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Canadian CPI (Dec): Looking through mortgage costs

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Consumer price index (% chg)	22:Q3	22:Q4	Oct	Nov	**Dec**
Year/year rate (unadjusted)	7.2	6.7	6.9	6.8	**6.3**
Monthly rate (unadjusted)	-	-	0.7	0.1	**-0.6**
Monthly rate (SA)	-	-	0.6	0.3	**-0.1**
Three-month rate (SAAR)	-	-	4.3	5.4	**3.4**
CPI-trim (year/year rate)	5.4	5.3	5.3	5.4	**5.3**
CPI-median (year/year rate)	4.9	5.0	4.9	5.1	**5.0**

Source: Statistics Canada

- 2022 ended with relief at the pump, which helped to cool Canadian CPI inflation. The 6.3% annual pace was down from 6.8% in the prior month and slightly below consensus expectations (6.4%). Excluding food/energy, prices rose by a seasonally adjusted 0.3% m/m in December, slightly slower than the recent 3-month average. The BoC's core measures CPI-median and CPI-trim also decelerated by one tick to 5.0% and 5.3% respectively, after being revised up in the prior month. While core inflation remains too high, when excluding the increase in mortgage interest costs, which reflect the rapidly rising interest rates, things look better with a monthly gain of about 0.2%. Overall, this report is largely as anticipated and we therefore continue to expect the Bank of Canada to raise rates by 25 bps next week before pausing for the rest of the year.
- The largest decline in monthly gasoline prices since April 2020 drove the overall deceleration. Also reflecting the drop in energy prices, fuel oil prices, which are included in shelter costs, pulled back significantly. Meanwhile, food price inflation slowed on the month. Progress in some grocery categories was offset by surging prices for vegetables, something not uncommon at this time of year.
- Excluding food/energy, shelter inflation decelerated on the month as rent price growth slowed, and homeowners' replacement cost and other owned accommodation continued to fall with the slowdown in the housing market. The overall increase in the cost of owning a house however accelerated, pushed by higher interest rates. Indeed, the 18.0% year-over-year increase in mortgage interest costs is now the largest contributor to overall annual inflation. This is an area that policymakers should look through when judging the underlying inflationary trend.
- As supply chain issues ease and demand falls, prices for many durable goods are declining. In December, there were notable declines in the prices for furniture and household appliances, the latter registering its sharpest monthly drop on record (-4.1%). Prices for used cars also fell on the month. The decline in goods prices is partially offset by continued growth in services. As anticipated, the recovery in travel demand for the holiday season led to a sharp increase in airfare prices on the month (+20.0%).
- Overall prices excluding food/energy rose by a seasonally adjusted 0.3% m/m, slightly below the 0.35% prior 3-month average. The three-month annualized rate now sits at 3.7%, down from 4.3% in November. This however includes the meteoric rise in mortgage interest costs, something the Bank of Canada will want to look through when assessing core inflation. When excluding food, energy and mortgage costs, seasonally adjusted inflation rose approximately 0.2% m/m in December, with a 3-month annualized rate of about 2.5%. That pace is much closer to target.

- This print leaves Q4 inflation at 6.7%, somewhat below the Bank of Canada's October MPR forecast (7.1%), in large part due to the decline in gasoline prices.

Implications & actions

Re: Economic forecast — The good news is that inflation is easing, and that will become more noticeable when the big monthly increases seen this past spring start to drop out of the annual calculation this year. Moreover, core inflation excluding mortgage costs is growing at a pace much closer to target. However, given the strong December job's report and tightness in the labour market, that likely won't be enough to deter the Bank of Canada from raising rates 25 bps one last time next week.

Re: Markets — With today's print largely as expected, market reaction was muted.

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