Canada: Inflation Rises to the Upper Target

HIGHLIGHTS

- The total consumer price index (CPI) rose 0.5% in July.
- The total annual inflation rate rose from 2.5% to 3.0%.
- The main components that made positive contributions to the change in the total CPI are air transportation (+16.4%), tour packages (+13.9%), telephone services (+2.2%), gas (+0.8%) and fresh fruit (+3.4%).
- Quebec continues to stand out with the weakest inflation in the country, at 2.4% in July.

COMMENTS

Big surprise this morning, with inflation rising far above expectations. On the one hand, seasonal price fluctuations moved in the opposite direction from what we usually see at this time of the year. While a seasonal price drop of about 0.1% is usually recorded, July 2018 ended with an uptick of about 0.1% instead. The biggest divergence was in transportation, where the seasonal price decline failed to materialize.

On the other, the seasonally adjusted total CPI, which provides a better snapshot of the underlying trend in inflation, accelerated sharply in July after four months of weak growth. However, this type of blip in this measure is quite common. This means we have to be cautious before concluding that this is the result of stronger inflation pressures. In fact, the average annual growth of the Bank of Canada’s benchmark indexes stayed put at 2.0%.

IMPLICATIONS

Even if July’s surge in inflation is mostly due to one-time factors, the damage has been done. The total annual inflation rate rose to 3.0%—the top of the Bank of Canada’s target range. In these conditions, the monetary authorities clearly have less wiggle room in which to manage the monetary policy. That said, our forecasts show that total inflation may have reached a plateau, as the impact of lower electricity rates in Ontario have completely disappeared from the annual change. Under the circumstances, the Bank of Canada should be able to wait until October to raise its key interest rates.

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