

## Canada Watch

Core inflation regains falling trend,  
opening the door to 1H cut

## Key takeaways

- Inflation surprised to the downside in Jan. falling to 2.9% from 3.4%. Core fell to 3.4% from 3.6%. We update our forecasts.
- We continue to expect the BoC to start cutting in June. But the surprise in core opens the door for a potential cut in April.
- We see scope for more outperformance in CAD rates vs the US. We see USDCAD sticking to the 1.35-handle for now.

## Headline surprised to the downside in January

Consumer Price Index (CPI) inflation surprised to the downside at 2.9% yoy in January (E. 3.3%, BofA 3.3%), and fell relative to the 3.4% observed in December (Exhibit 1). The main driver of the fall was gasoline price deflation (-4.0% yoy). CPI excluding gasoline decreased to 3.2% yoy in January from 3.5% a month ago (Exhibit 2). On a monthly basis, inflation was below expectations at 0.0% mom nsa (E. 0.4%, BofA 0.4%). Disinflation in airfares (-23.7% mom nsa), due in part to typically lower demand, also helps explain the lower CPI print (Exhibit 3, Exhibit 4). On a seasonally adjusted basis, CPI fell -0.1% mom sa, which is the first contraction since May 2020.

## Core fell as well to 3.4% due to lower goods inflation

The average of the two core measures (trimmed and median) fell to 3.35% yoy, down from a revised 3.60% in December. The trimmed mean fell to 3.4% (vs. 3.7% in December), while after revision the median CPI fell to 3.3% (vs. 3.5% a month ago). Both measures are now below 3.5%, the first time since December 2021 (Exhibit 5). The fall was mainly explained by lower goods inflation at 1.3% yoy (vs. 2.4% in December), where the slowdown was due to a broad-based deceleration of groceries' prices at 3.4% yoy (vs. 4.7% a month ago). Services' inflation fell as well, and it is now at 4.2% yoy from 4.3% in December. Economic weakness should keep bringing core down.

## We revise our inflation forecasts to the downside

After the surprise in January's inflation, we now expect headline inflation at 2.2% yoy by end-2024, down from 2.5%. We expect inflation to hit its 2% target in 2H 2025, with our expectation for year-end 2025 inflation unchanged at 2.0% (Exhibit 6, Exhibit 7).

## BoC: we expect a cut in June with risks skewed to April

Core inflation regaining a downward trend means that the beginning of the cutting cycle in Canada is not far. The [BoC has said it needs to see a "further and sustained easing" in core inflation](#). The January print likely checks the "further" part, now we need "sustained". There is no other inflation print before the March 6 meeting, so a cut there seems unlikely. There is only one inflation print (February) before the April 10 meeting, so April could be but still seems too soon to us. So, [we continue to expect the first cut to happen in June](#), but the rapid fall in core inflation increases the risk that BoC starts the cutting cycle in April (which is a meeting with Monetary Policy Report).

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## Glossary

CPI = Consumer Price Index

E. = Bloomberg Consensus estimate

nsa = not-seasonally adjusted

sa = seasonally adjusted

mom = month-over-month

yoy = year-over-year

BoC = Bank of Canada

StatCan = Statistics Canada

## Rates: soft inflation drives CA rate outperformance

CA rates rallied across the curve after the CA CPI print today, with most of the move seen in the front-end of the curve. The softer than expected print revitalized expectations of BoC cuts to start later this year as YoY inflation finally fell below 3.5% for both the headline and core measures. While one print is unlikely to move the needle on a BoC decision, the rapid deceleration of inflation has driven market repricing of BoC cuts from just under 70bps ahead of the print to over 80bps shortly after the print. The market is still pricing the first full cut in July, but soft inflation could still lead markets to reprice an earlier start to cuts. The market is currently underpricing cuts vs our economist's expectations of 5 cuts, or 125bps in 2024, with cuts starting in June, but risk skewed to April.

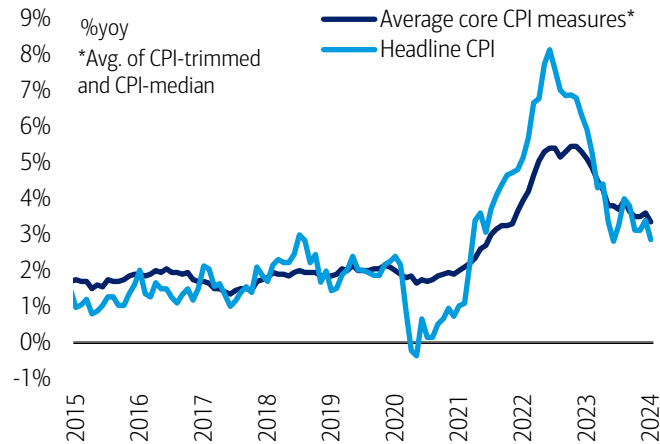
The rally in CAD rates has driven outperformance vs US, especially at the front-end of the curve today. With CAD pricing in less cuts than we expect and the US pricing in more, there may be scope for more outperformance of 2y CAD vs 2y US. The path of inflation will likely be the main determinant of the rate differential between the 2 regions this year as they drive market expectations for the terminal rate in each region.

