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Canadian CPI (Sep): Hotter core leaves more work than expected for the BoC

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Consumer price index (% chg)	22:Q2	22:Q3	Jul	Aug	Sep
Year/year rate (unadjusted)	7.5	7.2	7.6	7.0	6.9
Monthly rate (unadjusted)	-	-	0.1	-0.3	0.1
Monthly rate (SA)	-	-	0.1	0.1	0.4
Three-month rate (SAAR)	-	-	7.1	2.9	2.4
CPI-trim (year/year rate)	5.3	5.3	5.4	5.2	5.2
CPI-median (year/year rate)	4.7	4.8	4.9	4.7	4.7
CPI-common (year/year rate)	5.8	6.1	6.3	6.0	6.0

Source: Statistics Canada

- There will be some long faces at the Bank of Canada this morning as inflation cooled less than expected. Unadjusted headline CPI increased 0.1% in September, with the annual rate easing only one tick to 6.9% (consensus -0.1%, 6.7% y/y). This is the third consecutive deceleration in headline CPI driven mainly by the fall in gasoline prices. Given that those prices have since reversed, the next month could see headline inflation temporarily heading in the wrong direction again. But that is not the main focus for the Bank of Canada, who is paying closer attention to core inflation. CPI excluding food and energy rose by 0.4% seasonally adjusted on the month, faster than last month, and at a pace that's too high to be consistent with the 2% target. The Bank of Canada therefore still has work to do, and should be set for another 75 bps increase in the overnight rate next week.
- The 7.4% drop in gasoline prices once again drove the decline in CPI in September. But those prices started to reverse at the end of the month and continued to rise in October. That will likely imply at least a temporary acceleration in annual headline inflation next month. Meanwhile, food prices continued to grow at a historic pace. Part of the acceleration reflected another increase in dairy prices in the month, though price pressures at grocery stores remain broad-based.
- CPI excluding food and energy increased 0.4% seasonally adjusted on the month, above the prior month and the trend needed to sustain a 2% inflation target, but an improvement over earlier in the year. After declining last month, the price of passenger vehicles grew strongly and was the largest upward contributor to the 12-month change in CPI. This is another sign that supply chain issues in the sector are not improving as fast as expected. Prices for clothing, particularly woman's clothing, also rose strongly.
- Shelter prices rebounded somewhat in September, despite the cooling in the housing market. While other owned accommodation and homeowner's replacement continued to decelerate, this was more than offset by increases in mortgage interest cost (reflecting the increase in interest rates), homeowner's insurance, and the index for maintenance and repairs.
- The annual (5.4%) and the three-month seasonally adjusted annualized rates (4.9%) of inflation excluding food/energy are still well above 2%. Meanwhile, CPI-trim and CPI-median remained unchanged at 5.2% and 4.7%

respectively (remember that the Bank of Canada has stopped looking at CPI-common). With core inflation this high, the Bank of Canada will need to continue with its outsized rate hikes.

Implications & actions

Re: Economic forecast — The Bank of Canada has clearly not slayed the inflation dragon yet and is therefore set for another large rate hike next week. The pace of growth in seasonally adjusted inflation excluding food and energy picked up by more than expected this month and is too high for comfort. As such, we now believe the Bank will need to go with a 75 bps hike next week rather than the 50 bps we previously anticipated. The Bank might then be left with a last 25 bps in December if growth numbers support it.

Re: Markets — Bond yields jumped immediately after the release, but have since retraced part of those gains. The Canadian dollar, which had depreciated overnight, appreciated right after the release as investors understand that this CPI report adds some pressure on the Bank of Canada.