly 4% on a year-on-year basis in the three months to September. We'll take a further look at food inflation below, because it's also a Canadian story.

Chart 4: Canadian import prices look tame



Source: StatCan, CIBC

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What will Canadians pay for imports?

In line with what we see in wholesale price indicators for Canada's trading partners, prices for imports of non-energy consumer goods and autos thus far look reasonably contained at the Canadian border. Auto prices are going nowhere, while non-auto/energy consumer goods have bounced around but look cooler than earlier in the year (Chart 4).

Where to from here? According to the October MPR, the Bank of Canada fears that overseas producers will raise their prices across the board as they are squeezed by US tariffs. From our vantage point, and what we're seeing thus far, the reverse seems more likely.

Risking their market share in the US if they try to pass on any of the tariffs to their American customers, overseas manufacturers are likely to end up with excess capacity, and an eagerness to move more volume in the Canadian market by keeping prices in check. If, for example, a Korean carmaker can only pass on half of the 15% US tariff to its American customers, and therefore absorbed a 7.5% net price cut, it would still net a better year-on-year price change in Canada if it cut its price to this market by, say, 5%.

For imports from the US, it's a different story. American businesses are facing higher input costs due to tariffs on imported materials and parts, and could seek to pass those on to Canadian buyers. But as noted, the US share of Canadian finished consumer goods is relatively modest, other than in autos, where thus far inflation hasn't shown up, and in food. So the issue for inflation in Canada could come down to the spillover from US industrial goods and material prices for production costs and prices in Canada, and what happens at the grocery store.

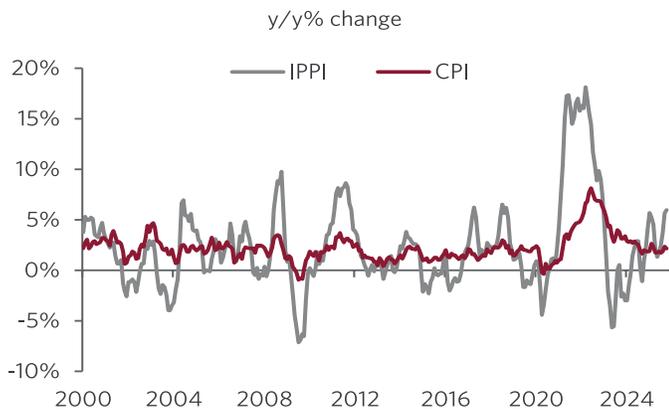
Costs on the home front

That brings us to the recent trend in Canadian producer prices, which is what the Bank of Canada might be eyeballing in its concerns over cost push-inflation. While not nearly as dramatic as what we saw in 2021, the Industrial Product Price Index has reaccelerated after coming back down to earth in 2024 (Chart 5).

That might raise eyebrows because that much larger spike in the IPPI did provide an advance warning of a subsequent escalation in the CPI. But we would question the relevance of that case for what we're seeing today.

For one, the fact that the 2021 IPPI surge was an early warning sign for the CPI was an exception to the historical relationship between these two series. In the decades prior to 2020, the strongest correlation between the IPPI and the CPI was with no lag from the former to the latter. That might have reflected the unusual breadth of the 2021 upsurge, as pandemic period supply chain challenges, and large scale policy stimulus to demand created a one-two hit to price stability across most goods categories. Typically, spikes in IPPI prices are centered around upside volatility in a narrower group of products.

