

Contributors

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Chart 1

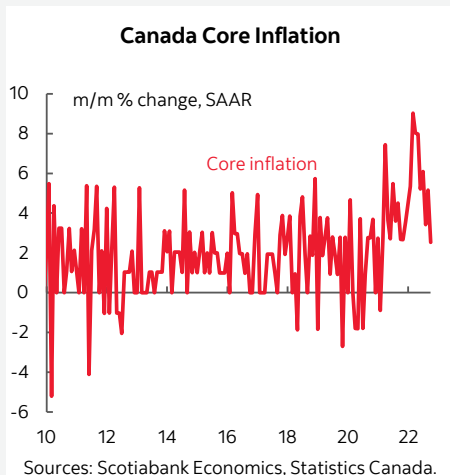
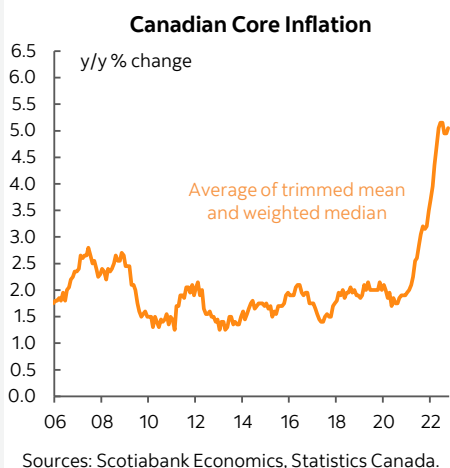


Chart 2



A Further Softening of Canadian Core Inflation Offers a Glimmer of Hope

- The simplest measure of core inflation continues to decelerate...
-and hit its lowest in nearly a year...
- ...driving cautious optimism that an inflection point may be building

CDN CPI m/m % NSA // y/y %, October:

Actual: 0.7 / 6.9

Scotia: 1.2 / 7.4

Consensus: 0.8 / 6.9

Prior: 0.1 / 6.9

Average 'Core' CPI ex-common: 5.1 y/y (5% prior)

Which set of inflation readings one focuses upon can lead to divergent opinions on what they mean to markets and monetary policy, but the one number that I think is the most telling continues to *tentatively* point to disinflationary pressures at the margin. I'll come back to that one measure in a moment after highlighting the implications to the BoC.

THE 8TH INNING FOR RATE HIKES

When combined with the fact that Governor Macklem has chosen to downplay wage growth—at least for now—the result may net out to support a further downshifting in the pace of rate hikes at the December meeting and more cautious guidance toward a coming pause. There are still major uncertainties overhanging the inflation picture into 2023 such as the need to open up slack in the economy and labour market compared to little to no real evidence this is happening to date and in order to sustainably drive inflation toward target. There is also the risk that if weakness in 2023 proves to be transitory and minor in nature as the BoC appears to think then it may face the risk of prematurely declaring victory. For now, however, the BoC is likely to be further encouraged by the evidence.

Additional factors inform this perspective in what is probably the 8th inning for near-term policy tightening. The BoC is increasingly pivoting away from rapid tightening into restrictive territory toward a more measured approach to the lagging effects of cumulative changes to date alongside rapidly shrinking its balance sheet. Its reaction function is also more muddled given changes to its new inflation targeting agreement with the Federal government last December that kept the 2% inflation target but mixed in muddled language on maximum sustainable employment. As written in my Global Week Ahead, I think new information in Macklem's speech last week can be interpreted to mean a willingness to rise in the upper-half of the flexible inflation target range of 1–3% if pushing it lower were to mean weaker employment. Peak concerns about a weakening currency and potential inflationary implications have also eased over the past month via the 5–6 cent appreciation in the C\$ in part a function of broad USD movements.

PICK WISELY AMONG MEASURES OF 'CORE' INFLATION

Relative weakness in underlying price pressures is best indicated by traditional core CPI ex-food and energy that was up by only 0.2% m/m SA. That's the lightest reading since November 2021. The annualized rate of 2.5% m/m SAAR converts to 3.7% on a three-month moving average basis which isn't exactly a light trend, but continues the deceleration since May. This is the deceleration shown in chart 1. The usual caution applies in that more data is required, but we're on the right path with greater evidence now than at any other point in quite some time.

