Economic Commentary

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Canadian inflation highest since 2003 on supply chain and re-opening shocks

Canadian consumer price inflation continued to surge in August with year-over-year growth in the consumer price index (CPI) reaching 4.1 per cent in August, up from 3.7 per cent in July and the strongest print since March 2003. Various factors continue to drive high inflation, including pandemic effects on supply chains, rising home prices, re-opening related increases and base- year effects from softer price conditions in 2020.

Large gains persisted for gasoline prices which rose 0.4 per cent from July and 32.5 per cent year-over-year which drove much of the headline gain. This largely owes to low prices that persisted into late 2020.

That said, broader inflation has increased. Excluding gasoline, CPI growth came in at 3.2 per cent, up from 2.8 per cent in July. Among other products, there are clear signs of the supply chain shocks are reverberating. Vehicle prices rose 7.2 per cent year-over-year owing to low supply as micro-chip shortages have driven prices higher. Furniture prices rose 8.1 per cent amidst high shipping costs as well as tariffs. Re-opening trends are also a factor. Increased domestic and international tourism pushed hotel prices up 19 per cent year-over-year and airfares rose 33 per cent.

On the housing front, shelter rose 0.3% from July and 4.8 per cent year-over-year. This was largely driven by home prices as homeowner replacement costs surged 14 per cent, offsetting declines in mortgage interest costs. Rent remained unchanged from July and up 1.6 per cent from a year ago. Food prices were up a relatively modest 2.7 per cent but on the rise.

The Bank of Canada’s core measures averaged nearly 2.6 per cent but its preferred core-common measures remained low at 1.8 per cent.

While inflation remains uncomfortably high, much of it remains in our view transitory. Supply chain shocks are likely to iron out and moderate price pressures, although timing is highly uncertain. Vehicle prices in the U.S. have started to ease suggesting this may be occurring already. Meanwhile, re-opening prices hikes in services sectors are likely one-off gains.

It is also worth noting that prices are not particularly high following a soft pricing environment last year. On a 2-year basis, CPI inflation came in at an annualized 2.1 per cent. Meanwhile, if a two per cent rate of inflation occurred from February 2020, CPI would roughly be where it is now.

Going forward, many of these factors will fade but there are signs that firm inflation could stick around. Housing costs are still increasing, while rental costs will pick up on higher demand and end to rent freeze policies. Labour markets remain a wild card. While there are signs of shortages, it could reflect temporary dislocation due to health fears, government income supports, and other frictions. There is little evidence of significant wage pressures at the current time that would fuel inflationary pressure.

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