



## Headline inflation slows more than expected in August

There was a smidge of good news for Canadian households in August as headline and core inflation measures surprised on the downside. CPI inflation slowed to 7.0 per cent y/y, down sharply from 7.6 per cent in July and lower than expected. Moreover, unlike our U.S. neighbour, core measures of inflation all moved lower which should provide minor relief for the Bank of Canada as it continues to adjust monetary policy to lower excessive inflation.

August's decline in headline inflation reflected a m/m decline in prices of 0.3 per cent which was the largest decline since April 2020, although prices edged higher on a seasonally- adjusted basis. Lower CPI and decelerated y/y growth was driven by another plunge in gasoline prices of 9.6 per cent following a 9.2 per cent drop in July. Gasoline prices fell to the lowest level since February. Excluding broader energy, CPI inflation came in at 6.1 per cent which was slightly lower than in July.

While households benefitted from lower gasoline prices the hits kept on coming through at the grocery aisle. Food prices rose 0.8 per cent m/m, pushing y/y growth to 9.8 per cent and up from July. Store-bought foods jumped 1.0 per cent and 10.8 per cent y/y with meat prices up 6.5 per cent y/y, bakery and cereals products (up 15.1 per cent) and growth of more than 10 per cent for fruit and vegetables. Restaurant prices also rose holding y/y growth steady at 7.3 per cent.

Among other goods, furniture prices slipped from July but remained 12.2 per cent higher than a year ago, while clothing prices were up only 0.2 per cent from a year ago. Vehicle pricing also decelerated.

Importantly, services prices decelerated sharply with a 0.1 per cent m/m gain from 0.9 per cent in July. This was the slowest pace since November 2021. 12-month growth remained high at 5.5 per cent but moved in the right direction. Services prices are generally more persistent and tend to be more associated with core inflation and wage dynamics.

Shelter costs fell for the first time since January 2021 with a 0.1 per cent decline, and y/y deceleration to 6.6 per cent which was the lowest since February. Higher interest rates are contributing to declining shelter inflation as homeowners' replacement cost growth slowed with the downturn in the housing market, while rental accommodation retraced slightly. Shelter makes up about 30 per cent of the CPI basket weight and is important in driving inflation lower. Sharp gains in tourism-related services such as air travel and hospitality are showing signs of peaking and potentially turning.

With constructive price patterns in August, the Bank of Canada's three measures of core inflation all declined significantly which will surely moderate some market hawkishness for interest rates. That said with the lowest reading at 4.8 per cent and the preferred CPI- common at 5.7 per cent, levels are much too high and well beyond the 1-3 per cent target range. The Bank will continue to hike at its next meeting, although this reading increases the odds of 25 rather than 50 basis point increase. We continue to forecast a terminal rate of 3.75 per cent by year end.

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