ECONOMIC NEWS

Canada: Danger – Inflation Is Too Hot to Handle

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HIGHLIGHTS

- Consumer prices rose 1.4% in May, pushing the annual rate of inflation up to 7.7% from 6.8% in April.
- Notable monthly increases continued in energy (+8.5%), food (0.8%) and shelter (+0.7%).
- Excluding food and energy, prices are 5.2% higher than they were a year earlier.
- The Bank of Canada's three core measures of inflation averaged 4.7% year-over-year, up from 4.4% in April.

COMMENTS

Statistics Canada really should add a warning label to these scorching hot inflation prints. Consumer prices rose 1.4% in the month of May alone. That is more inflation than Canadians had to contend with in all of 2015. The outsized increase in prices pushed the annual rate of inflation all the way up to 7.7%, a pace of growth not seen since 1983. We had expected stronger price increases than the consensus, but this is very surprising. On a seasonally-adjusted basis, headline CPI rose 1.1% in May, the fastest pace since the series was introduced in 1992.

Prices were rising sharply across the board. Energy prices were up another 8.5% in May, while food prices rose 0.8%. Gains were relatively broad based across other categories too. Indeed, the average of the Bank of Canada's three core measures accelerated to 4.7% from 4.4% in April.

The services sector inflation is also picking up quickly, increasing by 0.7% relative to April and 5.2% compared to last year. Higher shelter costs were a major culprit, up 7.4% over a year ago and showing no signs of slowing down. Statistics Canada also touched on rising services costs in the release, noting that part of the increase is due to faster wage growth. Remember that services inflation tends to be more persistent relative to goods inflation.

IMPLICATIONS

Ultimately, the Bank of Canada needs to get a handle on prices soon. The acceleration in inflation will likely force the Bank of Canada to raise rates a further 75bps, a jumbo-sized move central bankers should have made earlier this month. Thereafter, the decisions become more difficult. Monetary policy works with long and variable lags. The Bank of Canada's policy rate will no longer be so glaringly stimulative and out of touch with inflation and the housing market will likely feel the pinch of higher rates even more than it already has. As a result, we see more measured steps to tighten policy this fall.

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