Global News – August 15, 2023

Why inflation’s latest jump is bad news for the Bank of Canada

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August 15, 2023

Annual inflation rose to 3.3 per cent nationally in July, Statistics Canada said, putting it outside the Bank of Canada’s one-to-three per cent target range. That’s up from June’s inflation rate of 2.8 per cent – Aug 15, 2023

The annual rate of inflation’s July jump could be cause for concern at the Bank of Canada, economists warn.

Annual inflation rose to 3.3 per cent nationally last month, Statistics Canada said Tuesday, which falls outside the central bank’s one-to-three per cent target range.

That’s up from June’s inflation rate of 2.8 per cent. Economists had widely expected an increase, though the report outpaced the consensus’ estimates of 3.0 per cent.

Part of the reason inflation increased was because energy prices saw a smaller annual decline in July than in June, StatCan said. A monthly drop in gasoline prices between July and June last year is no longer affecting the agency’s inflation calculations due to the “base-year effect.”

On a monthly basis, Statistics Canada said gas prices in July were up slightly (0.9 per cent) from June.

Nova Scotia saw a 14 per cent month-to-month jump in prices at the pump — the fastest monthly pace in Canada — which Statistics Canada said was in part tied to the introduction of the federal carbon levy in the province.

Alberta, meanwhile, saw a sizeable jump of 127.8 per cent in electricity prices "amid high summer demand," StatCan said.

Food prices at the grocery store were up 8.5 per cent in the month, the agency noted, but are growing at a slower rate than the 9.1 per cent seen in June. Prices for fresh fruit and bakery products helped with the slowdown, StatCan said.

Singh proposes taxing grocery store chains' excess profits

Prices for fresh fruit were up only 4.1 per cent in the month, compared to a jump of 10.5 per cent in June. That deceleration was the biggest month-to-month decline in more than 15 years the agency said, thanks to a substantial drop in the prices for grapes (down 40.9 per cent) as well as oranges (down 1.8 per cent).

Mortgage costs once again grew at a record rate thanks to the rapid rise in interest rates, StatCan said.

Inflation's reversal is bad news for Bank of Canada: economists

The Bank of Canada is hoping restrictive interest rates will tamp inflation all the way back down to its two per cent target.

The central bank's mandate is to achieve price stability, which it seeks to do by keeping inflation between one and three per cent.

"There's no sense sugar coating this one — it is not a good report for the Bank of Canada," wrote BMO chief economist Doug Porter in a note to clients Tuesday morning.

While the central bank was almost certainly expecting some waning in the inflation progress to date, Porter noted that the July CPI report is already at the Bank's 3.3 per cent forecast for the entire third quarter. With gas prices continuing to climb, August is likely to see yet another tick up in the annual inflation rate, he added.

interest rate hike possible for September if data warrants action:

The slight "silver lining" in Tuesday's inflation report was some modest progress in the Bank of Canada's preferred "core" measures of inflation, Porter said. These core metrics, which tend to strip out more volatile inputs such as food and energy prices, showed slight improvement on a three-month basis, though they each remain stuck above 3.5 per cent.

RBC economist Claire Fan said in a note Tuesday that the latest data shows some room for optimism but it's clear there's more work to be done before the Bank of Canada's job is finished on inflation.

"Easing in (Bank of Canada)'s 'core' CPI measures in July is welcome after months of sticky prints at higher levels but is far from enough to signal that this period of above-normal inflation is at an end," she wrote.

Dawn Desjardins, chief economist at Deloitte Canada, told Global News on Tuesday that progress in the core inflation measures but a rebound in the headline figure puts the Bank of Canada in a "quandary."

On one hand, the declining core figures show progress in taming the underlying inflationary pressures, Desjardins says. Alternatively, with the overall inflation figures rising back above three per cent and potentially staying there in the months ahead, the central bank runs the risk of Canadians losing confidence in the Bank's ability to tamp down inflation, she adds.

"(The Bank) would want to lean against that happening," Desjardins says, which could lead to another hike at its next interest rate decision on Sept. 6. Desjardins nonetheless expects the Bank of Canada to remain on hold next month.

Tuesday's inflation print is the last one the Bank of Canada's governing council will get before its next rate decision, but it is not the only data policymakers will be considering.

Porter said in his note that recent upswings in the unemployment rate and signs of cooler spending from Canadian consumers will offset the impact of the higher July inflation reading and allow the Bank of Canada to remain on the sidelines next month.

Fan, too, said recent signs of softening in the Canadian economy should be enough for the central bank to forego another rate hike in September.

Not all economists are convinced a pause is likely, however.

Katherine Judge, senior economist at CIBC, said in a note Friday that the persistence in core inflation will put the Bank of Canada in line for a 25-basis-point rate hike in September.

She said CIBC would prefer policymakers hold pat instead, believing the central bank to be "overshooting" in its tightening cycle. CIBC expects inflation will therefore drop to the two per cent target as early as the second half of 2024, roughly a year ahead of the central bank's own forecasts.

Before the making its next rate decision, Porter noted that the Bank of Canada will get one more chance to see how the economy is faring with the second quarter gross domestic product figures released on Sept. 1.