That interpretation may be different compared to what are likely inferior measures of core inflation. The average of the two central tendency inflation readings—weighted median

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and trimmed mean—ticked up to 5.1% y/y from 5.0% which could be interpreted as ongoing pressure upon core inflation (chart 2). This reading has nevertheless been stuck at 5.0–5.2% y/y since May.

The problem with these latter measures is that they turn too slowly as they are different approaches to tracking central tendency price pressures on a monthly compounded basis over the past year. They are not spot year-over-year calculations, but since they drop the earliest month and add in the latest month in a rolling set of calculations that take into account revised estimates along the way over a full year's worth of data they will never provide the same degree of information at a potential inflection point for inflationary pressures as a purer and simpler m/m ex-food and energy price measure. This is a major shortcoming to the BoC's roll-out of these over-complicated measures several years ago.

DRIVERS AND DETAILS

Headline inflation landed at 0.7% m/m on a seasonally unadjusted basis and the year-over-year rate held at 6.9%. Seasonally adjusted prices were up 0.6% m/m. On the surface, that looks like a hot set of price pressures.

The rub lies in the lack of breadth. Strip out food and energy and prices were little changed (0.2% m/m SA). Gasoline's 9.2% m/m NSA (9.5% SA) rise added about 0.4 pts to m/m price pressures which was in line with my tracking. Food's 16% weight added a generously round 0.1 pts to m/m SA prices.

Chart 3 shows services price inflation has noticeably ebbed compared to prior months in m/m NSA terms. Goods price inflation accelerated but goods ex-food and energy has decelerated from earlier peaks.

House price inflation is ebbing (chart 4). Canada captures housing very differently compared to the way the US does by using the house only component of the new house price index as the driver to replacement cost within shelter costs. Replacement cost fell –0.1% m/m SA. This involves a much lower weight than how the US captures housing inflation with a different methodology that uses owners' equivalent rent.

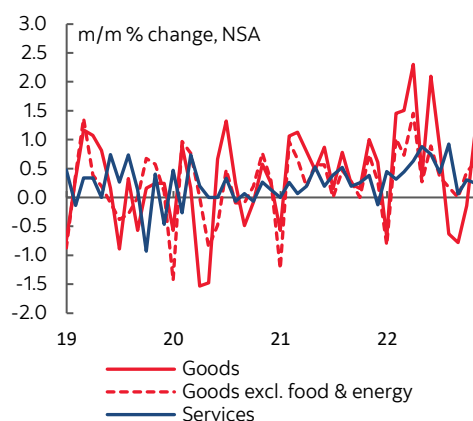
Restaurant price inflation remains elevated (chart 5).

Airfare inflation has sharply ebbed more toward seasonal norms (chart 6).

Chart 7 shows the m/m changes in prices in seasonally unadjusted terms across the basket and chart 8 does likewise by weighting the components' contributions to inflation. Charts 9 and 10 do likewise in y/y terms.

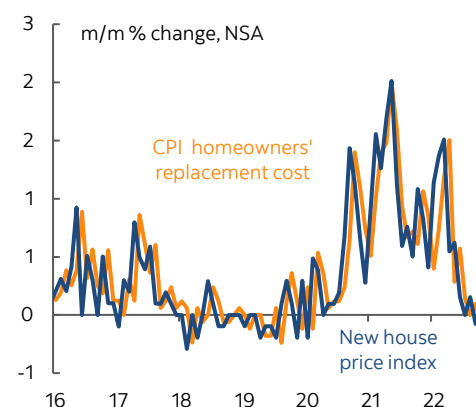
Also please see the accompanying table that provides a more detailed breakdown of the components including micro charts and 'z-score' measures of deviations from past multi-year trends.

Chart 3
Canadian Goods & Services Inflation



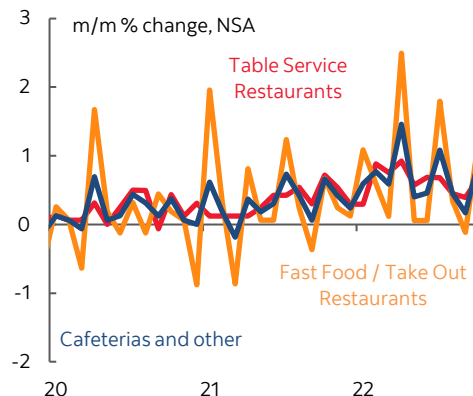
Sources: Scotiabank Economics, Statistics Canada.

