TD Economics

Inflation Tracker

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Highlights

- Inflation remains well above desired levels in most of the G7, but falling energy prices have brought some relief to households.
- Although headline inflation has cooled in recent months, central bankers are going to be more focused on measures of inflation that are more indicative of underlying price pressures in the economy.
- China's economic reopening looms as an upside risk to global inflation. The removal of COVID-era restrictions is going to help restart consumer activity and the increased demand will put upward pressure on energy and raw input prices.

Inflation remains well above desired levels in most of the G7. However, top-line inflation rates mask very different trends on both sides of the Atlantic. This report will shed some light on these distinctions that are impacting the outlook.

Advanced Economies

Falling Energy Prices Bring Relief

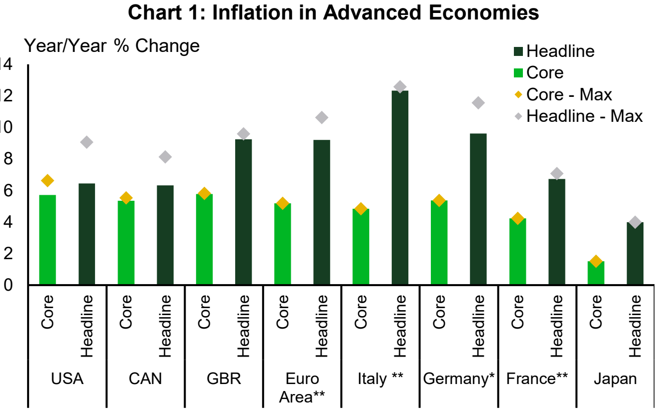
Overall price growth has decelerated around the G7 (Chart 1). In Europe, where surging energy prices were acutely felt, headline consumer price index (CPI) inflation has eased to 8.5% year-on-year (y/y) as of January's flash estimate, down from a peak rate of 10.6% in October 2022. A similar story is helping ease price growth in the U.S. (6.5% vs. 9.1% at the peak), Canada (6.3% vs. 8.1%), and Germany (9.6% vs. 11.6%).

Wholesale prices for oil and gas have pulled back significantly from their peaks in the summer months, while euro area member states have deployed varying degrees of subsidies for consumers and industry. This has brought inflation in the energy component of CPI in the euro area down from a high of 44.3% y/y, to 17.2% as of January (Chart 2). The UK, despite capping household energy bills, is still facing lingering energy inflation north of 50% y/y; however, these effects should begin to moderate in the coming months as the price cap was put in place in October 2022 and will run until April 2024.

Although headline inflation has cooled in recent months, central bankers are going to be more focused on measures of inflation that are more indicative of underlying price pressures in the economy. On this front, we see a divergence between the North American economies (Canada and the U.S.) and their European counterparts with Japan remaining the outlier (Chart 3).

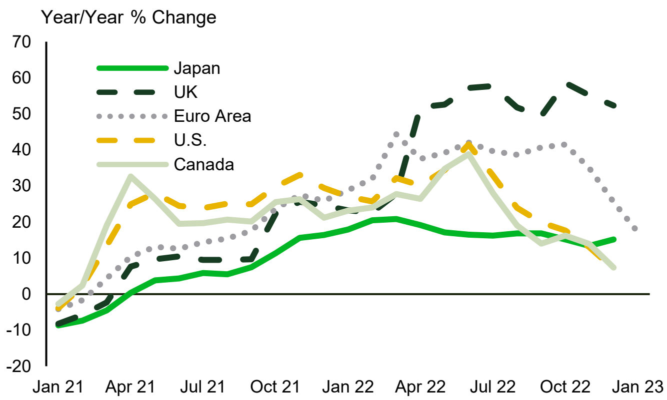
Near-term core price pressures have eased substantially in Canada and the U.S., with their respective three-month annualized rates of inflation decelerating to 4.0% and 3.1%, from 7.6% and 7.9%, respectively, in June. This dynamic is a large part of the reason both the Fed and Bank of Canada (BoC) are approaching the end of their rate hiking cycles.

