Economic Flash!

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Andrew Grantham (416) 956-3219

Canadian CPI (Sep): Rapid Descent on Airfare Turbulence

All Items (% chg)	18:Q2	18:Q3	Jul	Aug	**Sep**
Year/Year Rate (Unadjusted)	2.3	2.7	3.0	2.8	**2.2**
Monthly Rate (Unadjusted)			0.5	-0.1	**-0.4**
Monthly Rate (SA)			0.5	0.1	**-0.1**
Three-month Rate (SAAR)			2.7	3.0	**2.1**
CPI-Trim	2.0	2.1	2.1	2.2	**2.1**
CPI-Median	2.0	2.1	2.1	2.1	**2.0**
CPI-Common	1.9	1.9	1.9	2.0	**1.9**

- Headline CPI began its descent last month, but the speed of descent intensified in September thanks to a drop off in airline fares. Those prices had spiked strangely at the start of the summer, in part thanks to a change of methodology, and as such the pullback isn't a sign of anything worrisome within the Canadian economy. However, with headline CPI now only at 2.2%, versus 2.7% expected by the consensus, and the BoC's core measures taking a slight back-step, expectations for follow up hikes after next week's widely anticipated move will be pared back.
- Turbulence within the air transport category has been resulting in big shifts in headline CPI this year, in part related to a change of methodology to bring in greater online surveying of prices. After surging 16% in July, and only reversing part of that in August, prices dropped by almost 17% in September. With the annual rate of increase slumping from 26.4% to 7.4%, that small sector accounted for slightly more than 0.2%-pts of the slowing in headline CPI. And with airline fares also factoring into the softness in recreation prices due to their prevalence in travel tour costs (which eased from +1.9% to -4.4% y/y), the total impact on headline inflation is probably closer to 0.3%-pts.
- So that explains the majority, but not all, of the downside miss versus consensus expectations, and it's certainly true that underlying inflation was also a touch weaker than had been expected in September. The BoC's three core measures of prices, each of which is designed in different ways to ignore volatilities such as that seen in airline fares recently, all eased a tick from the prior month. However, the average of the three, at 2.0% vs 2.1% in August, is still bang in line with the Bank's 2% target and the slight easing therefore won't be a roadblock to a rate hike next week.

- On a seasonally adjusted basis, as well as the softness discussed in transportation and recreation prices, health and personal care costs were also on the soft side. The -0.1% seasonally adjusted change seen there, compares to an average increase of 0.1% in the previous four months.
- On the more positive side, the seasonally adjusted increase in shelter costs, at 0.2%, was slightly faster than that seen in August albeit only in-line with the year-to-date average. With interest rates continuing to rise, the mortgage interest cost component continues to bolster headline inflation after being a drag through much of the 2009-2016 period. The 6.4% year-over-year increase was up from 5.8% in August and the highest since late 2008.

Implications & Actions

Re: Economic Forecast — Headline inflation may have missed consensus expectations by a wide mark, but with much of that due to volatility in airline fares and the BoC's measures averaging bang on the 2% target, that won't prevent policymakers from hiking interest rates again next week. However, the slight easing in underlying price pressures combined with signs of softening growth (as indicated by manufacturing shipments and retail sales) will prevent a follow up hike in December and encourage a very gradual path higher in rates still.

Re: Markets — The softer CPI data combined with a weaker than expected retail sales print as well, weighed on the C$ and supported fixed income.