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Posthaste: Sorry Canada, this kind of inflation is sticking around — and it's huge

It's going to take a 'short and shallow recession' to get back on track, says economist

Pamela Heaven || February 6, 2024

Shelter costs, which include mortgage interest and rent, are going to be the single biggest driver of inflation for the foreseeable future, say economists. PHOTO BY LYLE ASPINALL/POSTMEDIA

There is one inflation problem in this country that isn't going away anytime soon, and even the Bank of Canada admits it.

Shelter costs, which include mortgage interest and rent, are going to be the single biggest driver of inflation for the foreseeable future, say economists.

The central bank acknowledged as much in its recent monetary policy report, saying "shelter price inflation is high and is expected to put upward pressure on inflation for some time."

It is expected to contribute an average of 1.8 percentage points to overall inflation throughout this year, almost four times the average in the five years before the pandemic, said Desjardins economist Randall Bartlett.

Rising mortgage interest costs are the biggest driver. The pace of this inflation set records in 2023, averaging 30 per cent year over year in the second half. Bartlett said this trend will continue in 2024 as mortgages renew under higher interest rates.

Rents too have been growing at a rapid pace.

The average rent for a two-bedroom apartment rose 8 per cent in the 12 months to October 2023, beating both the inflation rate of 3.1 per cent and wage growth of 4.8 per cent over the same period, said RBC economist Rachel Battaglia.

That was the fastest pace since 1990 and more than double the average rate in the five years before the pandemic.

With home construction lagging record population growth, there is little relief for renters in sight.

The national rental vacancy rate fell to a historic low of 1.5 per cent in 2023, the Canada Mortgage and Housing Corporation reported last week.

And based on the Bank of Canada's latest forecast for population growth and housing investment, National Bank economists predict the rental vacancy rate will fall below 1 per cent by 2025 — "keeping rent inflation uncomfortably high for the 37 per cent of Canadian households that make up the renter population."

So how does Canada get inflation back on track?

Prices for other things besides shelter will have to come down much further than in the past to get inflation back to the Bank of Canada's target of 2 per cent — and it will likely take a "short and shallow" recession to do it, said Bartlett.

Desjardins expects that higher interest rates will continue to weigh on the economy and labour market, tipping the Canadian economy into recession in the first half of the year.

“It will need to, as non-shelter core inflation … must come in sustainably below its pre-pandemic pace to offset higher-for-longer core shelter inflation,” said Bartlett.

Inflation categories outside of shelter are already showing signs of cooling, he said. And with the unemployment rate expected to rise further, slower demand will make it harder for businesses to raise prices.

“All told, while shelter inflation is expected to remain elevated for the foreseeable future, other drivers of inflation are likely to offset that strength and help to bring inflation back to around 2 per cent by the end of 2024,” said Bartlett.

That doesn’t mean the Bank of Canada will wait until then to cut interest rates.

A recession and weak labour market should provide the central bank with the evidence it needs by the spring — well before headline inflation has touched down at the 2 per cent target,” he said.