Musing on inflation: April 2025

In Canada, the annual rate of inflation fell to 1.7% YoY in April from 2.3% in March. The main factor behind the drop in inflation was the removal of the consumer carbon tax on 1 April. The decline in inflation below 2% might have been a hopeful sign that slower growth and rising unemployment were weighing on price pressures.

That is not the key message from the report.

Instead, there has been mounting evidence that underlying price pressures are mounting, and that the Bank of Canada will continue to face complicated deliberations on monetary policy.

Chart 1 shows the contributions to the annual rate of change of CPI from five components: energy, groceries, core goods, housing services, and other services. Three things stand out:

1. The annual rate of inflation has been lingering around 2%, the Bank of Canada's target since last August, but broke below 2% in April.
2. The negative contribution to the annual rate of inflation from energy was its largest since mid-2023. The contribution from gasoline and fuels for recreational vehicles was -0.7 ppt, in line with estimates from the Bank of Canada's April 2025 Monetary Policy Report.
3. The contribution to inflation from housing services has been declining since spring 2024 but has been mostly offset from higher positive contributions from other sectors, apart from energy.

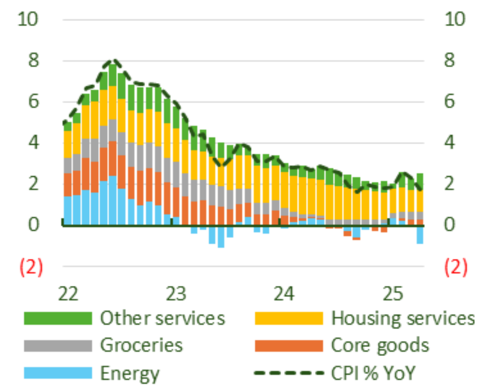
Chart 2 shows the contributions to the annual rate of inflation from housing services, and the sum of contributions from groceries, core goods, and other services (GCGOS). The inflation contribution from GCGOS was very high when inflation was at its peak in mid-2022 amid supply chain effects and strong domestic demand. The GCGOS contribution subsequently hit a low point in January 2025 due to the temporary GST cut. The GCGOS contribution has since increased to 1.5 percentage points (ppt) and now exceeds the contribution from housing services (mortgage interest costs, rent, and property taxes).

Though not yet set in stone, it seems as though important disinflationary forces in place since mid-2022 might have reversed course. This is occurring amid elevated tensions that are affecting global trade, tariffs that are putting upward pressures on costs, and prior Canadian dollar weakness that has put upward pressure on the costs of imports.

Chart 3 shows the core inflation rate (the average of the Bank of Canada's preferred measures CPI-trim and CPI-median) on a MoM basis, and an indicator of short-term momentum (3m annualized % change). On a MoM basis, despite the removal of the carbon charge, core inflation rose by 0.4% in April, its largest MoM increase since May 2024. The short-term momentum in core inflation came in at 3.4%, which was pretty much in line with readings observed over the past six months.

We also look at a broader set of core inflation measures to gather additional evidence on underlying price pressures. We include CPI-trim and CPI-median, and three other

