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Canadian January CPI Report - Refreshing Signs of Normalization, Further Progress Required

Since the Bank of Canada ended its tightening cycle in July of last year with a 5% overnight rate target, consumer prices have stabilized. The stagnation continued in January as total CPI remained unchanged from the previous month. Total CPI inflation is still positive at 2.9%, as prices rose briskly during the first half of 2023. A 2.9% reading, below the 3% psychological mark, will facilitate the normalization of consumer inflation expectations. At the same time, a 2.9% figure is too high for the Bank of Canada targeting 2%.

Not coincidentally, the latest Canadian Federation of Independent Businesses (CFIB) survey reveals a price increase intention below 3% (2.8%) for the first time since the Spring of 2021 as well. Accordingly, the most compelling progress in this CPI report relates to tamer underlying inflation. Indeed, less than half of CPI items have registered a price increase of 3%+ for the first time since the Spring of 2021. This broader disinflation and progressing normalization in the behaviour of consumers and companies have brought down the two less noisy core CPI metrics significantly. The 3-month annualized figures plunged to 3.3% for core CPI-median and 3.2% for core CPI-trim.

Given the economic underperformance of the Canadian economy relative to the United States, it makes sense to see CPI inflation running slower than south of the border despite our productivity woes and the unfortunate presence of a chronic housing supply shortage. For instance, in January, shelter costs continued to rise at a fast pace. Food costs also increased. Furthermore, several crown corporations and private companies raised utility rates, leading Canadians to pay more for water and electricity. But lower prices for other forms of energy and a plunge in travel costs after the busy holiday period contributed to keeping total CPI in check.

Looking ahead, the surge in transportation costs for containers between Asia and North America, which has remained elevated as of mid-February after the January surge according to the Drewry world container index, is poised to prevent further progress in the next two months. We see Canadian total CPI inflation close to 3% for the rest of the Winter. Then, if the excess supply situation of the Canadian economy cools down CPI inflation during the Spring, BoC officials will be in a favorable spot to debate between maintaining the policy rate at 5% and beginning a prudent easing cycle to prevent over-tightening. Accordingly, we continue to forecast the first 25bps policy rate cut at the June meeting.

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