Economic Commentary

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CPI inflation comes in at a hefty 4.8 per cent in December, stage is set for rate hikes ahead

Another month of red- hot inflation sets the stage for a thrilling Bank of Canada rate decision next week. Canadian CPI inflation rang in at 4.8 per cent year-over-year in December, up from 4.7 per cent in November. This was the strongest pace since 1991 but price levels were flat as seasonally- adjusted levels slip 0.1 per cent m/m.

The latest print continued to be driven by gains in gasoline prices which were up 33.3 per cent on a y/y basis despite easing from November. Consumer staples surged with food prices up 0.4 per cent (s.a.) from November and 5.2 per cent y/y, driven largely by higher grocery costs. Meat prices rose 9.0 per cent, while fruit costs surged to 5.2 per cent y/y. Shelter costs rose 0.6 per cent m/m and 5.4 per cent y/y amidst high depreciation costs (homeowners replacement of 13.6 per cent). Supply chain factors remained persistent and drove a surge in prices for household goods and appliances, with refrigerator and freezers up 14 per cent, while furniture prices gained 11 per cent from year ago. Vehicle prices rose six per cent. That said, clothing prices were unchanged. Broadly, goods prices rose 6.8 per cent and services were up 3.4 per cent.

It should be noted that COVID inspired weakness in early pandemic prices contributed to the outsized year-over- year gain. The two- year change in the CPI came in at a more modest 5.6 per cent (2.7 per cent annualized) reflecting some base year effects. Nevertheless, there is no question that inflationary pressures are hot. Excluding food and energy, prices were up 3.4 per cent y/y which was the highest since 2003 and up from 3.1 per cent in November. The Bank of Canada's three measures of core inflation all firmed during the latest month but were all over the map in magnitude. The trim measure came in at 3.7 per cent, median at 3.0 per cent and common- measure at 2.1 per cent. On average the measures came in at 2.9 per cent, which is uncomfortable but still within the Bank of Canada's target range.

Going forward, headline CPI could see another bump as oil prices have since ramped up, although Omicron health restrictions could do some damage to services- sector demand while further amplifying some goods and labour shortages. Improvement in supply chains is still anticipated to temper inflation to near two per cent in the back half of the year.

For the Bank of Canada, persistent strong CPI inflation adds to findings from its Q4 Business Outlook Survey and Canadian Survey of Consumer Expectations, which pointed to increased inflation expectations for the coming two years, increased capacity issues and rising wage expectations. Rate hikes to rein in inflation pressures are a given to curb expectations, and by extension cool an out-of- control housing market. The only question is whether the Bank hikes immediately on January 26 or use the meeting to signal a March hike and path forward. Either way, the yield curve will likely flatten rather quickly calming some of the excesses from low interest rates and contribute to slower inflation.

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