

Canada Watch

Rising inflation limits the BoC's room to cut the policy rate in October

Key takeaways

- Inflation accelerated to 2.4% in September from 1.9% in August, while core inflation edged higher to 3.15% from 3.10%.
- The Bank of Canada is likely to take note and hold its policy rate at 2.50% in the upcoming October meeting.
- Rates: The CAD curve prices out cuts - but not enough. FX: The risk/reward profile favors positioning for lower USD/CAD.

Headline inflation rose to 2.4% yoy in September

Consumer Price Index (CPI) inflation rose to 2.4% YoY in September, slightly above expectations (E. 2.2%, BofA 2.3%), up from 1.9% YoY in August (Exhibit 3). The increase was primarily driven by a smaller year-over-year decline in gasoline prices (-4.1% yoy vs. -12.7% yoy in August). Excluding energy, CPI rose 2.7% yoy, while excluding gasoline, it increased 2.6% yoy (Exhibit 4). Travel services prices also contributed, falling just -1.3% yoy (vs. -9.3% in August), but rising 4.6% mom due to higher costs in Europe and the US. On a monthly basis, headline CPI was 0.1% mom nsa (E -0.1%, BofA: 0.0%), following a 0.3% mom nsa increase in July. Seasonally adjusted, CPI rose 0.4% mom.

Core inflation edged higher to 3.15% yoy

The average of the two core measures (trimmed and median) was above expectations at 3.15% (E. 3.00%), up from 3.10% a month ago (revised up from 3.05%). (Exhibit 7). The median core measure rose to 3.2% yoy (revised up), while the trimmed mean increased to 3.1% from 3.0% in August. This print suggests persistent inflationary pressures that could be concerning for the Bank of Canada (BoC). Breaking it down by category, goods inflation accelerated to 1.6% yoy from 0.7% in July, driven by durable goods (2.2% yoy), and services inflation also picked up, rising to 3.0% yoy from 2.8% in the prior month.

We revised our inflation forecasts upward

After incorporating September's print to our forecast, we now expect headline inflation to reach 2.1% by end-2025, up from our previous forecasts of 1.9%, and 1.7% by end-2026, also revised from 1.9% (Exhibit 8, Exhibit 9). We continue to see upside risks, as firms report rising input costs, which are increasingly being passed on to consumers.

BoC: Rising inflation leaves little room for an October cut

We continue to expect the Bank of Canada to hold its policy rate at 2.50% at the upcoming meeting on October 29. We anticipate a 25bp cut in December 10, followed by another 25bp cut on January 28. In our view, [September's strong labor market report](#), and core inflation remaining stubbornly above 3.0% all support a hold in October. That said, downside risks remain: the BoC could judge that the economy requires additional support and opt to cut in October. Our highest conviction is for a total 50bp of cuts from here in the following months.

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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: CAD curve prices out cuts – but not enough

Canadian 2y-30y flattened 4bp on the firmer CPI print with front-end markets pricing out about 2bp of cuts from the Oct meeting, now pricing a 70% probability of a cut from prior 77%. 70% looks high given that Dec/Jan would be an equally viable option to deliver another 50bp cuts – but allows BoC to see if the inflation uptick continues. At 2.5% nominal policy, BoC is arguably running negative real policy and so is likely not worried about being overly restrictive. The 70% probability for the Oct meeting in our reflects a BoC that is more in a hurry than it may need to be.

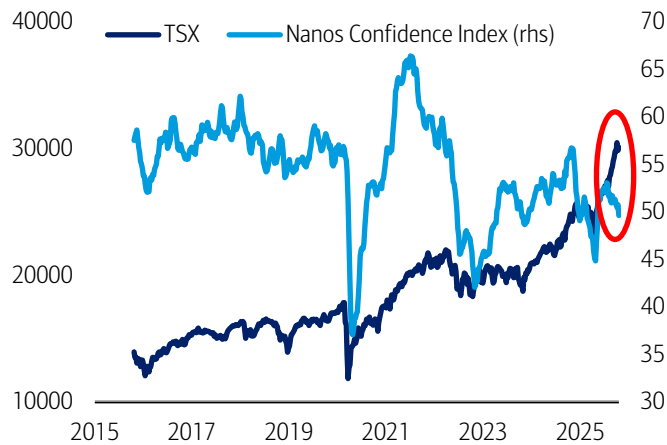
FX: risk/reward favors positioning for lower USD/CAD

Following dovish commentary from Governor Macklem and soft BoC Business and Consumer Surveys for Q3, market pricing for another rate cut at the next meeting materially increased. Despite upside inflation surprise for September, market continues to price in more than 50% chance of an October rate cut. We believe risk/reward now favors hedging for a hawkish BoC surprise.