1. Contributions to CPI inflation
(percentage points)

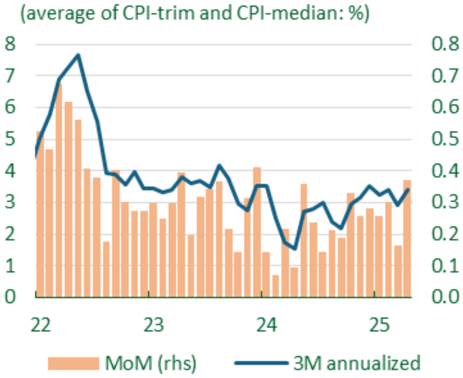


Source: Macrobond, Statistics Canada

2. Contributions to CPI inflation
(percentage points)

Source: Macrobond, Statistics Canada

3. Core inflation in Canada
(average of CPI-trim and CPI-median: %)



Source: Macrobond, Statistics Canada

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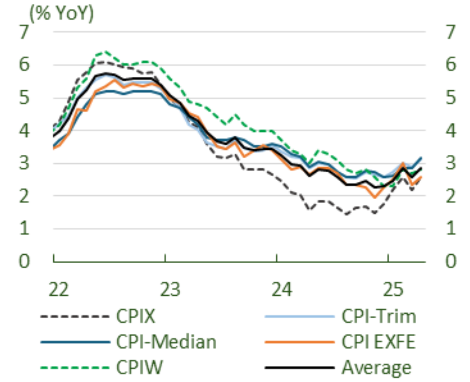
core inflation measures: CPIX (the Bank's core measure from 2001 until 2016 that excludes eight components of CPI and the impact of indirect taxes), CPI excluding food and energy and indirect taxes (CPIEXFE, the traditional core measure), and CPIW, which is a double-weighted measure of core designed to reduce the impact of volatile CPI components on inflation. One of the weights is the components weight in the CPI basket; the other is related to the historic volatility of the component. (CPIEXFE and CPIW are not released at the same time as other CPI data, they are released a day later).

4. Measures of core inflation



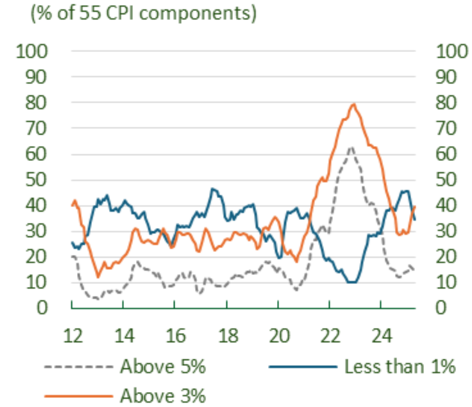
Source: Macrobond, Statistics Canada, Bank of Canada

Chart 4 shows all five of the core inflation measures on a YoY basis. The average of these measures was 2.9% YoY in April. Importantly, the core inflation average has crept up from 2.3% in November.

This highlights a stickiness to underlying price pressures, even as the temporary GST tax holiday caused some volatility in headline inflation.

To some extent the slight uptrend in the YoY rate of core inflation should not be that surprising. Chart 3 demonstrated that short-term momentum in core inflation had been trending upward since spring 2024. To us, that suggested that the YoY rate of core inflation might eventually stabilize and potentially rise if the short-term momentum indicator remained elevated. It is thus understandable that the annual rate of core inflation has moved modestly higher since November.

5. Inflation dynamics



Source: Macrobond, Statistics Canada

Given that the annual rate of core inflation is close to the short-term momentum indicator, suggests to us that there is only limited upside from here.

This is subject to an important caveat, given the outsized MoM jump in core inflation in April. We don't anticipate similar moves in coming months, but the MoM changes need to fall back toward 0.2% or lower on a regular basis or core inflation could remain elevated between 2.5% and 3.0% YoY.

Finally, Chart 5 shows the share of 55 CPI components that are rising at an annual rate of more than 5%, more than 3%, and those that have a rate of inflation of less than 1%. Note that at inflation's peak in mid-2022, almost 80% of CPI components were rising at over 3% YoY, over 60% were rising by more than 5%, and only 10% had a rate of inflation of less than 1%. As inflation cooled, these shares began to normalize and there is better balance now.

In the past few months though, the share of CPI components rising by more than 3% has increased from 30% to almost 40%. This is not a warning sign per se, but it does show some still rather widespread upward pressure on prices.

The key point is that there are more than just a few CPI components contributing to the pressure on core inflation, and the facts suggest that the underlying pressures on core inflation remain elevated and sticky. Meanwhile the economic backdrop — an economy operating in a state of excess supply, the rising unemployment rate and the spike in economic uncertainty — suggest that price pressures should ease.

That is why the Bank of Canada's Governing Council's deliberations will be complicated. The evolution of underlying inflation pressures will animate discussions at the Bank of Canada's Governing Council and leave significant hurdles in the way of additional rate cuts.

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