Chart 4
Housing's Inflation Factor



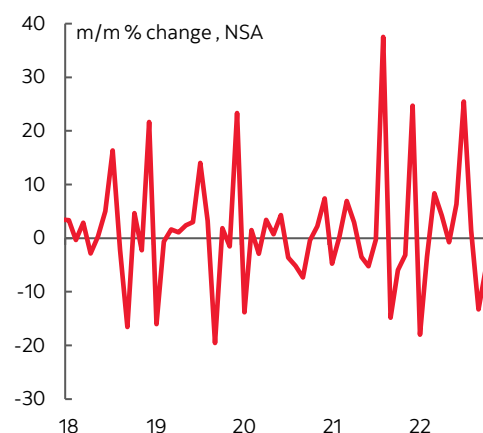
Sources: Scotiabank Economics, Statistics Canada.

Chart 5
Food Purchased from Restaurants Inflation



Sources: Scotiabank Economics, Statistics Canada.

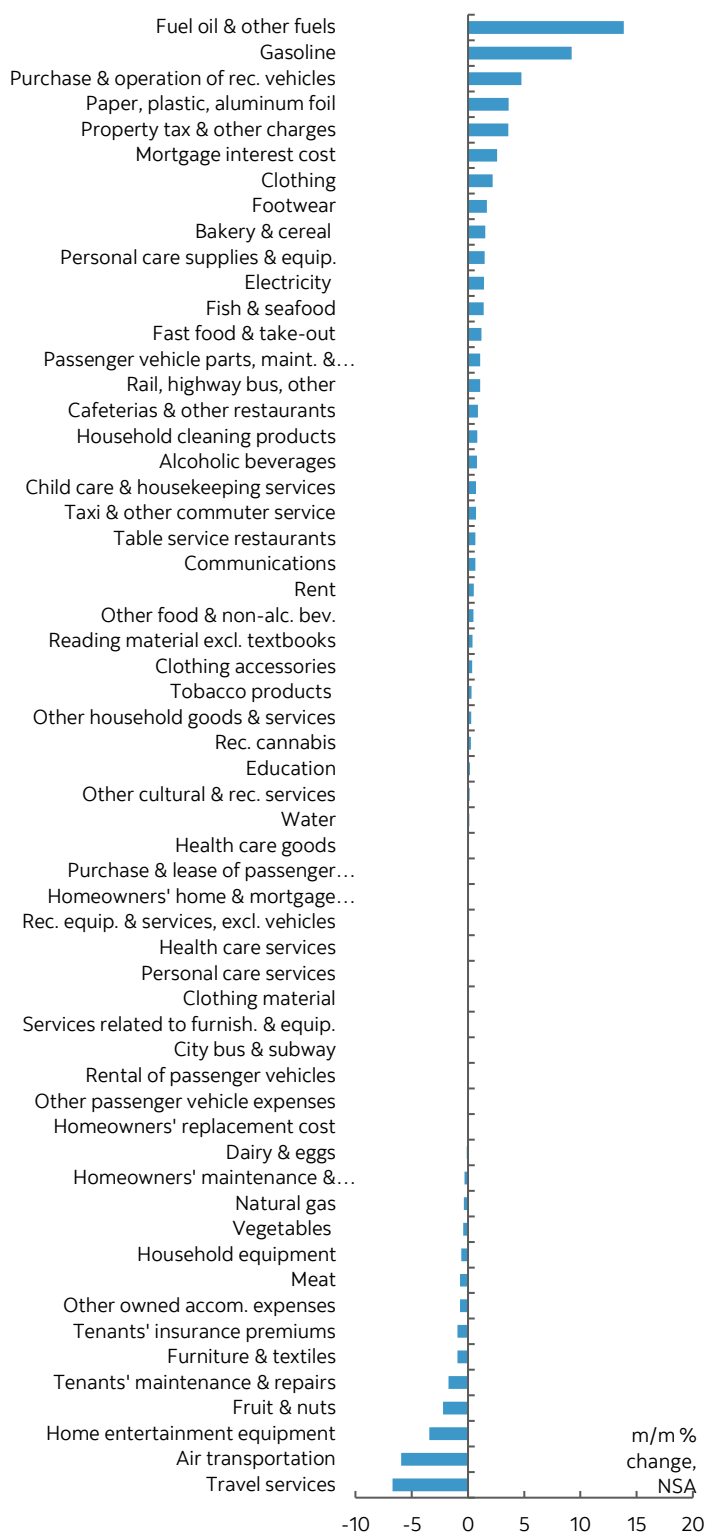
Chart 6
Canadian Air Transportation CPI



Sources: Scotiabank Economics, Statistics Canada.