Decline in sentiment in recent months has diverged from the rising domestic equity market (Exhibit 1). This dislocation suggests economic conditions is likely less dire than the sentiment data suggests. Front-end USDCAD implied vol now trades around 4.0 (Exhibit 2), which shows market is pricing little risk premium into next week’s central bank meetings in this pair. With USD/CAD spot currently trading above 1.40, another BoC rate cut is unlikely to lead to much further upside in spot. However, a hawkish surprise could lead to larger correction lower amid low implied vol positioning.

Exhibit 1: Decline in domestic sentiment in Q3 diverged from the continued equity market rally

TSX index vs Nanos Confidence Index

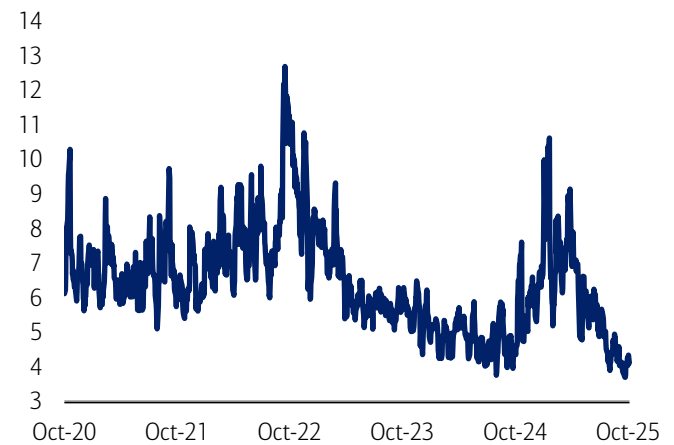


Source: BofA Global Research, Bloomberg

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Exhibit 2: Front-end USDCAD implied vol close to 4.0 is at the low vs history

2-week USDCAD implied vol



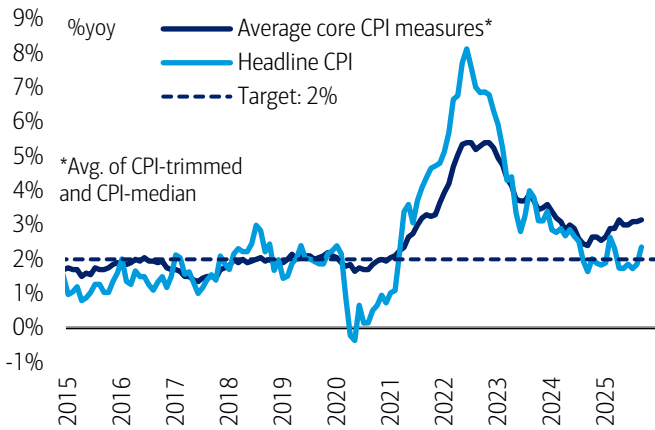
Source: BofA Global Research, Bloomberg

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Exhibit 3: Headline rose 2.4% and core rose 3.15% in September

Headline and core inflation (%yoy) (2015-2025)

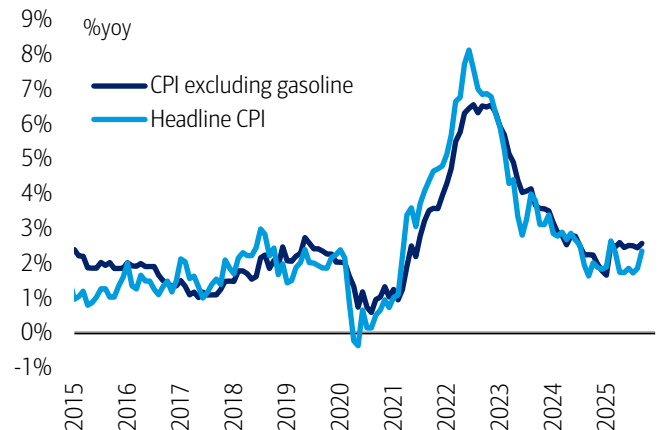


Source: BofA Global Research, Stat Canada, Haver

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Exhibit 4: CPI excl. gasoline rose 2.6% in September

