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Canadian CPI (May): Reversing progress

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Consumer price index (% chg)	23:Q4	24:Q1	March	April	May
Year/year rate (unadjusted)	3.2	2.8	2.9	2.7	2.9
Monthly rate (unadjusted)	-	-	0.6	0.5	0.6
Monthly rate (SA)	-	-	0.3	0.2	0.3
Three-month rate (SAAR)	-	-	1.0	2.3	3.0
CPI-trim (year/year rate)	3.5	3.2	3.1	2.8	2.9
CPI-median (year/year rate)	3.4	3.0	2.8	2.6	2.8

Source: Statistics Canada

- Another disappointment for Canada following the Oilers' loss yesterday, as inflation moved in the wrong direction in May. The CPI accelerated to 2.9% y/y, against expectations for an easing from 2.7% to 2.6%. The upside surprise reflected several factors including a surge in grocery store prices, and an acceleration in cell phone services, travel tours, rent, and air fares. Looking past the volatility, the Bank of Canada's preferred core measures also looked higher than expected, with CPI median rising by two ticks to a 2.8% y/y pace (vs. 2.6% expected), and CPI trim at 2.9% y/y (vs. 2.8% expected), with both increasing by a strong 0.3% m/m in seasonally-adjusted terms. Moreover, the breadth of price increases rose in those measures, with 38% of items rising at a pace faster than 3% y/y, up from 35% in April, casting some doubt on the need for another 75bps of rate cuts this year that we are currently expecting.
- Statistics Canada introduced new weights into the CPI basket for May, which reflect 2023 consumption patterns. The biggest change was to the mortgage interest cost (MIC) component, with the weight increasing by almost 2%-points, although that factor cannot explain the upside surprise in today's data. MIC decelerated to a pace of 1.2% m/m SA, meaning that the overall contribution from that component to the monthly pace of inflation didn't increase. Using the prior basket weights would have left the headline CPI rate at 2.9%. Inflation excluding MIC accelerated to 2.1% y/y from 1.8% y/y. Rents continued to increase strongly, and are up 9% y/y, reflecting strong population gains and higher interest rates that have pushed more people into the rental market, factors that should fade ahead given new government restrictions on non-permanent residents.
- The 0.5% SA surge in grocery store prices was the fastest increase seen in over a year, and that follows an average of no change in food prices in monthly terms from January-April. Prices for fresh vegetables and fruit rose strongly, possibly reflecting hotter-than-normal temperatures that could have hit supply.
- Other exclusionary measures of core inflation accelerated, as CPIX rose by two ticks to 1.8%, and ex. shelter to 1.5% y/y, but remained below the 2% target. However, the three-month annualized trend jumped, with CPIX at 2.1%, and CPI trim and median at 2.7% and 2.3%, respectively.
- There was also a surge in components that might reflect the pass-through of a weaker exchange rate such as travel tours which surged by 5% m/m SA, while health/personal care prices jumped by 1.0% m/m SA. These components could have risen from the depreciation of the CAD in April.
- Overall, today's inflation print has a number of mixed elements, but the headline reading was clearly not good. It does, however, come after four stellar readings to start the year, suggesting the roughly 1.6% three-month annualized pace we saw in recent months was unsustainable. On the surface, it is still difficult to see much of today's increase as

demand-driven but after a period of high inflation, and inflation expectations of households and business not fully back to normal, central bankers worry about how prolonged periods of inflation above target can get expectations stuck above target and make the last mile difficult.

Implications & actions

Re: Economic forecast — There is one more CPI print before the July BoC meeting and a plethora of other economic data. While this print clearly tilts the risks towards fewer cuts than the three more that we have penciled in for the year, policymakers are in data dependent mode and will need to see a wider set of data in order to determine if the acceleration in CPI in May was an anomaly or the start of a trend.

Re: Markets — Canadian bond yields jumped on the upside surprise as odds of further rate cuts were reduced.