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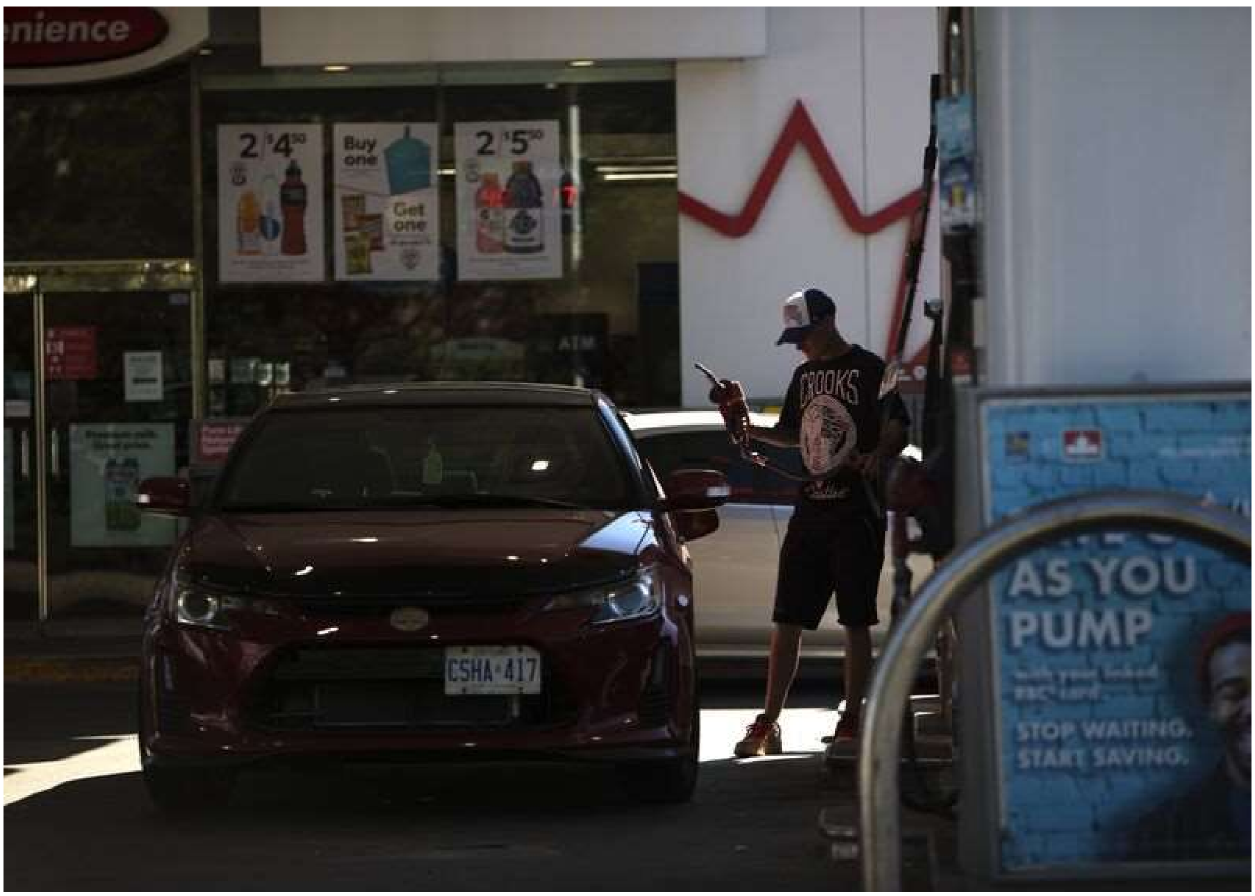
Inflation Slows in Canada, But Not Enough to Take Hike Off Table

- Annual rate falls to 3.4% and key core measures edge down
- GDP and jobs data may still force Macklem's hand next month

Randy Thanthong-Knight || June 27, 2023



An 18.3% year-over-year drop in gasoline prices helped drive a slowdown in Canadian inflation.
Photographer: Della Rollins/Bloomberg

Canadian inflation slowed to its weakest pace in two years and core measures edged lower, reducing — but not removing — pressure on the central bank for another interest-rate hike next month.

The consumer price index rose 3.4% in May from a year ago, the smallest increase since 2021, Statistics Canada reported Tuesday in Ottawa. That matched the median estimate in a Bloomberg survey of economists and was down a full percentage point from April. On a monthly basis, the index rose 0.4%, also matching expectations.

May's slowdown in price gains is a welcome development for the Bank of Canada, especially after a surprise acceleration in April when the headline rate rose for the first time since June 2022. But the deceleration might not be enough to quash bets for another hike in coming months. Policymakers could be forced to raise rates again for the second straight month in July if gross domestic product and jobs figures still point to an overheated economy.

Two key yearly inflation measures tracked closely by the central bank — the so-called trim and median core rates — also dropped, averaging 3.85% from an upwardly revised 4.25% a month earlier, slightly slower than the 3.95% expected by economists.

A three-month moving average of the measures that Governor Tiff Macklem has flagged as key to his team's thinking fell to an annualized pace of 3.72%, from 3.83% previously, according to Bloomberg calculations.

“While the softer-than-expected core prints are a bit of good news, every inflation metric remains far above the 2% inflation target,” Benjamin Reitzes, a rates and macro strategist at Bank of Montreal, said in a report to investors. “Policymakers won’t breath a huge sigh of relief after this report as core inflation remains sticky and has yet to show signs of a durable slowdown.”

