

2% inflation in 2025? Why not sooner?

By Taylor Schleich

Back in January, the BoC warned that CPI inflation won't return to target until 2025. This sticky inflation outlook isn't a new one and has helped policymakers justify pushing back on near-term rate cut discussions. We've been skeptical for a while that it would take that long to get 'home' on inflation and this week's softer-than-expected CPI report reinforced that skepticism. Given our sub-consensus growth outlook, one may naturally assume we incorporate material price softness to arrive at 2% around the middle of 2024. However, as we illustrate below, to get 2% inflation, one doesn't need to assume inflation decelerates at all from the recent run-rate. Indeed, simply plugging in the average monthly increase from the past six months (+0.2%) brings you right to target in Q3. And that's with the problematic shelter inflation that Canada is contending with. If you want to assume that a now-negative output gap generates softer inflation or that we simply return to pre-pandemic inflation dynamics (+0.15% average from 2010-19), 2% inflation would be hit even earlier.

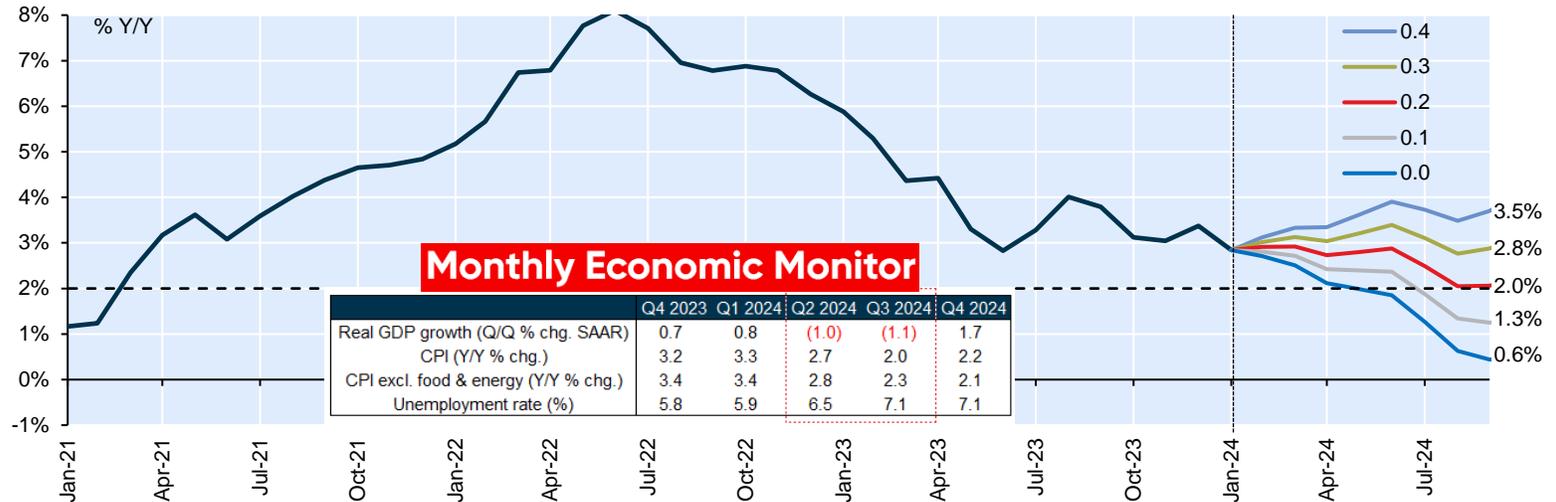
To be clear, the chart below is purely illustrative and isn't meant to represent an official forecast for Canadian CPI (although, as it

happens our colleagues' fresh [Monthly Economic Monitor](#) offers a forecast that doesn't stray far from taking the 'recent average' path.) Rather, consider this an inflation-style 'choose your own adventure' book. And the moral of this story is, despite the BoC's repeated warnings that inflation victory won't come until next year, there's a path to 2% that's shorter and clearer than some may appreciate.

In this world, the 125 bps of rate cuts we're forecasting for 2024 aren't that much of a stretch. We think that's true even if the BoC waits to gain more confidence that inflation is really slowing and doesn't begin easing until June. In fact, that's our baseline view per our latest [Fixed Income Monitor](#). Considering our outlook for the rest of the economy (flat-to-negative growth, a rising unemployment rate), cuts at every meeting in H2 are entirely reasonable. And while not contained in our base case outlook, one should also factor in the risk of 50 bp cuts along the way, given today's above-neutral setting. All that to say, we'll happily take the 'over' on the ~75 bps of rate cuts that markets are currently discounting. And despite the more hawkish stance (for now), we still have conviction the BoC can out-ease the Fed in 2024.

Chart 1: There's a clear path to 2% inflation by the summer

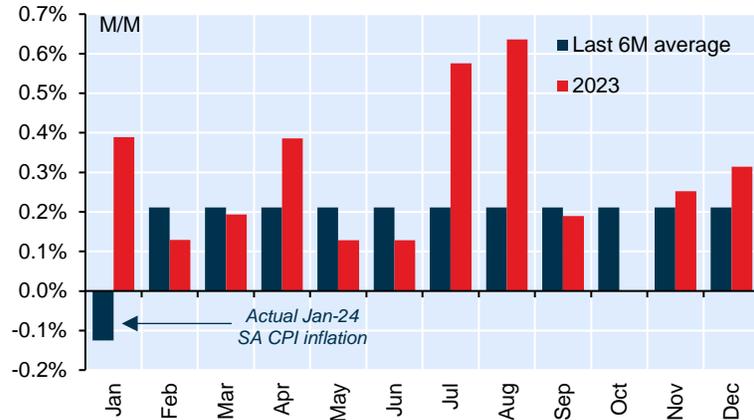
Canada all-items CPI inflation based on scenarios for monthly (seasonally adjusted) inflation readings



Source: NBF, StatCan | Note: NBF's February's Monthly Economic Monitor was published before the January CPI print, which came 0.4%-pts below our forecast.

Chart 2: Base effects are particularly helpful in Q3

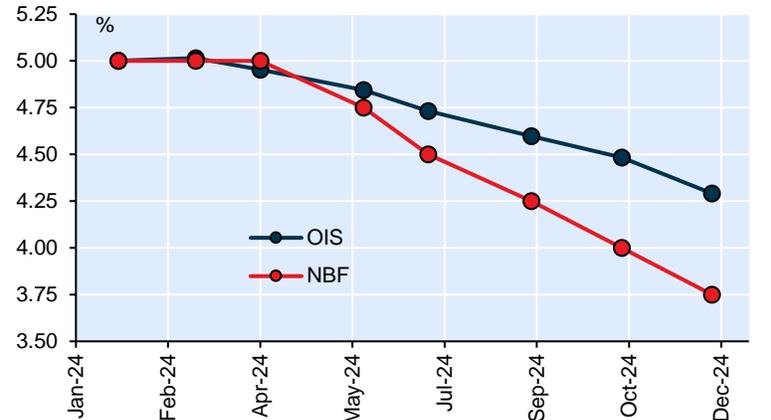
Monthly seasonally adjusted CPI change in 2023 vs. last 6M average



Source: NBF, StatCan

Chart 3: To us, the market is underpricing 2024 rate cuts

OIS-implied BoC overnight rate vs. NBF forecast: 2024



Source: NBF, Bloomberg



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