Chart 1: Inflation in Advanced Economies



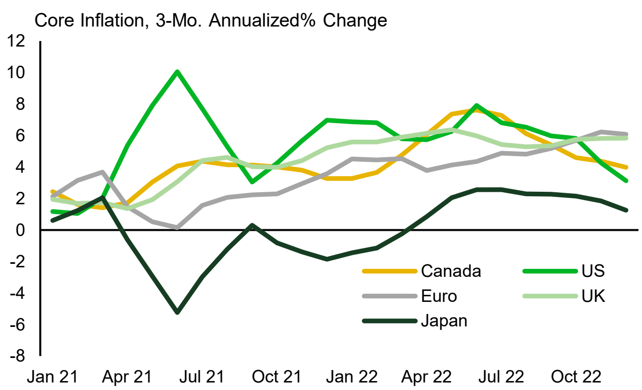
*CPI Including Homeowners' Equivalent Rent
**Harmonized CPI.
Source: National Statistical Agencies, TD Economics.

Chart 2: Energy Shock Rapidly Abating in Europe



Source: MIC, BLS, Euro Stat, ONS, Stat Can, TD Economics.

Chart 3: Core Inflation Softens in North America



Source: BoE, BoJ, BoC, FRB, ECB, TD Economics.

Showing signs of much more weakness is Japan's "Western-Core" measure of CPI which, unlike the official core measure, excludes both food and energy prices. This gauge has decelerated to a mere 1.3% on a three-month annualized basis. Unlike other G7 central banks, the Bank of Japan (BoJ) is going to be concerned with inflation undershooting its desired level.

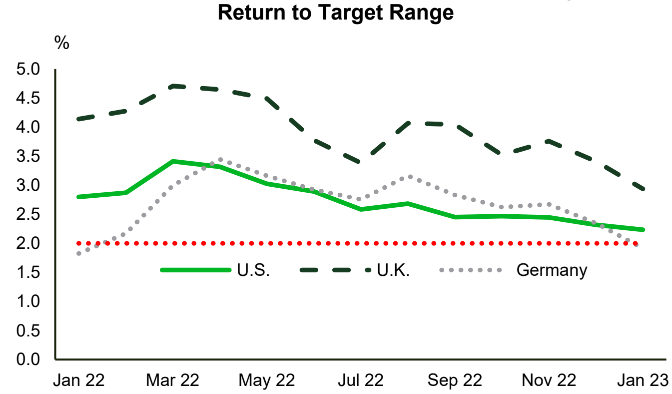
In contrast, core price inflation remains persistently elevated in the U.K. and euro area. The euro area, where the European Central Bank (ECB) was much slower to begin tightening policy, has seen near-term core inflation (on a three-month annualized basis) run above 6% since November. This persistence in core measures is going to be top of mind for ECB rate setters as they look to combat inflation in the coming months (more on this later). Lastly, core price pressures tend to be sticky and underpin our outlook for CPI inflation to remain above the 2% target into 2024.

Policy Rates and Expectations

When it comes to the changing dynamics in inflation, the rate hikes imposed by central banks have contributed to slowing demand and cooling price pressures. The aggressive campaign against inflation has been motivated, in part, by the concern that inflation expectations could inextricably rise, forcing even tighter monetary conditions and the associated deleterious economic affects. As we wrote about this week, markets are believing that targets are achievable, as five-year implied inflation rates have steadily declined since the spring of 2022 (Chart 4).

