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Canadian CPI (Feb): Another downside surprise

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Consumer price index (% chg)	22:Q3	22:Q4	Dec	Jan	**Feb**
Year/year rate (unadjusted)	7.2	6.7	6.3	5.9	5.2
Monthly rate (unadjusted)	-	-	-0.6	0.5	0.4
Monthly rate (SA)	-	-	0.0	0.3	0.1
Three-month rate (SAAR)	-	-	3.4	2.4	1.6
CPI-trim (year/year rate)	5.5	5.4	5.3	5.1	4.8
CPI-median (year/year rate)	5.0	5.2	5.2	5.0	4.9

Source: Statistics Canada

- A second consecutive faster-than-expected deceleration in headline CPI will leave the Bank of Canada confident that pausing the rate hike cycle was the right choice and that, at least for now, inflation is decidedly heading in the right direction. The rapid fall should continue over the next few months as last year's large price increases fall out of the annual calculation. Headline CPI rose by 0.4% NSA in February, with the annual rate easing to 5.2%, one and two ticks below consensus expectations, respectively. Moreover, over the past three months, annualized rates of core inflation suggest that policymakers are getting much closer to their 2% target than year-over-year rates indicate, particularly when excluding mortgage costs.
- The Bank of Canada's preferred core measures of inflation, CPI-trim and CPI-median, continue to sit close to 5% on a year-over-year basis, as they are still being influenced by big monthly increases last spring. However, the 3-month annualized rates, which the Bank favours, are at 3.3% and 3.8% for CPI-trim and CPI-median, respectively. While that is still above the Bank's 1-3% target band, we know those measures are currently impacted by the high food prices and that they would be trending lower if those were excluded.
- In February, seasonally adjusted CPI excluding food/energy rose by 0.3% month-over-month. While this is a pick up from January's weak 0.1%, these monthly advances remain much closer to being consistent with the 2% target than what we observed last year. Moreover, some of that strength reflects the continued pressure on inflation from rising mortgage costs, which at 23.9% above last year, are rising at the fastest pace since July 1982. Excluding mortgage interest costs as well, which the Bank of Canada should look through since they reflect its own interest rate hikes, prices would have grown less on the month. Indeed, on this breakdown, the 3-month annualized rate of inflation stood at 2.3% in February, suggesting that policymakers have already slowed the economy enough for inflation to stay around the 2% goal.
- Lower gasoline prices were the main driver of the deceleration in headline CPI in February, as they were 4.7% lower than the prior year. Child care and housekeeping services (-14.2%) also contributed meaningfully to the annual decline as federal-provincial agreements, part of the national plan to reduce child care costs, are coming into effect. On the other hand, the price for a number of items, such as clothing and telephone services, which had declined in January, rebounded strongly in February. Unfortunately for consumers, the relief felt in a number of goods and services has yet to extend to grocery prices, which remain elevated (+10.6% y/y). Statistics Canada pointed to bad weather in growing regions, as well as higher input costs to explain the strength. We continue to expect food price inflation to decelerate more meaningfully in the second half of the year.

Implications & actions

Re: Economic forecast —The faster-than-anticipated deceleration in CPI will comfort the Bank of Canada in its choice to pause interest rate hikes. We continue to expect headline inflation to ease below 3% by May, although continued strength in food prices and mortgage interest costs will likely keep the annual pace sticky between 2-3% throughout the second half of the year. This release supports our call for the BoC to remain on pause in April.

Re: Markets — Bond yields continue to evolve mainly with the developments in the banking crisis. They started the day higher and though they fell immediately after the release, they have since resumed their climb. There was no significant movement in the Canadian dollar.

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