Chart 5: Apart from 2021-23, IPPI hasn't led CPI movements

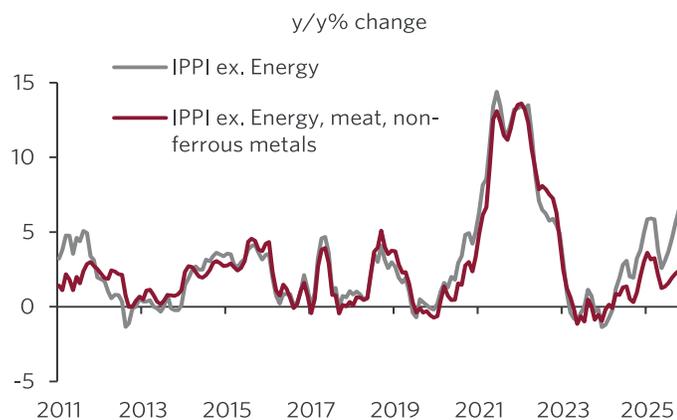


Source: StatCan, CIBC

The recent acceleration in the IPPI doesn't show much breadth, as it has been heavily tilted towards price hikes in two categories: food (particularly meat) and primary non-ferrous metals. Strip those out, and the IPPI looks much more benign (Chart 6). Vehicle prices, which have a heavy weight in the IPPI given the industry's share of Canadian manufacturing, did escalate a bit on a year-over-year basis to October, but that series tends to mirror the year-on-year Canadian dollar exchange rate, as these are vehicles that are actually priced in US dollars. If that continues into November, it should show up in a cooling in that IPPI component on a 12-month basis. As well, most of the vehicles Canadians buy are imports rather than the domestic goods in the IPPI.

So that leaves any concerns resting on "primary non-ferrous metals" and food. We can quickly dismiss the first of these from our worry list. That metals category has been pushed by soaring gold and precious metals prices. While that would be captured in inflation rates facing jewelry consumers in Canada, that category accounts for a tiny 0.2% of Canada's CPI basket.

Chart 6: IPPI acceleration driven by meat and non-ferrous metals



Source: StatCan, CIBC
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In contrast, as they say, you are what you eat, and food does carry an important weight in Canada's CPI basket. While some core inflation measures strip out food, that's not the case for the Bank of Canada's CPI median and trim measures. Indeed, given their large weight in the CPI basket, our earlier research found that trends in food inflation are an important determinant of those two core measures.

But the sharp acceleration in meat prices in the IPPI actually tells us little about what you're going to pay for steak or hamburger at the grocery store in upcoming quarters. Statistically, the IPPI for meat only leads the CPI meat index by a single month. That's not surprising given that, other than for some high-end aged steaks or frozen foods, the inventory cycle at the retail level is short. So if meat has been sizzling in the IPPI, then nearly all of that heat has shown up in the CPI at this point, rather than looming as a harbinger of what's to come.

Both of these series have been tied to soaring cattle prices, which came under pressure as herds were pared back in the face of drought-related increases in feed costs. There are, however, some signs that cattle prices have crested, with a recovery in herd size starting to put some downward pressure on US cattle futures. At some point, consumer resistance should at least slow the inflation pace for meat prices given how fast they have run in recent years relative to incomes. As a result, we're projecting more tempered food inflation in 2026, assuming the weather cooperates for crop supplies.

The push-back against cost-push

All told, we don't see persuasive evidence that either import prices or domestic production costs are destined to accelerate or that cost increases have yet to filter through. Against tariff or supply chain lifts to input costs, we are seeing an important counterweight in labour costs. Wage data in Canada are choppy and the various indexes have measurement challenges, but the trend appears to be towards more moderate pay hikes. As of Q3 2025, business sector compensation was up a moderate 2.3% from the prior year. After allowing for productivity gains, so far this year, year-over-year unit labour costs are climbing by an average pace of 1.1%, versus 2024's average of 2.6%. Bank of Canada business surveys also show employers are expecting to pay more temperate wage hikes in the coming year.

While cost and supply side issues are important, everything in economics comes down to supply AND demand. On the demand side, Canada still has economic and labour market slack. Yes, GDP for the past few years was revised upward, but that reflected stronger productivity, and to some extent, better capital spending, so the estimate of potential GDP will also be revised upward by a similar degree. What hasn't been revised are the labour market data. Although the unemployment rate has fallen, the ratio of employment to the working age population still shows considerable slack. Rental demand has also softened, and data on what newly available units are going for suggests that there is an easing ahead in the CPI's rent measure.

All of that is an important wall of resistance against cost escalations being fully passed on in the CPI. Bank of Canada surveys suggest that business are expecting that sort of squeeze on margins. If they're right about their own markets, policymakers will have less to fear from cost-push inflation than they think. Bank of Canada rate hikes should still be a long way off.

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