



CPI... my oh my

By Warren Lovely & Taylor Schleich

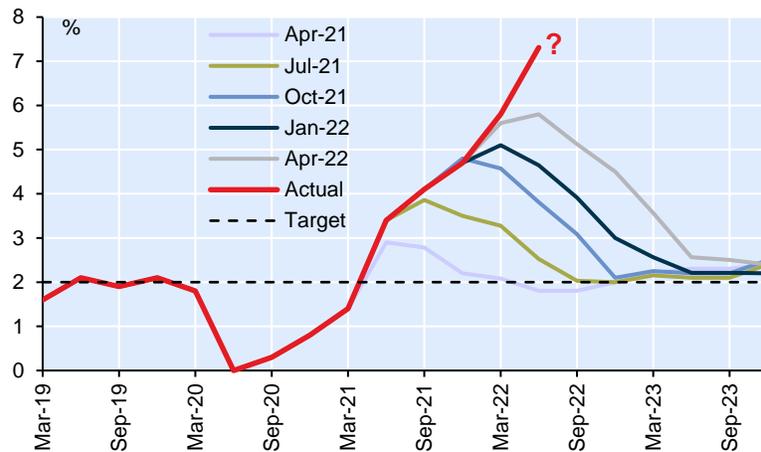
Inflation forecasts aren't worth the paper they're written on. That will be the all-too-familiar refrain when the Bank of Canada presents its next detailed economic forecast in a July 13th MPR—a document destined to accompany an historic interest rate hike by Canada's central bank. With headline inflation galloping away at 7.7% in May, even the most benign of forecasts for June would seemingly leave Q2 inflation running about 1½%-pts above the BoC's April forecast. That's the biggest miss yet in what has been a systematic underestimation of inflation. So if May's CPI report doesn't set alarm bells ringing at Governing Council, someone should check their collective pulse. It's not simply a case of one or two special factors at play. Yes, there's variation across the major components; when is that not the case? But nearly all are clear of the desired range. And core inflation, averaging 4.7%, tells us in no uncertain terms that we a serious inflation problem requiring urgent action.

For BoC watchers trying to compare today's inflation trajectory with earlier monetary tightening episodes, give up. There's simply no comparison in the overnight rate target era (that started in the mid-1990s). That's why the current tightening cycle is unlike anything we've observed in the past. As aggressive as the past couple of BoC actions may have seemed at the time, it's time to turn the screws even tighter. A 75 bp rate hike on July 13th won't fix Canada's inflation problem, not with labour markets as tight as they are. As an aside, job vacancy data are clearly worrying and Canada's acute labour shortage won't be remedied quickly despite a resumption of healthy population growth.

To summarize: We have out-of-control inflation. Simply sending more money to households like some governments have done (or intend to do) is just like adding gasoline (itself already expensive) to the fire. Inflation demands an uber-forceful BoC reaction, including a 75 bp hike in three weeks' time. Exceptional rate hikes have done little to control prices (so far) but have turned housing markets upside down. Consumer psyches bear watching and recession risks have mounted. Indeed, with inflation data like this, securing a 'soft landing' might be like threading the eye of a needle. We haven't totally abandoned hope, but today's CPI report should sober up even the most enthusiastic among us.

Chart 1: Another miss incoming for BoC forecasts

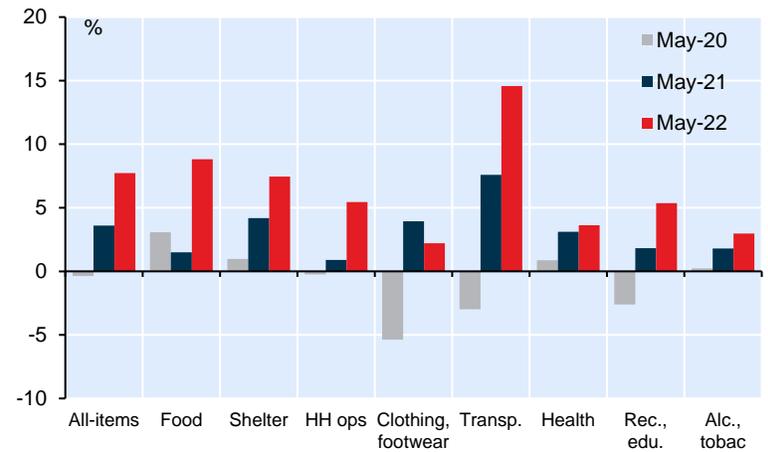
BoC's projected inflation trajectory from last 5 MPRs vs. actual inflation rate



Source: NBF, StatCan, BoC | Note: Some quarters not explicitly provided by BoC. These are estimated based on the quarterly, Q4/Q4 and full-year inflation projections given.

Chart 2: Inflation way up (almost) across the board

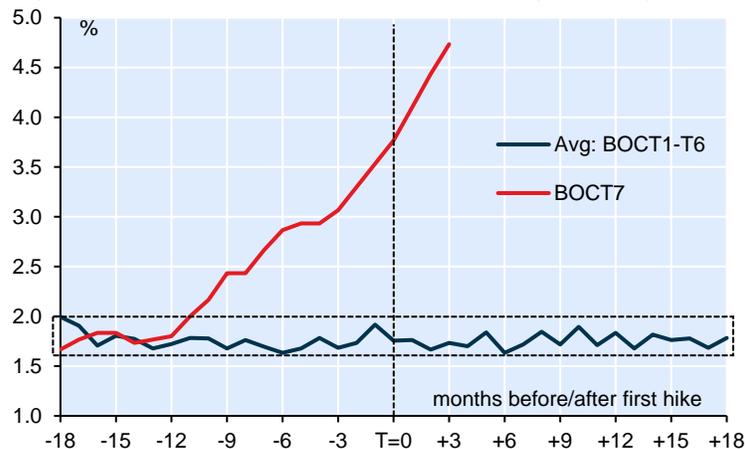
Y/Y CPI inflation by major component: May-22 vs. prior years



Source: NBF, StatCan

Chart 3: Clearly, not your average hiking cycle

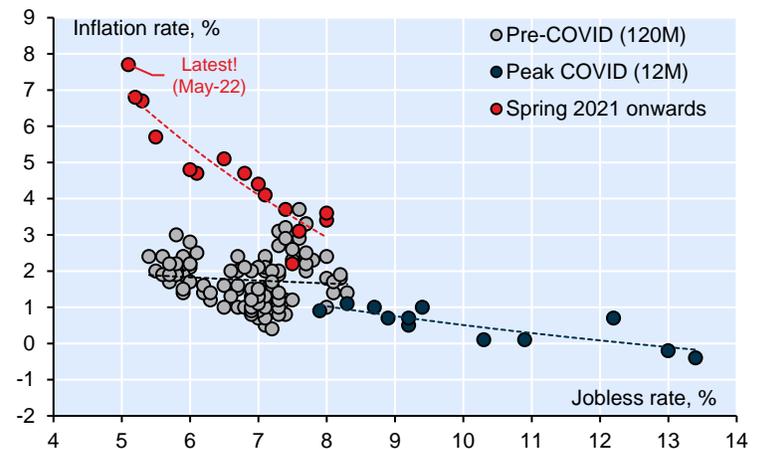
Trajectory of core inflation in the lead-up to and during BoC hiking cycles



Source: NBF, StatCan | Note: BOCT1-6 includes all hiking cycles since 1997

Chart 4: From a Phillips blob to a Phillips curve

Jobless rate vs. all-items inflation rate, differentiated by era



Source: NBF, StatCan



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