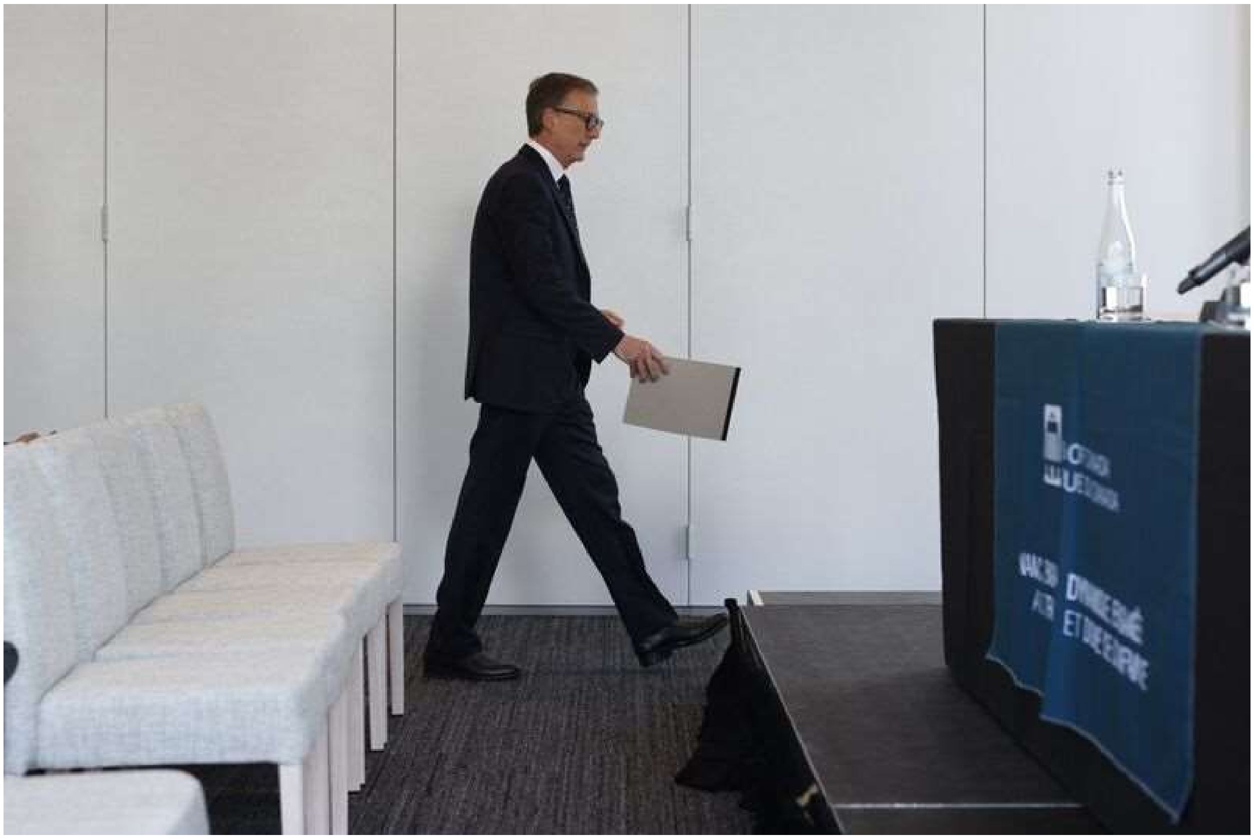
Bonds got a temporary lift on the news, with the yield on the benchmark 2-year Canada note tumbling as much as 9 basis points before reversing. It was down 1.4 basis points from Monday’s close at 4.604% at 10:57 a.m. Ottawa time. The loonie was down about 0.2%.

Traders hedged their bets on a second-straight rate increase. Overnight swaps markets are now putting about 60% odds on a hike at the July 12 meeting, down from a two-thirds chance before the release.

A string of hotter-than-expected data since Macklem and his officials declared a pause in January forced them to hike the policy rate earlier this month to 4.75%, the highest since 2001. During their deliberations this month, they were concerned that monetary policy wasn’t sufficiently restrictive and that inflation could remain stuck above the 2% target.

Resilient output, strong consumer consumption and a tight labor market, coupled with still-elevated underlying price pressures, could prompt policymakers to hike again in a bid to squeeze excess demand out of the economy. Only eight out of 33 economists in a Bloomberg survey so far expect the Bank of Canada to raise rates to 5% at its next meeting.

Since Macklem upended markets with a 25 basis-point hike on June 7, data still show an economy that’s holding up in the face of higher borrowing costs. GDP figures due Friday may confirm preliminary estimates for a strong start to the second quarter. And the statistics agency will release another labor force survey that will show whether the minor job losses recorded in May were a blip or the start of a trend.



Tiff Macklem arrives to speak at the Toronto Region Board of Trade on May 4.
Photographer: Cole Burston/Bloomberg

The inflation slowdown in May was driven by lower year-over-year prices for gasoline resulting from a base-year effect. Gasoline prices fell 18.3% that month, from a year ago.

Energy prices fell 12.4% in May compared with the same month a year earlier, when supply uncertainty after Russia's invasion of Ukraine led to surging prices. The first year-over-year decline in natural gas prices since August 2020 also contributed to the deceleration.

The mortgage interest cost index, which rose 29.9% in May, remained the largest contributor to the year-over-year increase. For the third straight month, this was the largest increase on record, as Canadians continued to renew and initiate mortgages at higher rates.

Grocery prices remain elevated, rising 9% and nearly unchanged from the 9.1% increase in April. Prices for restaurant food accelerated, increasing

6.8% from 6.4% in April, amid elevated labor shortages, input costs and expenses.

Regionally, prices rose at a slower pace in May compared with April in all provinces, with price growth slowing more in Atlantic provinces due to lower prices for fuel oil commonly used in the region.