BANK OF CANADA
BANQUE DU CANADA

BACKGROUNDERS

The Consumer Price Index

The Consumer Price Index (CPI) provides a broad measure of the cost of living in Canada. While there are other ways to measure price changes, the CPI is the most important indicator because of its widespread use, for example, to calculate changes in government payments such as the Canada Pension Plan and Old Age Security.

Through the CPI, Statistics Canada tracks on a monthly basis, the retail price of a representative shopping basket of about 600 goods and services from an average household's expenditure on food, housing, transportation, furniture, clothing, and recreation.

The percentage of the total basket that any item occupies is called the "weight" and reflects typical consumer spending patterns. For example, since people tend to spend more on food than clothing, changes in the price of food have a bigger impact on the index than changes in the price of clothing and footwear.

Calculating the CPI

Prices are measured against a base year. The base year is currently 2002, and the basket for that year is given the value of 100. In 2012 the CPI averaged 121.7, which means that what you could buy for $100 in 2002 cost $121.70 in 2012. The Bank of Canada website has an Inflation Calculator that uses monthly CPI figures from 1914 to the present to show the impact of inflation on purchasing power.

The rate of change of the CPI is typically reported as the percentage change in the index over the past 12 months. To provide a reliable picture of the short-term trend of inflation, comparisons of month-to-month changes in the index are adjusted to reflect predictable seasonal price changes.

Updating the CPI

The CPI basket is updated from time to time by Statistics Canada to reflect broad changes in consumer spending habits, as well as to take account of changes in products and services.

Because of the difficulties of measuring price changes due to changes in the quality of products and other factors, the CPI may contain a certain measurement bias that prevents it from giving a completely accurate picture of inflation. Recent studies of this bias suggest that the CPI may overstate inflation by about half a percentage point.

The Bank of Canada monitors changes in the CPI in deciding when to adjust its policy interest rate to keep inflation on target. To assess the trend of inflation, the Bank finds it very helpful to monitor "core" inflation measures, including the CPIX, which excludes eight of the most volatile components (fruit, vegetables, gasoline, fuel oil, natural gas, mortgage interest, intercity transportation, and tobacco products), as well as the effect of changes in indirect taxes on the remaining components. The Bank monitors core inflation to help achieve the total CPI inflation target, not as a replacement for it.

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