Headline Inflation and CPI excluding gasoline (%yoy) (2015-2025)



Source: BofA Global Research, Stat Canada

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Exhibit 5: Recreation, Education and Reading put the most upside pressure at 0.7% mom sa on inflation, followed by food at 0.4%

CPI heatmap: % mom nsa, (September 2025)

Component	Sep-25	Aug-25	Jul-25	Jun-25	May-25	Apr-25	Mar-25	Feb-25	Jan-25	Dec-24	Nov-24	Oct-24	Sep-24
Headline	0.1%	-0.1%	0.3%	0.1%	0.6%	-0.1%	0.3%	1.1%	0.1%	-0.4%	0.0%	0.4%	-0.4%
Food	0.4%	0.0%	0.6%	0.1%	0.5%	0.4%	1.7%	1.9%	-0.5%	-1.8%	0.5%	0.1%	0.0%
Shelter	0.1%	0.1%	0.3%	0.2%	0.0%	-0.1%	0.2%	0.2%	0.3%	0.3%	0.3%	0.7%	0.1%
Household Operations/Furnishings/Equipment	0.1%	0.3%	0.5%	-0.2%	0.5%	0.8%	-0.3%	0.9%	1.5%	-1.1%	-0.9%	0.2%	-0.2%
Clothing and Footwear	-0.1%	0.3%	-1.9%	-0.4%	1.4%	-0.2%	1.6%	1.6%	0.0%	-3.0%	-0.8%	2.4%	0.9%
Transportation	-0.5%	-0.3%	0.4%	0.5%	0.7%	-1.5%	-0.3%	0.3%	-0.2%	1.8%	0.3%	0.4%	-2.4%
Health and Personal Care	0.3%	0.3%	0.1%	0.3%	1.0%	0.5%	0.1%	0.5%	-0.1%	-0.2%	-0.2%	0.0%	0.5%
Recreation, Education and Reading	0.7%	-1.2%	0.5%	-0.8%	1.7%	-0.2%	-0.8%	3.4%	-0.6%	-0.7%	-0.5%	0.0%	-0.4%
Alcoholic Beverages and Tobacco Products	0.1%	0.2%	0.0%	-0.1%	0.2%	0.2%	2.3%	1.5%	-0.6%	-2.4%	0.2%	0.1%	-0.1%

Source: BofA Global Research, Stat Canada, Haver

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Exhibit 6: Year over year, in August food inflation ticked up to 3.8%, followed by Health and Personal Care at 2.6%

CPI heatmap: % yoy (September 2025)

