Canada's inflation rate rises to 4% in August, putting pressure on BoC

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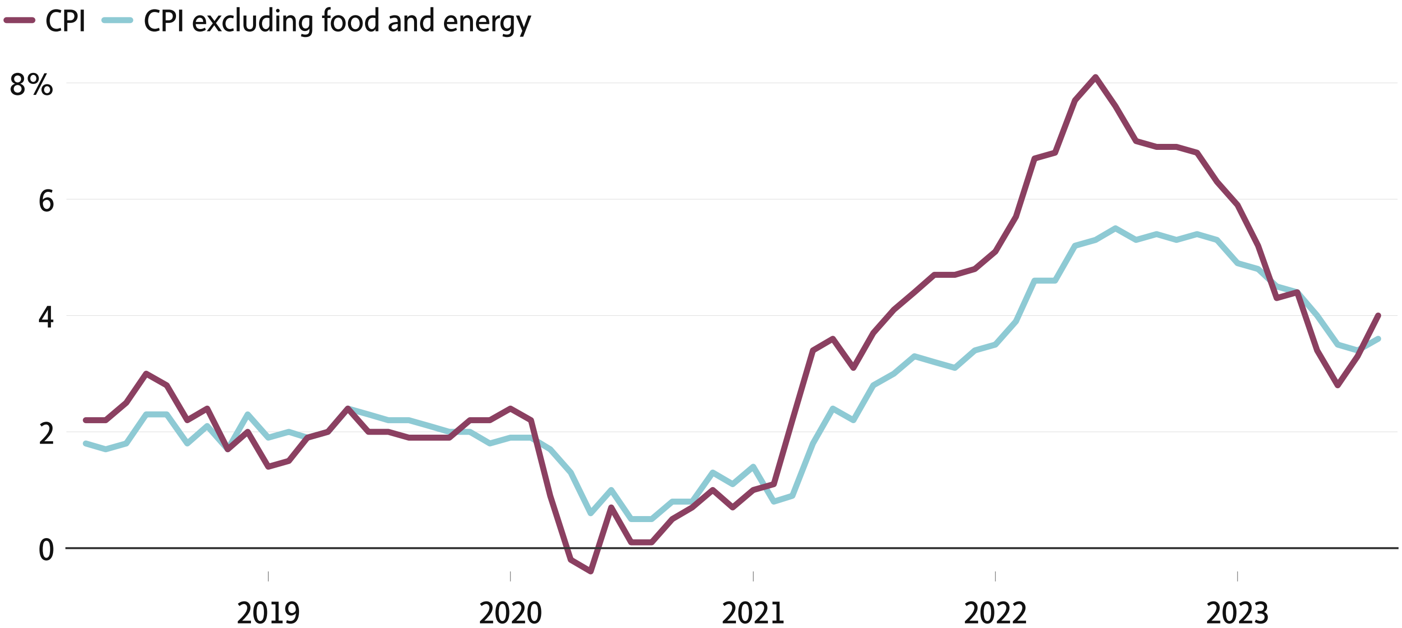
Consumer Price Index (CPI) and CPI excluding food and energy
12-month percentage change



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Canada's annual inflation rate accelerated sharply for the second month in a row, raising the odds that the Bank of Canada could deliver at least one more interest rate increase this year despite hitting pause on monetary policy tightening earlier this month.

The Consumer Price Index rose 4 per cent in August from a year earlier, up from 3.3 per cent in July and the highest annual inflation rate since April, Statistics Canada said Tuesday. Bay Street analysts were expecting inflation to clock in at 3.8 per cent.

The larger-than-expected increase was driven by gasoline prices, which have surged in recent months after oil-production cuts by Saudi Arabia and Russia. But it was more than just energy prices pushing up headline inflation.

Shelter costs accelerated for both renters and homeowners facing higher mortgage payments. While grocery prices grew less quickly in August than in July, food inflation remains far above most other components of the Consumer Price Index.

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Tony Keller: The Trudeau government has two plans for lower grocery prices. One is for show. The other is real

Most worrying for the Bank of Canada: Measures of core inflation, which filter out volatile price movements to capture underlying trends, moved markedly higher. The average of the central bank's two preferred core inflation metrics hit 4 per cent in August, up from 3.75 per cent in July. That's twice the central bank's 2-per-cent inflation target.

