Canadian CPI Is Undershooting The BoC's Forecast, But For Reasons That Matter Little

Canada, CPI, y/y / m/m NSA %, January:
Actual: 1.4 / 0.1
Scotia: 1.5 / 0.2
Consensus: 1.4 / 0.1
Prior: Unrevised from 2.0 / -0.1

Core inflation, y/y %, January:
Average: 1.9 (prior 1.9%)
Common component: 1.9 (prior 1.9%)
Weighted Median: 1.8 (prior 1.8%)
Trimmed Mean: 1.9 (prior 1.9%)

- Inflation is undershooting the Bank of Canada's forecast but for reasons that shouldn't be of significant concern. Headline inflation may not have bottomed yet as discussed in a look ahead to the February report below. For the same reasons discussed below (base effects, gas, seasonality etc), it is reasonable to expect headline inflation to be back at around 2% toward year end into next year such that one should look through the present downdraft in headline inflation.
- A reason for this is that the average of the three central tendency measures held unchanged at 1.9% y/y and so did each of the three individual readings. The headline deceleration is the stuff of shifting base effects, gasoline prices and seasonality that the BoC would look through in favour of the fact that 'core' inflation remains stable.
- Seasonally adjusted headline CPI fell by 0.1% m/m, but bear in mind that prices ex food and energy came off a strong December when they jumped by 0.4% m/m in seasonally adjusted terms and so some slippage in January isn't too surprising.
- At 1.4% y/y in January, headline CPI is tracking below the BoC's Q1 forecast of 1.7% for the full first quarter. The challenge then becomes whether inflation will accelerate over the duration of Q1 to hit this quarterly average forecast and I doubt it.
- For instance, I've crunched estimates for February CPI to look ahead based on the new information from this report. Base effects alone would drop headline CPI down to 0.8% y/y in February. Seasonal influences would likely lift that back to about 1.2–1.3% y/y. Gas prices may become a stabilizing influence that could add about one-tenth to the year-ago headline CPI inflation rate in February given how prices are tracking ahead of CPI (see chart). The chart shows that higher frequency weekly gas prices are pointing toward less of a drag in the February CPI report given the tight correlation in the measures. Therefore headline inflation may either remain toward present readings and may not have even hit bottom yet. Nevertheless, as long as the average of the three central tendency measures remains steady then this shouldn't matter much to the BoC.

CONTACTS

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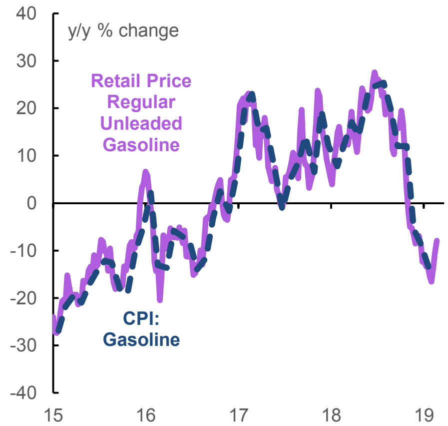
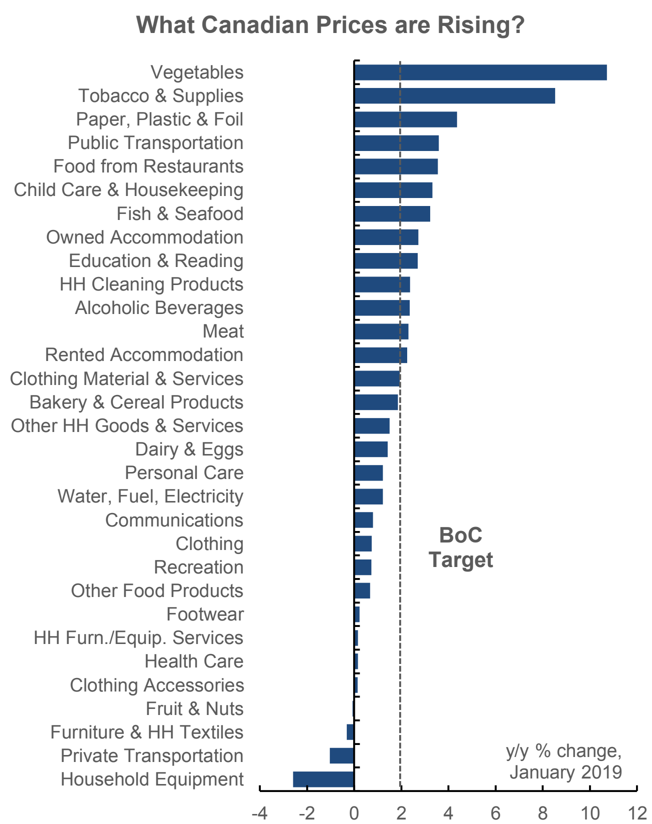
Gas Prices are Dragging Down CPI



Sources: Scotiabank Economics, Statistics Canada, Natural Resources Canada.

- There were changes to the 2017 weightings in the CPI basket with this report that were well telegraphed in advance but with modest influences as StatsCan added some new goods and services and deleted some others compared to the prior basket that was formed in 2017. Recall that Canada shifts weights and composition every couple of years, versus, say, the US PCE measures that dynamically adjust. StatsCan also introduced methodological changes to rent that jumped by 0.9% m/m.
- On breadth, please see the bar chart below that depicts the spread among components.



Source: Scotiabank Economics, Statistics Canada.