## FX: USDCAD sticking to the 1.35-handle for now

USD/CAD knee-jerk rallied by around 30 pips, with CAD broadly underperforming rest of the G10 FX complex for the day. Rates market continuing to reprice to an earlier BoC rate cut from July should lead to further near-term weakness for the Loonie, in our view. We were estimating 1.34-1.35 as the fair value range for USDCAD ([Canada Watch: 09 February 2024](#)), but now expect USD/CAD to firmly stay at an 1.35-handle until the next US data triggers a broad USD move. Looking ahead, should December retail sales (to be released on Feb 22) and Q4 '23 GDP (to be released on Feb 29) surprise to the downside for Canada, it would increase the upside risk to our end of Q1 '24 forecast of 1.35 for USD/CAD ([FX Viewpoint: 05 January 2024](#)).

**Exhibit 1: Headline and core inflation**

Headline and core inflation seem to be trending down again

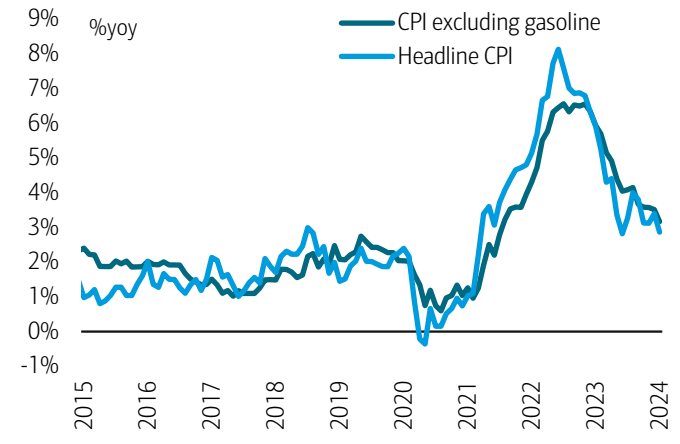


Source: BofA Global Research; Stat Canada, Haver

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**Exhibit 2: Inflation excluding gasoline keeps falling**

Headline inflation continues to fall, even when excluding gasoline



Source: BofA Global Research, Stat Canada, Haver

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**Exhibit 3: % mom nsa CPI heatmap**

Inflation was pulled by clothing and footwear at -3.2% mom nsa, as well as by a fall in transportation prices

Component	Jan-24	Dec-23	Nov-23	Oct-23	Sep-23	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23
Headline	0.0%	-0.3%	0.1%	0.1%	-0.1%	0.4%	0.6%	0.1%	0.4%	0.7%	0.5%	0.4%	0.5%
Food	0.7%	0.3%	0.6%	-0.1%	-0.1%	-0.1%	0.4%	0.1%	0.8%	0.4%	0.2%	0.6%	1.7%
Shelter	0.3%	0.4%	0.5%	0.9%	0.5%	0.8%	0.7%	0.5%	0.4%	0.6%	0.4%	0.2%	0.1%
Household Operations/Furnishings/Equipment	0.8%	-0.9%	-0.3%	0.0%	-0.7%	0.3%	-0.3%	-0.6%	-0.5%	0.3%	0.4%	1.1%	-0.4%
Clothing and Footwear	-3.2%	-2.2%	0.7%	0.1%	0.9%	1.1%	-1.0%	-1.7%	0.4%	0.7%	1.3%	1.9%	-1.1%
Transportation	-1.2%	0.6%	-0.6%	-1.4%	-1.0%	0.7%	1.3%	1.2%	-0.2%	1.5%	0.7%	-0.4%	0.7%
Health and Personal Care	0.7%	-0.5%	0.1%	-0.1%	0.1%	0.4%	0.1%	0.3%	0.2%	1.4%	0.5%	0.4%	0.6%
Recreation, Education and Reading	-0.6%	-3.4%	-0.4%	0.9%	-0.5%	-0.9%	2.1%	-0.8%	1.9%	0.2%	1.1%	0.9%	0.7%
Alcoholic Beverages and Tobacco Products	1.1%	-0.5%	0.4%	0.1%	0.1%	0.4%	0.4%	0.1%	0.5%	0.2%	0.9%	0.4%	1.2%

Source: BofA Global Research, Stat Canada, Haver

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**Exhibit 4: % yoy CPI heatmap**

