Jump in Canadian inflation argues against rate cuts

Core inflation, as measured by the average of the Bank of Canada's three key measures, is the highest it's been since 2012. Combined with better domestic growth prospects for later in the year, this suggests the central bank is unlikely to head for policy easing for now, although a lot depends on how trade tensions evolve over coming months

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Markets are beginning to price in Bank of Canada easing over the coming months, but for the time being, the latest inflation data argues against imminent rate cuts.

Headline inflation came in considerably on the upside rising 2.4% YoY in May, despite the ongoing drag from gasoline prices. Statistics Canada reported that gains were broad-based across all eight major components, with shelter, food and transport seeing heavy upward contributions. More importantly, the Bank of Canada's three main measures of core inflation reached their highest average since February 2012.

2.4%

May Headline CPI

Year-on-year

Higher than expected

This better inflation trajectory comes as the domestic economic outlook is starting to look a little brighter. The lagged effect of the late-2018 oil price decline has largely worked its way through, and while prices have taken a hit over recent weeks, our commodities team expect them to edge higher through this year and next.

Meanwhile, the labour market is looking strong, and we expect some better news on exports and the housing market later in the year too. With the improved core inflation backdrop, there are few domestic reasons to ease monetary policy at this stage.

However, the external environment is looking a little trickier. We expect the Federal Reserve to signal rate cuts are coming at its meeting later today, while there is little optimism surrounding the global trade outlook. Our team expects little to come of the meetings planned between the US and China at next week's G20 summit.

Bank of Canada unlikely to follow the Fed .. just yet

Despite the rapid switch in the monetary policy stance at the Fed and ECB, the Bank of Canada's more upbeat tone at its May meeting suggests they are unlikely to follow suit imminently.

Policymakers signalled they have growing confidence that the recent economic weakness is merely a 'soft-patch'. This latest inflation data reinforces our view that the BoC is likely to keep rates on hold for the rest of 2019, although a lot will depend on how the external environment evolves.

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