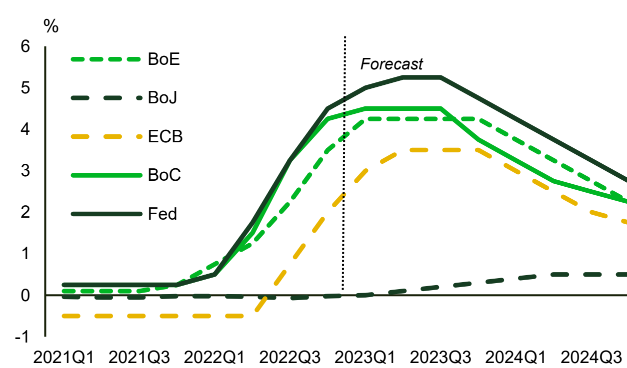
In Canada, the U.K., and U.S., central banks began tightening policy in early 2022 (and December 2021 in the case of the Bank of England). Meanwhile, the ECB waited until the summer of 2022 to start the rate hiking cycle while the Bank of Japan remains on the sidelines.

Chart 4: Five-Year Inflation Expectations Slowly Return to Target Range



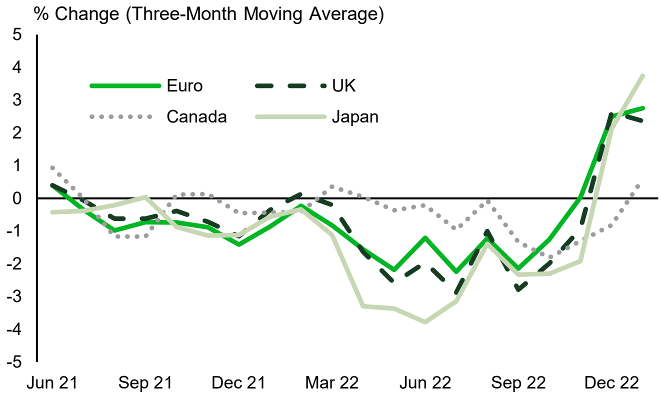
Note: Monthly Average of Daily Data.
Source: FRB, BoE, Bundesbank, TD Economics.

Chart 5: As Central Banks Aggressively Raise Interest Rates



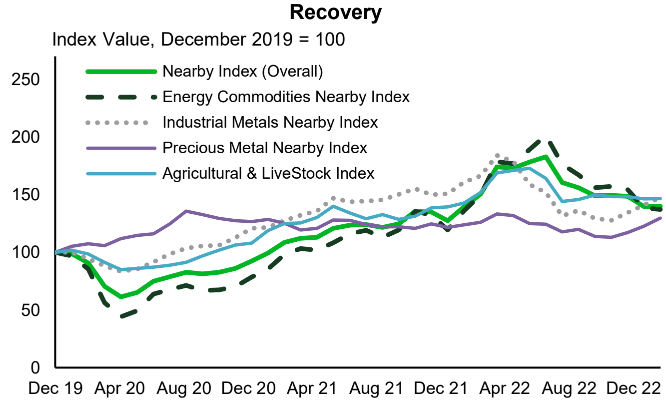
Source: BoE, BoJ, BoC, FRB, ECB, TD Economics.

Chart 6: Dollar's Dominence Fades



Last Observation: Jan. 2023
Source: FRBNY, TD Economics.

Chart 7: Industrial & Precious Metals Prices Begin Recovery



Last Observation: January 2023.
Source: S&P Globlal, TD Economics.

Given its delayed start, the ECB is going to continue raising interest rates in 2023 as it plays catch up with inflation, as our projection has the policy rate reaching 3.5% in the second quarter of this year (Chart 5). Rates this far in restrictive territory will help dampen demand, and ease some of the inflationary pressures in the economy.

Household and business expectations have been more mixed (Appendix 1). For the most part, households in Canada, U.S., and most of the euro area have decreased their expectations of inflation in the coming one-to-five years. In the U.K., the BoE/Kantar inflation survey has seen five-year expectations (a key focus for central bankers) recede from their highs in the second quarter of 2022 – despite rising relative to the past quarter. Conversely, households in Japan and Italy have uniformly raised inflation expectations over the past three months.

On the business side, most survey measures focus on near-term inflation expectations so given recent trends in inflation, it's not surprising that these have risen. However, the euro area's Survey of Professional Forecasters shows expectations for inflation have moderated with long-term headline and core inflation projections are running at 2.1% and 2.0%, marginally lower relative to prior readings.