Chart 7

October Detailed Category Monthly Change in Canadian CPI



Sources: Scotiabank Economics, Statistics Canada.

Chart 8

October Detailed Category Contributions to Monthly Change in Canadian CPI

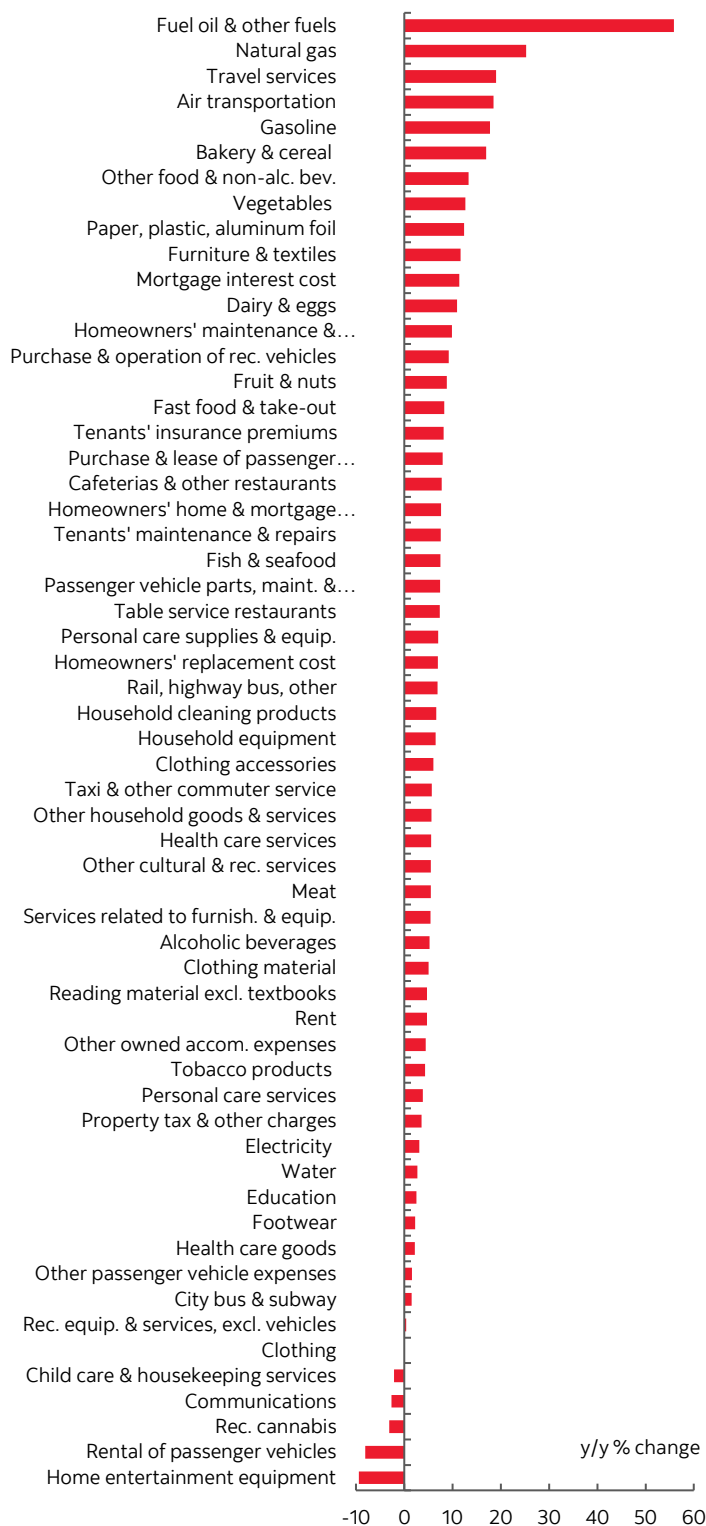


Sources: Scotiabank Economics, Statistics Canada.

