Economic Commentary

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Economics

Upside surprise for already hot inflation

Canadian CPI inflation came in surprisingly high at 3.7 per cent year-over-year, compared to 3.1 per cent in June and a consensus expectation near 3.4 per cent. This was the highest print since 2003. While base year effects were a factor, prices accelerated in July with the seasonally- adjusted consumer price index (CPI) up 0.5 per cent month-to-month. Significant growth was observed among most aggregate components of the index.

Key drivers of the price acceleration included higher homeownership costs (up 5.1 per cent), driven largely by increased replacement costs (13.8 per cent from 12.9 per cent in June) as the cost of construction and home prices surged, and real estate transactions costs jumped. Fuel prices further increased from June with gasoline prices up 3.5 per cent month-to-month, but 12-month growth moderated to 30.9 per cent from 32 per cent due by a rise in prices last July. Furniture costs jumped 13 per cent, due to higher input costs and tariffs. Food prices firmed to 1.7 per cent year-over-year, with restaurant prices up 3.1 per cent. Restaurants are making up for delayed price hikes during the pandemic. Traveller accommodation costs jumped 7.4 per cent year-over-year as increased social interactions and rollback of restrictions has boosted tourism.

While headline figures are uncomfortably high, excluding food and energy, CPI inflation came in at 2.8 per cent, up from 2.2 per cent in June. The average of the Bank of Canada core measures rose from 2.3 per cent to nearly 2.5 per cent but its preferred CPI-common came in at a mild 1.7 per cent.

Inflation readings will likely be volatile going forward with upside risk. The re-opening phase is expected to lead to re-pricing of services such as costs for air travel, general tourism and food and hospitality. These increases temporary impact inflation, although price levels are permanently higher. Other pandemic factors, such as supply chain impacts from the semi-conductor industry, will put upward pressure on prices for vehicles and other electronic goods as kinks iron out over time. Housing impacts are more persistent due to higher home prices, upside for mortgage rates, and rising rents as policy induced rent freezes end.

Bryan Yu
Chief Economist
byu@central1.com / P 604.742.5346
Mobile: 604.649.7209