Average core CPI measures are now below 3.4% yoy

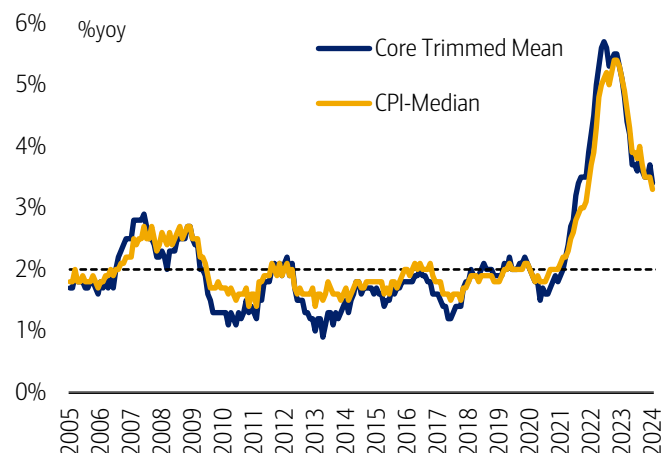
Component	Jan-24	Dec-23	Nov-23	Oct-23	Sep-23	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23
Headline	2.9%	3.4%	3.1%	3.1%	3.8%	4.0%	3.3%	2.8%	3.4%	4.4%	4.3%	5.2%	5.9%
Food	3.9%	5.0%	5.0%	5.6%	5.9%	6.8%	7.8%	8.3%	8.3%	8.3%	8.9%	9.7%	10.4%
Shelter	6.2%	6.0%	5.9%	6.1%	6.0%	6.0%	5.1%	4.8%	4.7%	4.9%	5.4%	6.1%	6.6%
Household Operations/Furnishings/Equipment	-0.5%	-1.7%	-1.5%	-1.2%	-1.1%	0.0%	-0.1%	0.3%	1.1%	3.0%	3.3%	4.1%	3.7%
Clothing and Footwear	-1.3%	0.9%	0.6%	-0.5%	1.0%	1.7%	1.0%	0.3%	0.7%	2.5%	2.4%	1.9%	0.4%
Transportation	1.2%	3.2%	-0.1%	-0.4%	3.2%	2.3%	-1.0%	-3.4%	-2.4%	1.3%	0.3%	3.1%	5.4%
Health and Personal Care	3.7%	3.7%	4.2%	4.9%	5.6%	5.8%	5.8%	6.2%	6.4%	6.4%	6.5%	6.2%	6.2%
Recreation, Education and Reading	0.3%	1.7%	3.8%	2.9%	1.8%	2.2%	1.8%	1.2%	3.1%	3.1%	1.6%	2.3%	2.9%
Alcoholic Beverages and Tobacco Products	4.2%	4.3%	4.6%	4.7%	5.3%	5.2%	5.3%	5.4%	5.5%	5.3%	5.4%	4.9%	4.7%
Average core CPI measures	3.4%	3.6%	3.5%	3.5%	3.7%	4.0%	3.7%	3.8%	3.8%	4.3%	4.5%	4.9%	5.1%
Core Trimmed Mean	3.4%	3.7%	3.5%	3.5%	3.6%	3.9%	3.6%	3.7%	3.7%	4.2%	4.4%	4.8%	5.1%

Source: BofA Global Research, Stat Canada, Haver

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**Exhibit 5: Core inflation measures**

Both measures are now below 3.5% yoy. First time since December 2021



Source: BofA Global Research; Stat Canada, Haver

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**Exhibit 6: Inflation forecasts**

We decrease our inflation expectations for end-2024 to 2.2% yoy from 2.5%



Source: BofA Global Research estimates, Stat Canada, Haver

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**Exhibit 7: Monthly CPI forecasts (nsa)**

We expect inflation at 2.2% by end-2024 and at 2.0% by end-2025

	Level	mom (%)	yoy (%)
2023: Dec	158.3	-0.3	3.4
2024: Jan	158.3	0.0	2.9
2024: Feb	159.1	0.5	3.0
2024: Mar	159.8	0.4	2.9
2024: Apr	160.3	0.3	2.5
2024: May	161.1	0.5	2.6
2024: Jun	161.4	0.1	2.6
2024: Jul	161.9	0.3	2.4
2024: Aug	162.1	0.1	2.1
2024: Sep	161.8	-0.2	2.1
2024: Oct	162.0	0.1	2.1
2024: Nov	162.1	0.1	2.1
2024: Dec	161.8	-0.2	2.2
2025: Jan	161.8	0.0	2.2
2025: Feb	162.6	0.5	2.2
2025: Mar	163.5	0.6	2.3
2025: Apr	163.8	0.2	2.2
2025: May	164.5	0.4	2.1
2025: Jun	164.9	0.2	2.2
2025: Jul	165.2	0.2	2.0
2025: Aug	165.3	0.1	2.0
2025: Sep	165.3	0.0	2.2
2025: Oct	165.2	-0.1	2.0
2025: Nov	165.2	0.0	1.9
2025: Dec	165.0	-0.1	2.0

Source: BofA Global Research estimates

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