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Chart 9

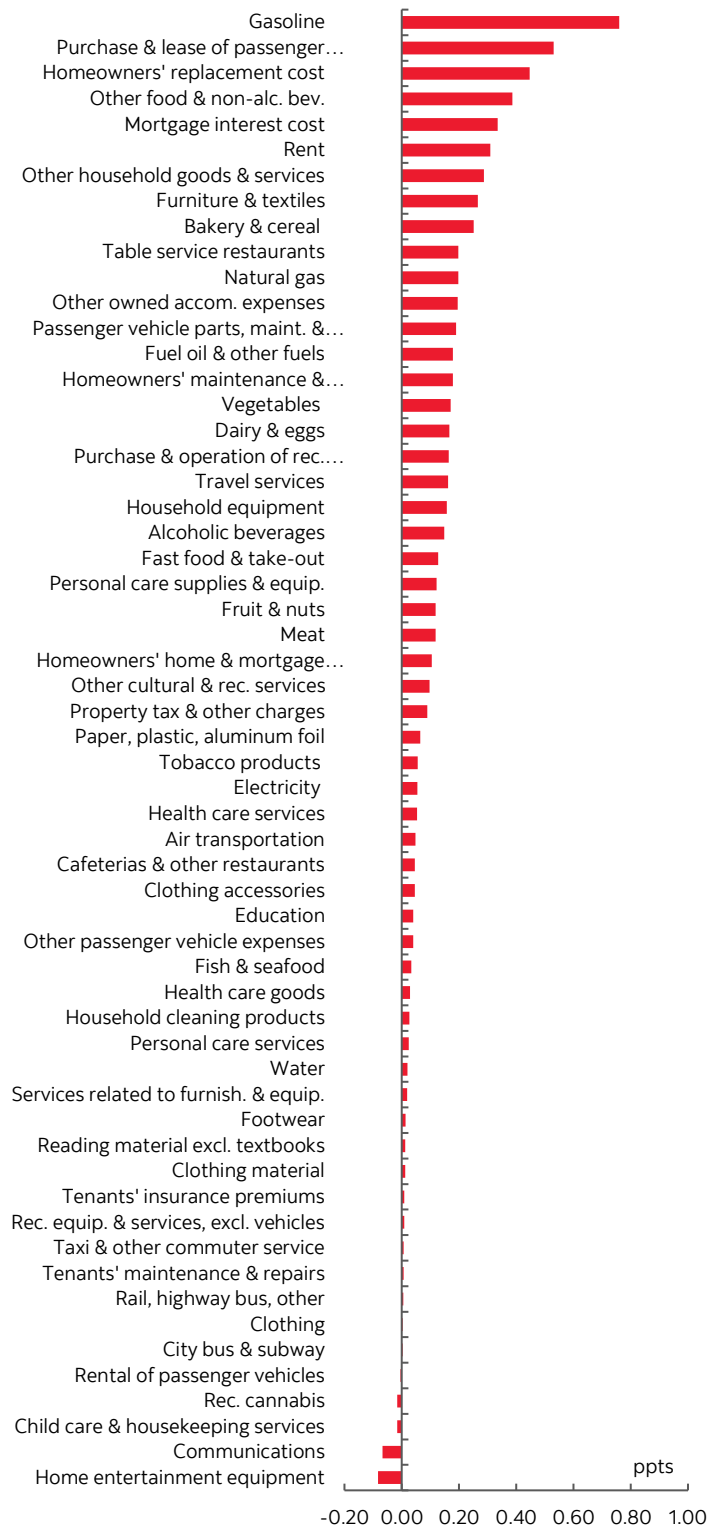
October Detailed Category 12-Month Change in Canadian CPI



Sources: Scotiabank Economics, Statistics Canada.

Chart 10

October Detailed Category Contributions to 12-Month Change in Canadian CPI




















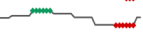



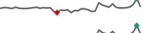

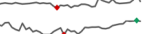





















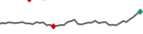


















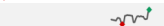



Sources: Scotiabank Economics, Statistics Canada.