Lastly, amid the expected narrowing of interest rate differentials, the U.S. dollar has given back some of its gains from earlier in the year (Chart 6). This has been beneficial for oil importers as oil tends to be transacted in U.S. dollars, helping take pressure off the energy crunch on the continent.

Commodities Prices

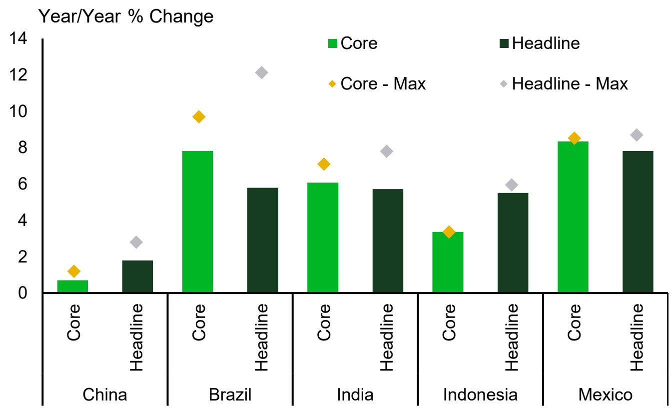
Broad commodity indexes have continued to fall since the peak in the summer of 2022, however, a closer look shows that it is primarily falling energy prices dragging down the composite index (Chart 7). In fact, precious and industrial metals have rallied off their lows in the fall, while agricultural product prices have been roughly steady since the summer.

Table 1. Wage Growth

Measures	U.S.	Germany***	Canada	Italy***	Japan*	U.K.**	France
Current (Y/Y)	4.4	2.3	4.3	1.5	1.7	5.8	4.3
2022 Max	5.9	2.4	4.7	1.5	3.2	5.8	4.3
Pre-Pandemic Avg.	3.0	2.5	2.6	[illegible]	1.4	2.9	1.5
Last Observation	Jan.	Nov.	Nov.	Dec.	Oct.	Oct.	Sept.

[illegible]
[illegible]
[illegible]
[illegible]

Chart 8: Inflation in Emerging Markets



Source: National Statistical Agencies, TD Economics.

That said, consumers have certainly felt relief amid falling wholesale energy prices. European households, in particular, have benefitted from a steep decline in natural gas prices as the abnormally warm winter has helped keep stockpiles near record highs and prices fall over 80% from their highs last summer. The outlook for raw materials prices is steeped in uncertainty, as the economic reopening in China gains steam. A stronger than expected recovery represents a substantial upside risk to commodity prices for 2023.

Wages

Wage growth continues well above pre-pandemic trends in most of the G-7 (Table 1), with Germany as the lone exception. The current pace of wage gains remains supportive of above-target inflation in most jurisdictions.

Japan here remains an exception where wage growth of 1.7% is still below what is needed to sustain inflation at 2%. The tepid wage growth is one of the reasons policymakers have maintained a dovish stance despite the multi-decade high in inflation. Looking forward, the spring wage-bargaining season could provide a lift to Japanese wages and secure more durable wage growth that would support the BoJ in tightening monetary policy.

Emerging Markets

Inflation in emerging markets has cooled this year as falling commodity prices have helped ease the burden on households (Chart 8). Inflation in Brazil has simmered down substantially, with headline CPI inflation receding from 12.1% y/y to 5.8% in December. China continues to be the laggard as consumer price inflation is still below 2%, with the measure excluding food and energy costs registering a tepid 0.7% y/y.

That said, while China is the laggard as of December, it presents the greatest global upside risk to inflation moving forward. The removal of COVID-era restrictions is going to help restart consumer activity and the increased demand will put upward pressure on energy and raw input prices. At a minimum, sustained growth in China will put a floor under commodity prices, but should growth prove stronger than anticipated, it could send them higher yet again.

