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Canadian CPI (July): Accelerating core spells trouble

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Consumer price index (% chg)	22:Q1	22:Q2	May	June	**July**
Year/year rate (unadjusted)	5.8	7.5	7.7	8.1	7.6
Monthly rate (unadjusted)	-	-	1.4	0.7	0.1
Monthly rate (SA)	-	-	1.1	0.5	0.3
Three-month rate (SAAR)	-	-	12.5	10.4	7.7
CPI-trim (year/year rate)	4.3	5.3	5.4	5.5	5.4
CPI-median (year/year rate)	3.8	4.7	4.8	4.9	5.0
CPI-common (year/year rate)	3.9	5.0	5.1	5.3	5.5

Source: Statistics Canada

- Canadian inflation has taken its foot off the gas, but other elements in July's inflation story were not as reassuring. Headline CPI inflation decelerated to 7.6% year-over-year in July on a much smaller 0.1% month-over month increase, roughly in line with consensus expectations. As expected, gasoline prices were the main driver of the slowdown. In what is bad news for consumers, food prices resumed their climb in July after taking a pause in June. CPI inflation excluding food and energy spelled further trouble with an increase of 0.5% on a seasonally adjusted basis. Prices for services impacted by the pandemic, such as hotels, air transportation and restaurants all increased. With the large revisions to CPI common in recent months muddying the message from the preferred core measures, the Bank of Canada is probably keeping a close eye on inflation ex food/energy these days. Today's acceleration in that category is therefore not good news for the Bank, which should still be on track for a 75bps increase in rates at its next meeting.
- As was widely expected, gasoline prices fell 9.2% in June to be the main downward contributor to the deceleration in total inflation. Within the energy category, this was partially offset by higher natural gas prices, which at 12.4% growth on the month were the largest contributor to the monthly CPI increase.
- After taking a pause in June, food prices resumed their climb in July with a 0.9% increase on the month, to reach 9.2% on an annual basis. The war in Ukraine had earlier led to a spike in food commodities, particularly wheat, and although many food commodities have since cooled off, the lagged impacts of the earlier jump are still pushing up the price of groceries. On a seasonally adjusted basis, food prices increased 0.7% on the month.
- CPI inflation excluding food and energy picked up speed in July with a 0.5% seasonally adjusted monthly increase to reach 5.5% year-over-year. Goods price inflation fell while service inflation accelerated. For Canadians trying to enjoy their summer, services that were previously impacted by the pandemic such as traveller accommodation (+10.1% m/m), air transportation (+25.5% m/m), and restaurants (+1% m/m) all became pricier. Hotel prices are now almost 50% more expensive than a year ago.
- Shelter prices continued to rise at a steady monthly clip, but decelerated a tick on an annual basis to 7%. Other owned accommodation, which includes real estate agent fees and is linked to house prices, declined a further 0.9% on the month. Homeowner's replacement costs also slowed. However, the rapid increase in interest rates is pushing up shelter prices and offsetting the impact the cooling housing market is having on these other components. Mortgage interest costs jumped 1.7%, outdoing the June increase, and turned positive on the year for the first time since

September 2020. As rental demand increases from those steering away from home ownership because of high mortgage rates, rent prices also went up.

Implications & actions

Re: Economic forecast — While inflation seems to finally have started its long descent, the acceleration in inflation excluding food and energy will be a concern for the Bank of Canada. With gasoline prices set to decline further in August, so should headline CPI, but that is not what the Bank will be watching. The focus should be on shelter prices (outside of mortgage costs), which should decelerate with the cooling housing market, and overall service inflation. For now, the Bank of Canada remains on track for a 75 bps increase at its September rate decision.

Re: Markets — Bond yields increased after the release as the acceleration in inflation ex food and energy is putting pressure on the Bank of Canada. The CAD also appreciated.