

# The BoC will need to up the ante as inflation heats up in Canada

22nd June 2022

**Speculation over a 75 basis point hike from the Bank of Canada at their July 13th meeting was rife heading into today's CPI report, purely due to the fact that the US Federal Reserve conducted an interest rate hike of that magnitude last week.**

With inflation ramping up from 6.8% to 7.7% YoY in May and price pressures remaining broad as measured by the composite core measure that ticked up from 4.43% to 4.73%, that debate is surely settled. The increase in prices on a year-on-year basis was the largest since 1983, when the top radio single was "Every Breath You Take" by the Police. Without even delving into the nitty-gritty of the report, the Bank of Canada will face tremendous pressure to follow the Fed by hiking rates more aggressively due to the optics alone.

Not only did headline inflation rise substantially in May, but the pace of the increase also picked up. On a month-on-month basis, headline CPI inflation increased to 1.4%, compared with 0.6% from the month prior. While some of this can be attributed to the StatCan measure now using new CPI weightings, which have finally begun to incorporate a used cars index, these changes to the basket weights were well signalled in advance and were thus likely to have been factored into the economist median estimate that stood much lower at just 1%. While the inclusion of the new measure likely had some impact on the MoM readings, the StatCan report nevertheless highlighted that the year-on-year print of 7.7% would have been the same even without the introduction of the used car series.

**“ Much of the increase in month-on-month headline inflation was driven by higher energy costs (+8.5%), with the price of gasoline rising 12% from last month. That was largely attributable to renewed uncertainty over future global supply of oil and gas, as countries continue to debate the appropriate response to Russia over its invasion of Ukraine. ”**

The rise in gas prices was the largest monthly gain since May 2020, when oil prices started to recover from the Covid recession. Compared with last May, Canadian consumers are paying 48% higher prices at the pump. According to Gasbuddy, the average price paid for a litre of gas was \$1.94 in May.

Food prices, which have been another major driver of the inflation over the last year, picked up by another 0.8%

this month. Although this is dwarfed by the rise in other prices within the consumption basket, it is still roughly 4x the rate consistent with at-target inflation. Looking at the YoY figures, food inflation has reached 8.8%, 1.1pp higher than the headline figure. Prices for groceries in general remained elevated at 9.7% YoY. More worryingly, shelter costs rose by 1.1% MoM, bringing the annual increase to 7.4%.

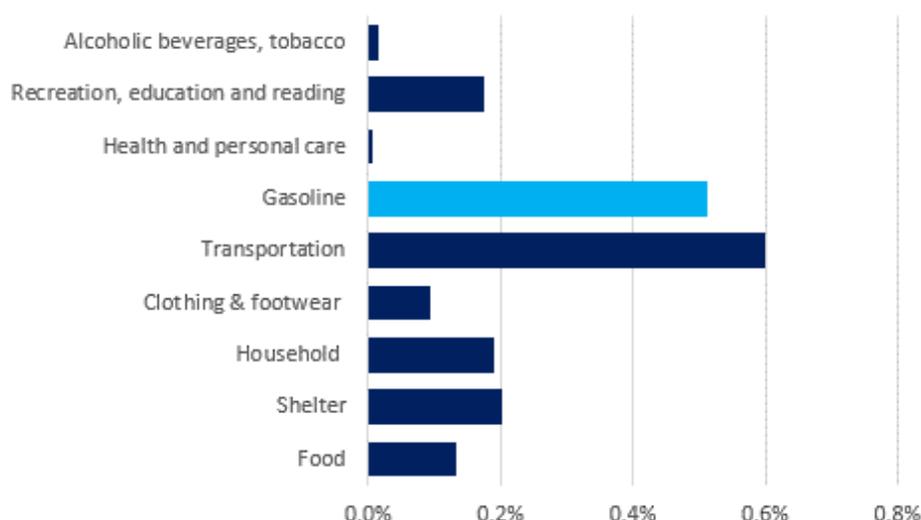
“ *With shelter inflation being one of the stickiest components in the consumption basket, the large rise suggests that the peak in inflation may not have arrived just yet.* ”

Looking to the split between goods and services, which has been a major story ever since the pandemic forced a rotation in consumption away from services and towards goods, goods (+2.1%) continued to lead the charge, with the biggest increase coming from non-durables (+2.8%). Services nevertheless chugged along, rising by 0.7% MoM. That increase brought the year-on-year growth rate to 5.2%, up from 4.6%. Services are a better gauge of domestic demand-driven inflation than goods because they are less intertwined with global supply chains. With domestic-led inflation well above target, even if global inflation conditions were to normalise overnight, the Bank of Canada would still need to bring real interest rates into restrictive territory to bring supply and demand back into balance.

“ *For markets, the impact of today's CPI report was mired by broader concerns over global growth and the downturn in commodities.* ”

Money markets continue to price in just 70bps worth of rate hikes by the BoC next month, although should the macroeconomic backdrop stabilise in the coming days, we expect this to change. The same can be said for CAD. The near-7% drop in WTI today has more than offset the impact today's CPI report would have had, especially as global equities also tumble and Canadian government bonds remain supported by risk-averse inflows.

### Contributions to the MoM increase: prices at the pump are creating pain in the purse



Note: Gasoline is a subcomponent of the CPI Transportation series

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