Table 2. Inflation Expectations in G7				
Financial Measures*				
Country	Measure	Unit	Value	Change from 3 Months Ago/Prior Quarter
Germany	5-Year Breakeven Inflation	%	[illegible]	Decrease
Germany	10-Year Breakeven Inflation	%	[illegible]	Decrease
U.K.	5-Year Inflation Rate	%	[illegible]	Decrease
U.K.	10-Year Inflation Rate	%	[illegible]	Decrease
U.S.	5-Year Breakeven Inflation	%	[illegible]	Decrease
U.S.	10-Year Breakeven Inflation	%	[illegible]	Decrease
Canada	10-Year Breakeven Inflation	%	[illegible]	Decrease
Consumer Survey Measures				
Canada	CES - 2 Years Ahead	%	[illegible]	Decrease
Canada	CES - 5 Years Ahead	%	[illegible]	Decrease
Euro Area	Cons. Price Trends Next 12 Months	% Bal	[illegible]	Decrease
France	INSEE Household Survey - 12 Months	% Bal	[illegible]	Decrease
Germany	Deutsche Bundesbank Inflation Exp. 1-Year	%	[illegible]	Decrease
Germany	Deutsche Bundesbank Inflation Exp. 5-Year	%	[illegible]	Decrease
Germany	Deutsche Bundesbank Inflation Exp. 10-Year	%	[illegible]	Decrease
Italy	Banca d'Italia 1 Year Cons. Price Exp.	%	[illegible]	Increase
Italy	Banca d'Italia 2 Year Cons. Price Exp.	%	[illegible]	Increase
U.K.	BoE/Kantar Inflation Survey 1-Year	%	[illegible]	Decrease
U.K.	BoE/Kantar Inflation Survey 5-Year	%	[illegible]	Increase
Japan	Bank of Japan Consumer Survey	% Bal. Expecting Higher Prices in 1 Yr	[illegible]	Increase
Japan	Bank of Japan Consumer Survey	% Bal. Expecting Higher Prices in 5 Yrs	[illegible]	Increase
U.S.	U Mich. Consumer Inflation Exp. 1-Year	%	[illegible]	Decrease
U.S.	U Mich. Consumer Inflation Exp. 5-Year	%	[illegible]	Unchanged
Business Survey Measures				
Canada	Bank of Canada Business Outlook Survey	% of Firms Expecting Prices Above 3%	[illegible]	Increase
France	Banque de France MPS Price Forecast - Services	% Bal	[illegible]	Increase
France	Banque de France MPS Price Forecast - Total Industry	% Bal	[illegible]	Increase
Germany	ZEW Survey 12 Month Inf. Expectations	% Bal	[illegible]	Decrease
Italy	Banca d'Italia Business Survey Inflation Exp. 1-Year	%	[illegible]	Increase
Italy	Banca d'Italia Business Survey Inflation Exp. 2-Year	%	[illegible]	Increase
Japan	Tankan Survey Inflation Exp. 1-Year	%	[illegible]	Increase
Japan	Tankan Survey Inflation Exp. 3-Year	%	[illegible]	Unchanged
Japan	Tankan Survey Inflation Exp. 5-Year	%	[illegible]	Increase
Euro Area	Surv. Prof. Forecasters - Next Year	%	[illegible]	Decrease
Euro Area	Surv. Prof. Forecasters - Two Years Ahead	%	[illegible]	Decrease
Euro Area	Surv. Prof. Forecasters - Long-Term	%	[illegible]	Decrease
Euro Area	Surv. Prof. Forecasters - Next Year (Core)	%	[illegible]	Decrease
Euro Area	Surv. Prof. Forecasters - Two Years Ahead (Core)	%	[illegible]	Decrease
Euro Area	Surv. Prof. Forecasters - Long-Term (Core)	%	[illegible]	Decrease
U.K.	CBI - Change in General Prices Next 12 Mo	%	[illegible]	Unchanged
U.S.	CFO Survey - Price Growth Next Year	%	[illegible]	Increase

[illegible]

[illegible]

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