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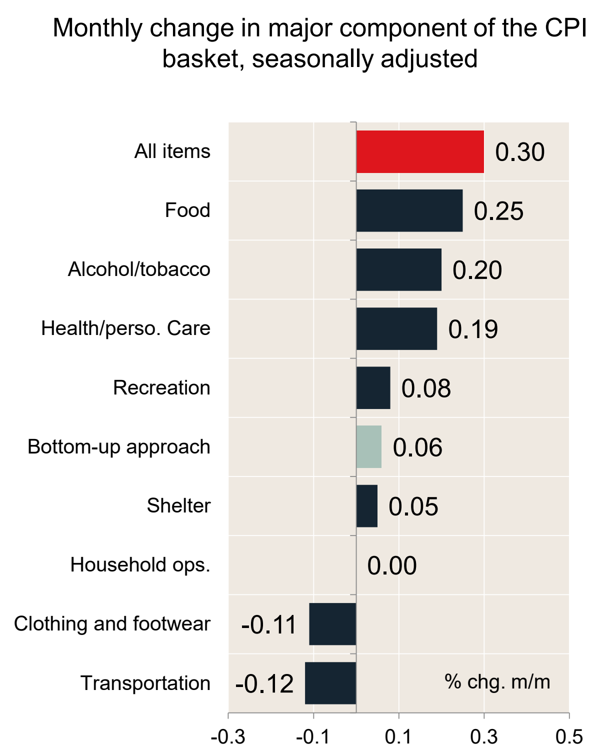
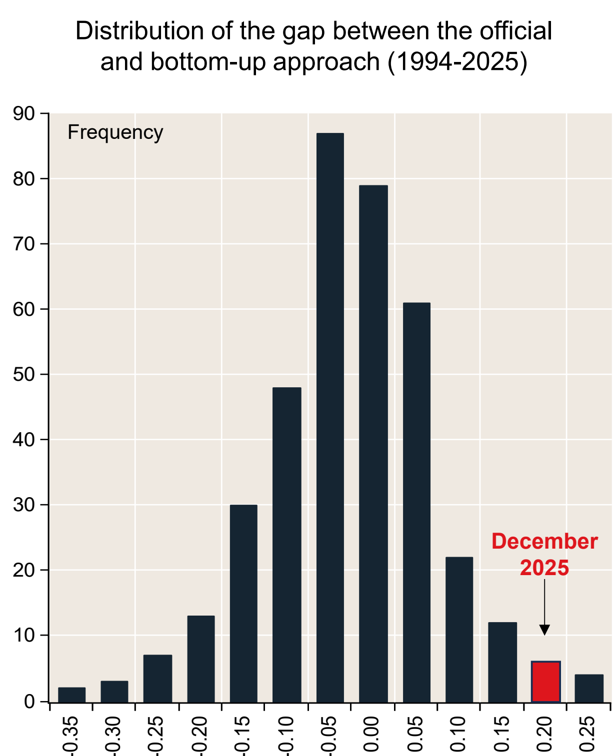
Canada Watch

By Matthieu Arseneau and Alexandra Ducharme

When the CPI was released on Monday, the market reaction was mixed in the face of puzzling results. On the one hand, headline annual inflation came in well above consensus expectations (2.4% vs. 2.2% expected). On the other hand, the two core inflation measures tracked by Bloomberg pointed to more contained price pressures: CPI-Trim matched expectations at 2.7%, while CPI-Median came in two-tenths below consensus (2.5% vs. 2.7%). Part of these discrepancies stem from differences in the seasonal-adjustment process. For CPI-Trim and CPI-Median, Statistics Canada seasonally adjusts each sub-component and then aggregates them using the appropriate weights. In contrast, for headline CPI, the agency seasonally adjusts only the main components but does not use these results when constructing the overall index, which is instead seasonally adjusted independently. Statistics Canada justifies this approach by arguing that it filters out seasonal patterns more effectively, but we note that it can also create frustrating inconsistencies. As today's Hot Chart shows, in December, every seasonally adjusted sub-component grew at a slower pace than the overall index—an unprecedented intellectual impossibility. Had Statistics Canada used a bottom-up approach similar to that of the U.S. Bureau of Labor Statistics, seasonally adjusted monthly inflation would have been just 0.06%, instead of the official 0.30%. The last time such a large gap between the two methods appeared was in 2009. While the Bank of Canada officially prioritizes CPI-Trim and CPI-Median as core measures, its recent communications indicate it is also monitoring inflation excluding food and energy, as well as CPI excluding the 8 most volatile components. The first two, which rely on the bottom-up method, rose only 0.07% on average in December (0.8% annualized), while the latter two, which are seasonally adjusted independently, grew 0.19% on average (2.3% annualized). At a time when the Bank of Canada is reassessing which core inflation metrics to emphasize, it would be appropriate for both the Bank and Statistics Canada to align on a consistent seasonal-adjustment methodology. Maintaining the status quo makes it unnecessarily difficult to assess underlying inflation pressures.

Canada: CPI is greater than the sum of its parts?





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Subscribe to our publications:
NBC.EconomicsStrategy@nbc.ca

To contact us:
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Jocelyn Paquet
Senior Economist
jocelyn.paquet@nbc.ca

Kyle Dahms
Senior Economist
kyle.dahms@nbc.ca

Alexandra Ducharme
Senior Economist
alexandra.ducharme@nbc.ca

Daren King, CFA
Senior Economist
daren.king@nbc.ca

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

Ethan Currie
Strategist
ethan.currie@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Nathalie Girard
Senior Coordinator
n.girard@nbc.ca

Giuseppe Saltarelli
Desktop Publisher
giuseppe.saltarelli@nbc.ca