"Underlying inflation is still well above the level that would be consistent with achieving our target," Bank of Canada deputy governor Sharon Kozicki said in a speech Tuesday, where she reiterated that the central bank was prepared to raise interest rates further if inflation remains stubbornly high. The next rate decision is on Oct. 25.

Earlier this month, the central bank held its key interest rate steady after a string of data suggested economic growth had begun to stall in Canada. The bank has raised interest rates 10 times since March, 2022, pushing its policy rate to 5 per cent, the highest level since 2001. Higher interest rates make it more expensive for individuals and businesses to borrow money and service their debts, with the goal of reducing spending and curbing upward pressure on consumer prices.

Ms. Kozicki said there are signs that higher interest rates are working, and that "past increases in interest rates will continue to weigh on activity." But she said the central bank is facing a fine balance: "We know that if we don't do enough now, we will likely have to do even more later. And that if we tighten too much, we risk unnecessarily hurting the economy."

Interest-rate swap markets, which capture market expectations about future Bank of Canada decisions, are now pricing in around a 40-per-cent chance of another quarter-point rate hike in October, according to Refinitiv data. Before Tuesday, market odds of another rate hike were about one in five.

"We all knew that the extended back-up in gasoline prices was going to be a headache for headline CPI and inflation expectations, but the inconvenient truth is that core has suddenly heated up as well," Bank of Montreal chief economist Douglas Porter said in a note to clients. "There's still lots of data to go before the bank next decides on rates … including another swing at the CPI. Unfortunately, we suspect that with oil firing higher and core inflamed again, that report will be no better than today's."

Government eyes bringing food prices in line with general inflation

Inflation has come down considerably over the past year, after hitting a four-decade high of 8.1 per cent last June. But the August inflation numbers show that prices for a broad range of goods and services continue to rise rapidly, undermining Canadians' purchasing power and adding to widespread affordability concerns.

This has made inflation a red-hot topic in Ottawa, where the federal government is being criticized by opposition parties for not doing enough to get prices under control. Last week, Prime Minister Justin Trudeau announced a suite of measures aimed at improving affordability, which included cutting the goods and services tax on rental-housing construction and enhancing the powers of the Competition Bureau.

The government also summoned grocery chain executives to Ottawa on Monday to discuss lowering food prices. The government threatened them with unspecified "tax measures" if they don't stabilize food prices, and on Tuesday, Innovation Minister François-Philippe Champagne said Ottawa intends to "go after" large food manufacturers as well.

Food was actually one of the few bright spots in the August inflation data. Annual grocery price inflation fell to 6.9 per cent from 8.5 per cent in July. On a monthly basis, grocery prices were down 0.4 per cent. Prices for fruit, cereal and chicken rose at a slower year-over-year pace than in July; prices for frozen beef, coffee and tea and sugar and confectionery rose more rapidly.

Prices for other essentials, however, are moving in the wrong direction. Gasoline, which had previously helped pull the annual inflation rate lower as prices were compared favourably with the sky-high prices after Russia's invasion of Ukraine in early 2022, is once again adding to inflation. Gas prices were up 0.8 per cent compared with last August and 4.6 per cent compared with the previous month.

Meanwhile, annual rent inflation came to 6.5 per cent in August, compared with 5.5 per cent in July. Rents are rising rapidly for several reasons. Higher interest rates are making it harder for families to buy homes, leaving more households in the rental market and boosting demand for units, Statscan noted. Some landlords may also be pushing up prices to deal with their own rising mortgage costs.

Mortgage interest costs, which have risen alongside the Bank of Canada's interest rate increases, remain the single biggest driver of CPI inflation. They were up 30.9 per cent in August compared with a year before, which is a touch higher than in July.

The prominence of mortgage interest costs in CPI inflation has led some politicians to blame the Bank of Canada itself for driving inflation. Bank officials disagree. "It's true that if we hadn't raised interest rates, mortgage costs might be lower today, but inflation throughout the economy would be a much bigger problem for everyone," Bank of Canada Governor Tiff Macklem said in a speech two weeks ago.

The August inflation data jarred financial markets, as traders dashed to price in the possibility that interest rates may move higher and stay high longer. Yields on two-year Government of Canada bonds jumped to 4.9 per cent, exceeding highs reached in July.

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