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Canadian CPI (Jan): Signs of a cooler core

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Consumer price index (% chg)	22:Q3	22:Q4	Nov	Dec	**Jan**
Year/year rate (unadjusted)	7.2	6.7	6.8	6.3	5.9
Monthly rate (unadjusted)	-	-	0.1	-0.6	0.5
Monthly rate (SA)	-	-	0.3	0.0	0.3
Three-month rate (SAAR)	-	-	5.1	3.4	2.4
CPI-trim (year/year rate)	5.5	5.4	5.5	5.3	5.1
CPI-median (year/year rate)	5.1	5.2	5.3	5.2	5.0

Source: Statistics Canada

- A steeper deceleration in headline CPI than expected, largely due to some of the weakest core readings in almost two years, suggest that the Bank of Canada has already done enough to bring inflation under control. Although the annual rates of headline (5.9%) and core (around 5%) inflation remain well above the Bank's 2% goal, those figures will look much lower by May as some of the largest monthly price increases from last year drop out of the annual calculation. Over the past three months, annualized rates of core inflation suggest that policymakers are already closing in on, or on some breakdowns have already met, their 2% target.
- Alongside revisions to seasonally-adjusted price series, Statistics Canada also released for the first time a monthly profile for the Bank of Canada's CPI-trim and CPI-median series. These are important as policymakers have been focusing on the 3-month annualized rate of change in these series, knowing full well that the annual rates (5.1% and 5.0% respectively) are still being influenced by big monthly increases last spring. The latest data suggest that the 3-month annualized rate for both were around 3.5% which, while still above the top end of the Bank's 1-3% target band, is a big improvement from the peaks seen towards the middle of 2022.
- Moreover, other core measures of inflation have shown even greater improvement. In January, seasonally adjusted CPI excluding food/energy rose by only 0.1% month-over-month, which was the weakest increase since March 2021. Excluding mortgage interest costs as well, which are rising as a direct consequence of Bank of Canada interest rate hikes, prices would have been flat on the month. Indeed, on this breakdown, the 3-month annualized rate of inflation stood at 1.9% in January, suggesting that policymakers have already slowed the economy enough to hit their 2% inflation goal.
- While a rebound in gasoline prices and further surges in food and mortgage costs contributed to headline inflation in January, these were partly offset by price declines in other areas. The near 20% decline in unadjusted airline fares was a slightly steeper drop than has become typical for the month of January, while new car prices fell for the first time since last August as some of the supply chain issues in that area have eased. Declines in seasonally adjusted clothing and household furniture prices could also be a sign of supply chain improvements and a build up of inventory. One of the largest contributors to the weakness was telephone service costs, with Statistics Canada suggesting that some Boxing Day sales had continued further into January than normal. This is therefore one area that could accelerate again with the release of February data.
- The 0.5% NSA increase in headline inflation, taking the annual rate down to 5.9% (from 6.3% in the prior month) was weaker than the 0.7% rise expected by the consensus.

Implications & actions

Re: Economic forecast — Alongside some healthy readings for retail sales in December/January, the deceleration in CPI adds to evidence that the Bank of Canada doesn't need to engineer a recession to get inflation under control. Headline inflation should 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. That supports our call for no further interest rate hikes, but also no cuts until early 2024.

Re: Markets — Bond yields started the day higher due to some better than expected international data overnight, only to fall back close to yesterday's levels following the weaker than expected inflation readings. The Canadian dollar weakened.

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