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Oct 2022						Weighted Contributions (ppts)*			5-Year Pre-Pandemic			10-Year Pre-Pandemic		
CA INFLATION COMPONENT BREAKDOWN	y/y % change	10-year trend	Pandemic trend (Jan 2019–Present)	m/m % change, NSA	m/m % change, SA**	Weights (%)	y/y	m/m	2015–2019 avg. y/y	Std. Dev.	Z-Score	2011–2019 avg. y/y	Std. Dev.	Z-Score
Food	10.1			0.2	0.4	15.94	1.60	0.04	2.1	1.7	4.6	2.2	1.5	5.4
Food, stores	11.0			-0.1		11.14	1.23	-0.01	1.7	2.4	3.8	2.0	2.0	4.5
Meat	5.5			-0.7	-0.5	2.14	0.12	-0.02	2.5	3.6	0.8	3.4	3.6	0.6
Fish & seafood	7.5			1.4	0.8	0.44	0.03	0.01	2.9	1.4	3.2	2.8	2.5	1.9
Dairy products & eggs	10.9			-0.1	0.7	1.52	0.17	0.00	0.2	1.5	7.0	0.6	1.5	6.9
Bakery & cereal products	16.9			1.5	1.0	1.48	0.25	0.02	0.5	2.1	7.9	1.2	2.3	6.7
Fruit, fruit prep. & nuts	8.8			-2.2	-1.3	1.34	0.12	-0.03	1.8	4.4	1.6	2.0	3.5	1.9
Vegetables & vegetable prep.	12.7			-0.4	0.5	1.35	0.17	-0.01	4.9	6.4	1.2	3.6	5.8	1.6
Other food & non-alcoholic beverages	13.3			0.5	0.7	2.91	0.39	0.01	1.0	1.5	8.0	1.3	1.7	6.9
Food, restaurants	7.7			0.9		4.80	0.37	0.04	3.0	0.7	7.1	2.6	0.7	7.1
Table service restaurants	7.4			0.7		2.68	0.20	0.02	2.9	0.6	8.2	2.6	0.6	7.5
Fast food & take-out	8.3			1.2		1.54	0.13	0.02	3.2	1.2	4.2	2.6	1.2	4.9
Cafeterias & other restaurants	7.8			0.9		0.58	0.05	0.01	3.0	0.6	7.6	2.6	0.7	7.3
Shelter	6.9			0.8	0.8	29.80	2.07	0.23	1.8	0.6	8.8	1.7	0.8	6.7
Rented accomm.	4.7			0.4		6.77	0.32	0.03	1.3	0.8	4.3	1.3	0.6	5.7
Rent	4.7			0.5		6.57	0.31	0.03	1.3	0.8	4.2	1.3	0.6	5.6
Tenants' insurance premiums	8.1			-0.9		0.11	0.01	0.00	1.1	1.6	4.4	0.3	1.6	4.8
Tenants' maintenance & repairs	7.5			-1.7		0.08	0.01	0.00	2.2	1.0	5.1	2.6	2.2	2.3
Owned accomm.	6.8			0.6		19.46	1.31	0.13	2.3	0.4	10.5	1.7	0.8	6.1
Mortgage interest cost	11.4			2.6	2.6	2.94	0.34	0.08	2.1	3.6	2.6	-0.1	3.6	3.2
Homeowners' replacement cost	6.9			-0.1	-0.1	6.44	0.45	-0.01	1.9	1.7	3.0	2.1	1.5	3.2