Component	Sep-25	Aug-25	Jul-25	Jun-25	May-25	Apr-25	Mar-25	Feb-25	Jan-25	Dec-24	Nov-24	Oct-24	Sep-24
Headline	2.4%	1.9%	1.7%	1.9%	1.7%	1.7%	2.3%	2.6%	1.9%	1.8%	1.9%	2.0%	1.6%
Food	3.8%	3.4%	3.3%	2.9%	3.4%	3.8%	3.2%	1.3%	-0.6%	0.6%	2.8%	3.0%	2.8%
Shelter	2.6%	2.6%	3.0%	2.9%	3.0%	3.4%	3.9%	4.2%	4.5%	4.5%	4.6%	4.8%	5.0%
Household Operations/Furnishings/Equipment	2.4%	2.1%	1.4%	1.5%	1.6%	1.1%	0.8%	0.8%	-0.2%	-0.8%	-0.7%	-0.1%	-0.2%
Clothing and Footwear	0.8%	1.7%	0.8%	2.0%	0.5%	-0.8%	0.2%	1.4%	-1.3%	-4.5%	-3.8%	-2.3%	-4.4%
Transportation	1.5%	-0.5%	-1.5%	-0.6%	-1.3%	-1.9%	1.2%	3.0%	3.4%	2.3%	1.1%	0.2%	-1.5%
Health and Personal Care	2.6%	2.8%	2.8%	2.7%	2.1%	1.9%	2.5%	2.4%	2.3%	3.1%	2.8%	3.1%	3.1%
Recreation, Education and Reading	1.6%	0.5%	0.9%	1.6%	0.8%	1.4%	0.9%	3.7%	1.9%	1.8%	-0.9%	-0.9%	0.0%
Alcoholic Beverages and Tobacco Products	1.5%	1.3%	1.9%	1.9%	2.0%	2.1%	2.4%	0.6%	-1.0%	0.7%	2.7%	3.0%	3.0%
Average core CPI measures													
Core Trimmed Mean	3.2%	3.1%	3.1%	3.0%	3.0%	3.2%	2.9%	2.9%	2.7%	2.6%	2.7%	2.7%	2.4%
	3.1%	3.0%	3.1%	3.0%	3.0%	3.1%	2.9%	2.9%	2.7%	2.6%	2.7%	2.7%	2.5%

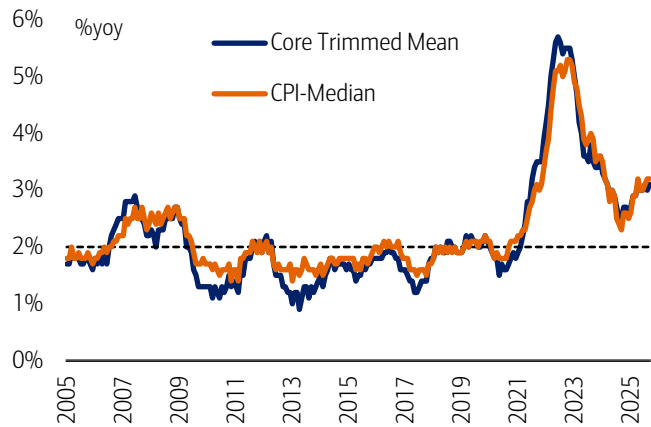
Source: BofA Global Research, Stat Canada, Haver

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Exhibit 7: Both core measures proved sticky in September and remained above 3.0%

Core inflation measures (% yoy) (2005-2025)



Source: BofA Global Research, Stat Canada, Haver

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Exhibit 8: We expect inflation to rise 1.7% by end-2026

Inflation forecasts (yoy%) (2008-E2026)



Source: BofA Global Research estimates, Stat Canada, Haver

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Exhibit 9: We now expect inflation at 2.1% YoY by end-2025 and at 1.7% YoY end-2026

Monthly CPI forecasts (nsa)(2024-E2026)

	Level	mom (%)	yoy (%)
2024: Dec	161.2	-0.4	1.8
2025: Jan	161.3	0.1	1.9
2025: Feb	163.0	1.1	2.6
2025: Mar	163.5	0.3	2.3
2025: Apr	163.4	-0.1	1.7
2025: May	164.3	0.6	1.7
2025: Jun	164.4	0.1	1.9
2025: Jul	164.9	0.3	1.7
2025: Ago	164.8	-0.1	1.9
2025: Sep	164.9	0.1	2.4
2025: Oct	165.3	0.2	2.1
2025: Nov	165.1	-0.1	2.1
2025: Dec	164.6	-0.3	2.1
2026: Jan	164.3	-0.2	1.9
2026: Feb	165.2	0.5	1.3
2026: Mar	166.0	0.5	1.5
2026: Apr	166.3	0.2	1.8
2026: May	167.1	0.5	1.7
2026: Jun	167.4	0.2	1.8
2026: Jul	167.8	0.3	1.8
2026: Aug	168.0	0.1	1.9
2026: Sep	167.8	-0.1	1.7
2026: Oct	167.9	0.1	1.6
2026: Nov	167.8	-0.1	1.6
2026: Dec	167.4	-0.2	1.7

Source: BofA Global Research Estimates, Stat Can, Haver

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