Inflation rises unexpectedly despite lower gas prices

HIGHLIGHTS

- The total consumer price index (CPI) rose 0.1% in October.
- The main components contributing to the rise are new autos (+2.0%), property taxes (+2.2%), footwear (+4.6%), air transport (+2.4%) and furniture (+2.0%).
- In contrast, the main components negatively contributing to the monthly change in total CPI are gas (-4.0%), traveller accommodations (-7.2%), fresh vegetables (-2.3%), alcoholic beverages (-2.8%) and dairy products (-0.8%).
- The total annual inflation rate went from 2.0% to 2.4%.
- The Bank of Canada’s core index (CPIX), which excludes eight volatile components, advanced 0.3% in October. Its annual change rose to 2.3%, compared with 2.1% in September.

COMMENTS

The increase in total CPI seen in October is really surprising, as all signs pointed to a decrease. Not only had gas prices fallen significantly based on preliminary data, but seasonal effects typically trim 0.2% off the monthly change in CPI in October.

However, gas prices fell less sharply than expected, and the negative impact this had on total CPI was almost completely offset by an increase in new auto prices. In addition, the seasonal jump in the price of clothing and footwear was nearly twice as large as is normal for October. As such, the overall impact of seasonal fluctuations on total CPI was zero instead of the 0.2% drop normally recorded at this time of year.

It is clear that CPIX’s progression continues to be relatively high, increasing an average of 0.3% month over month since the beginning of the year. Annualized, this corresponds to a gain of 3.7%. Under these circumstances, it is not surprising to see the annual change in the CPIX go from 1.3% in December 2013 to 2.3% in October 2014, and our projections indicate that it could reach 2.5% by the end of the year. Remember that the Canadian dollar’s depreciation is currently putting upside pressure on the prices of imported goods and services. Some calm is nonetheless expected in 2015, when the CPIX’s annual change could reach the median target (2%) thanks to the disappearance of certain temporary factors.

Implications: With total inflation at 2.4% and core inflation at 2.3%, the overall picture shows that price growth is higher than expected across the country. Clearly, the upside risks in growing inflation are mounting, a situation that Canadian monetary authorities must take into consideration. In the short term, persistent uncertainty as to the economic outlook calls for maintaining the status quo on key interest rates. However, it is clear that the situation with inflation must be monitored closely in the coming months.

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