Property tax & other charges	3.6			3.6	1.9	2.47	0.09	0.09	2.4	0.6	2.1	2.8	0.7	1.2
Homeowners' home & mortgage insurance	7.6			0.0	0.0	1.37	0.10	0.00	5.2	2.3	1.0	4.5	2.6	1.2
Homeowners' maintenance & repairs	9.8			-0.3	-0.3	1.81	0.18	-0.01	2.0	1.1	7.0	2.0	1.4	5.4
Other owned accommodation expenses	4.4			-0.7	-0.3	4.43	0.20	-0.03	2.0	1.2	2.0	2.4	2.0	1.0
Water, fuel, & elec.	12.0			1.8		3.57	0.43	0.06	0.8	2.1	5.3	2.5	3.4	2.8
Electricity	3.1			1.4	1.4	1.75	0.05	0.03	1.2	4.4	0.4	2.5	3.8	0.2
Water	2.7			0.1	0.2	0.72	0.02	0.00	3.7	0.9	-1.1	4.9	1.4	-1.5
Natural gas	25.3			-0.4	-0.4	0.78	0.20	0.00	-1.3	9.0	2.9	0.4	10.6	2.3
Fuel oil & other fuels	55.9			13.8	13.9	0.32	0.18	0.04	-0.1	15.5	3.6	5.1	14.2	3.6
Household operations, furniture & equipment	5.1			0.2	0.1	14.50	0.73	0.02	1.2	1.0	3.7	1.4	0.9	4.1
Household ops.	3.2			0.7		9.30	0.29	0.07	1.3	1.1	1.6	2.1	1.3	0.9
Communications	-2.6			0.7	0.7	2.54	-0.07	0.02	0.0	2.8	-1.0	1.5	2.9	-1.5
Child care & housekeeping services	-2.1			0.7	0.3	0.76	-0.02	0.01	3.4	1.4	-4.0	3.3	1.3	-4.1
Household cleaning products	6.6			0.8	-0.7	0.40	0.03	0.00	1.3	1.9	2.8	0.8	1.9	3.0
Paper, plastic, aluminum foil	12.4			3.6	1.7	0.52	0.06	0.02	2.2	2.2	4.6	2.0	2.0	5.3
Other household goods & services	5.6			0.3	0.4	5.11	0.29	0.01	1.8	0.5	8.0	2.4	1.1	3.0
Household furnishings & equip.	8.8			-0.7		5.20	0.46	-0.04	0.8	1.7	4.7	0.1	1.6	5.4
Furniture & textiles	11.7			-0.9		2.28	0.27	-0.02	0.4	2.1	5.3	-0.3	2.1	5.6
Household equipment	6.5			-0.6	0.1	2.42	0.16	-0.01	0.9	1.7	3.3	0.0	1.8	3.5
Services related to furnishings & equipment	5.4			0.0	0.3	0.35	0.02	0.00	2.4	1.8	1.6	2.7	2.9	0.9
Clothing & footwear	1.8			1.7	0.3	4.3	0.08	0.07	0.6	1.2	1.0	0.3	1.4	1.0
Clothing	0.1			2.2	0.3	2.73	0.00	0.06	0.5	1.6	-0.2	-0.3	2.1	0.2
Footwear	2.2			1.7	0.2	0.57	0.01	0.01	0.4	1.2	1.6	0.1	1.4	1.5
Clothing accessories	6.0			0.4		0.75	0.05	0.00	1.0	1.8	2.8	2.3	2.6	1.4
Clothing material	5.0			0.0		0.23	0.01	0.00	2.2	0.7	4.2	2.7	1.2	2.0

