Inflation eases but core measures signal higher interest rates

By David Parkinson
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Canada's overall inflation rate eased for the first time in four months in August, but another uptick in core measures of inflation suggest that further Bank of Canada interest-rate increases remain on track.

Statistics Canada reported Wednesday that the consumer price index 12-month inflation rate dipped to 2.8 per cent last month from 3 per cent in July, its first decline since April. CPI dipped 0.1 per cent from July on a non-seasonally adjusted basis, snapping a seven-month string of month-over-month gains. Declines in transportation costs were the key source of the monthly downturn, as gasoline prices and airline tickets both reversed some of their previous strong gains.

But the Bank of Canada's three favoured measures of so-called core inflation – which filter out short-term volatility in individual components in order to better gauge underlying inflation across the broader economy – all rose 0.1 percentage point, averaging 2.1 per cent. All three measures were at or above the Bank of Canada's inflation target of 2 per cent – the first time that has happened since February, 2012.

Economists said the continued strength in core inflation highlights the building of inflationary pressures as the Canadian economy continues to operate near its full capacity – which is the key reason the Bank of Canada has been raising interest rates this year, and is expected to continue.

"While the rise in the average core inflation pace above 2 per cent isn't enough to force the hand of [Bank of Canada Governor Stephen] Poloz and company to quicken the pace of interest rate increases, it will give the [central] bank comfort to continue gradually moving rates higher," Canadian Imperial Bank of Commerce economists Andrew Grantham and Katherine Judge wrote in a research report.

"Providing that [North American free-trade agreement] talks do not take a sharp turn for the worse, we expect it to raise interest rates in October," said Stephen Brown, senior Canada economist at Capital Economics, in a research note.

While overall inflation surged well above the central bank's 2-per-cent target over the summer, a large portion of the gains have come from sharp increases in gasoline costs, which were up nearly 20 per cent year over year in August despite a pullback from July. Excluding gasoline, the inflation rate last month was 2.2 per cent, unchanged from July. Nevertheless, CPI excluding gasoline has risen sharply in recent months, from an average of 1.7 per cent in the first half of the year.

Statscan noted that all of the major components of CPI have increased year over year. In addition to an 8.1-per-cent rise in the transportation segment, which includes gasoline, prices have also shown substantial increases in alcohol and tobacco (up 4.5 per cent) and shelter (up 2.4 per cent). Food prices were up 1.4 per cent year over year.

"There is no single factor behind the steady upswing in core, just plenty of signs that price pressures are slowly building and fanning out," said Douglas Porter, chief economist at Bank of Montreal, in a note to clients.

Separately, Statscan also reported that retail sales rose 0.3 per cent monthly in July from June on a seasonally adjusted basis. The rise was driven mostly by higher sales at grocery stores and gas stations, although the gains were fairly broad-based, with eight of 11 segments showing increases.

However, after factoring out inflation, retail volumes dipped 0.1 per cent month over month, their second straight decline. Economists noted that despite the weakness in volumes, retail sales have largely held onto their strong growth of earlier in the year.

“This was a not too hot, not too cold type of report,” said Brian DePratto, senior economist at Toronto-Dominion Bank, in a research report. “That retail spending is holding up, despite a string of interest rate increases, should give the Bank of Canada confidence that the Canadian consumer continues to manage higher borrowing costs.”

“Today’s data are another sign of an economy that continues to perform well despite a number of headwinds,” Mr. DePratto said.