Inflation above BoC’s two-per-cent target for third straight month

By David Parkinson
May 18, 2018 – *The Globe and Mail*

Canadian inflation data gave off mixed signals for April, with closely watched core measures inching higher even as the country’s overall inflation rate eased slightly amid signs that consumer spending has bounced back from its recent lull.

Statistics Canada reported that the consumer price index (CPI) rose 0.3 per cent month over month in April, in a broadly based increase that was highlighted by a nearly 7-per-cent jump in gasoline prices. That left the year-over-year CPI inflation rate at 2.2 per cent, down slightly from the three-and-a-half-year high of 2.3 per cent posted in March. Despite the slight pullback, it’s the third consecutive month that the annual inflation rate has run above the Bank of Canada’s target of 2 per cent, the central bank’s key guide for setting interest rate policy.

Meanwhile, two of the Bank of Canada’s three preferred measures for core inflation – designed to filter out short-term volatility and temporary fluctuations – posted year-over-year gains, while the third held steady. That edged the average of the three measures above 2 per cent for the first time in more than six years.

The inflation figures come amid indications that Canadian shoppers have shaken off their doldrums of late 2017 and the start of 2018. Statscan reported that retail sales gained 0.6 per cent month over month in March, their biggest rise in five months. Statscan also revised upward its retail sales figures for February.

Both the CPI and retail sales reports were closely scrutinized by financial markets, as they gauge whether the pace of inflation and economic growth are sufficient to prompt the Bank of Canada to raise interest rates again – either at its next rate decision at the end of May or the following decision in July.

The Canadian dollar fell more than a half-cent against its U.S. counterpart in the wake of the two reports, as the market interpreted the dip in the overall year-over-year inflation rate as easing the pressure on the central bank for a near-term rate increase. Economists noted that overall inflation was a touch weaker than the consensus expectation of a repeat of March’s 2.3-per-cent level, and that the central bank’s core inflation measures, while up slightly, aren’t accelerating meaningfully above the central bank’s 2-per-cent target.

“The underlying trend is right where the central bank wants it,” Canadian Imperial Bank of Commerce economist Katherine Judge said in a research report.

“With a relatively benign inflation outlook, the Bank of Canada will remain focused on the risks to the Canadian economy, namely headwinds to growth from a slowing housing market and uncertainty around NAFTA,” James Marple, senior economist at Toronto-Dominion Bank, said in a note to clients.

But others noted that the solid retail figures – which included an even better 0.8-per-cent monthly rise on a volume basis – add to the emerging picture of a pick-up in domestic demand that bodes well for the country’s economic growth outlook.

“The retail sales data follow already reported increases in manufacturing activity and exports. Labour markets have also continued to improve,” said Royal Bank of Canada senior economist Nathan Janzen. He estimated that the Canadian economy grew at an annualized pace of 1.8 per cent in the first quarter – well above the Bank of Canada’s most recent estimate of 1.3 per cent.

The retail gains were led by a 3.3-per-cent jump in new-car sales, as well as strong growth in home furnishings (up 3.1 per cent) and clothing (up 2.5 per cent).

But economists noted that despite the rebound over the past two months, the weak finish to 2017 and slow start of the year meant that for the first quarter as a whole, retail sales were down slightly compared with the fourth quarter.

“Stronger increases over the last two months bode well for a return to positive growth in the second quarter,” Mr. Janzen said.

Bank of Montreal economist Doug Porter argued that the two reports, taken together, “do not significantly move the needle” on the economic outlook and do little to change the likelihood of a Bank of Canada interest rate increase in the near term. The markets have placed modest odds of another quarter-percentage-point rate hike at the May rate-setting meeting, with a hike considered much more likely in July.

“The market reaction to the largely uneventful pair [of reports] was a tad surprising, as the odds of a May rate hike were scaled back notably in the wake of the data,” Mr. Porter said in a note to clients. “We continue to believe that the [central] bank is likely to wait until the July meeting before hiking again.”