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Transportation	9.5			2.2	1.6	16.9	1.60	0.37	1.7	3.1	2.5	2.3	3.0	2.4
Private trans.	9.4			2.5		16.1	1.52	0.39	1.3	3.2	2.5	2.2	3.2	2.3
Purchase, lease, rental of passenger vehicles	7.9			0.1		6.71	0.53	0.01	2.3	1.5	3.7	1.9	1.6	3.7
Purchase & lease of passenger vehicles	8.0			0.1		6.65	0.53	0.01	2.3	1.5	3.8	1.9	1.6	3.7
Rental of passenger vehicles	-8.1			0.0	0.4	0.06	0.00	0.00	1.4	5.2	-1.8	1.2	4.1	-2.3
Operation of passenger vehicles	10.6			4.2		9.37	0.99	0.39	0.7	5.7	1.7	2.4	5.4	1.5
Gasoline	17.8			9.2	9.5	4.28	0.76	0.39	-0.6	13.5	1.4	3.0	12.2	1.2
Passenger vehicle parts, maintenance & repairs	7.4			1.1	0.5	2.56	0.19	0.03	1.9	0.3	16.0	1.6	0.8	7.5
Other passenger vehicle expenses	1.6			-0.1	0.0	2.53	0.04	0.00	2.4	2.2	-0.4	2.6	2.0	-0.5
Public trans.	10.7			-2.7		0.82	0.09	-0.02	4.8	3.9	1.5	3.4	3.7	2.0
Local & commuter transportation	3.4			0.3	0.2	0.28	0.01	0.00	1.5	0.5	3.9	2.2	1.2	1.0
City bus & subway	1.5			0.0		0.17	0.00	0.00	2.1	0.7	-0.8	2.8	1.4	-0.9
Taxi & other commuter service	5.7			0.7		0.11	0.01	0.00	0.1	0.8	6.9	0.9	1.2	4.0
Inter-city transportation	16.4			-4.8	-6.5	0.37	0.06	-0.02	6.2	5.7	1.8	3.9	5.8	2.2
Air transportation	18.5			-5.9		0.26	0.05	-0.02	6.5	6.2	1.9	4.0	6.4	2.3
Rail, highway bus, other	6.9			1.1		0.07	0.00	0.00	2.7	1.8	2.4	2.0	4.2	1.2
Health & personal care	4.9			0.6	0.5	4.62	0.2	0.03	1.4	0.4	8.7	1.3	0.9	4.2
Health care	3.6			0.1		2.26	0.1	0.00	1.3	0.6	3.9	1.1	0.8	3.0
Health care goods	2.2			0.1	0.1	1.31	0.0	0.00	0.5	0.7	2.4	-0.1	1.1	2.1
Health care services	5.5			0.0	0.3	0.96	0.1	0.00	2.5	0.6	5.5	2.9	0.8	3.4
Personal Care	6.2			1.1		2.36	0.1	0.03	1.5	0.5	8.8	1.5	1.2	4.1
Personal care supplies & equipment	7.0			1.5	0.8	1.72	0.1	0.03	0.4	0.9	7.0	0.5	1.6	4.0
Personal care services	3.8			0.0	0.2	0.64	0.0	0.00	2.9	0.7	1.3	2.7	1.4	0.8
Recreation, education & reading	4.1			-0.2	0.4	9.29	0.4	-0.01	1.7	0.8	3.1	1.3	0.9	3.3
Recreation	4.5			-0.27		7.43	0.33	-0.02	1.4	1.0	3.0	0.6	1.2	3.1
Recreational equipment & services, excl. vehicles	0.4			0.0	-0.5	2.18	0.0	0.00	-0.8	1.6	0.8	-2.2	2.0	1.3
Purchase & operation of recreational vehicles	9.2			4.8	4.4	1.78	0.2	0.08	2.6	1.8	3.6	1.9	2.0	3.8
Home entertainment equipment	-9.4			-3.4	-6.5	0.88	-0.1	-0.03	-3.8	2.0	-2.8	-4.9	2.2	-2.1
Travel services	19.0			-6.7	-1.2	0.85	0.2	-0.06	0.8	2.9	6.2	0.4	2.8	6.6
Other cultural & rec. services	5.5			0.1	0.0	1.75	0.1	0.00	3.5	1.1	1.9	3.4	1.4	1.6
Educ. & reading	2.8			0.23		1.86	0.05	0.00	2.5	1.4	0.2	3.0	1.1	-0.1
Education	2.5			0.2	0.2	1.60	0.0	0.00	2.4	1.4	0.1	3.0	1.2	-0.4
Reading material excl. textbooks	4.7			0.4	0.4	0.26	0.0	0.00	3.8	2.8	0.3	3.2	2.9	0.5
Alcoholic beverages, tobacco & rec. cannabis	4.1			0.6	0.5	4.63	0.2	0.03	3.2	1.2	0.9	2.7	1.3	1.1
Alcoholic beverages	5.2			0.79		2.83	0.15	0.02	1.7	0.5	6.7	1.4	0.7	5.2
Alc. beverages served in licensed establishments	3.7			0.0	0.2	0.67	0.0	0.00	1.8	0.6	3.1	2.0	0.7	2.5
Alc. beverages purchased from stores	5.7			1.1	0.7	2.16	0.1	0.02	1.7	0.7	6.2	1.1	1.1	4.3
Tobacco products	4.3			0.32		1.28	0.06	0.00	5.6	2.1	-0.6	4.8	2.8	-0.2
Cigarettes	4.4			0.4		1.16	0.1	0.00	5.6	2.1	-0.6	4.8	2.8	-0.2
Other tobacco products & supplies	3.6			-0.4		0.11	0.0	0.00	5.6	2.0	-1.0	4.9	2.6	-0.5
Rec. cannabis	-3.1			0.27		0.50	-0.02	0.00						

*Number may not add due to rounding

** Only available for components that are tracked on a seasonally adjusted basis.

Sources: Scotiabank Economics, Statistics Canada.

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