

## ECONOMIC VIEWPOINT

# The Impact on Inflation of Recent Changes to Federal Pollution Pricing

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### HIGHLIGHTS

- ▶ With Canada's new Prime Minister having announced that the federal price on pollution will be eliminated, members and clients have asked: what will be the impact on inflation?
- ▶ We've estimated that total CPI inflation will be about 0.7 percentage points lower in April 2025 than it would have been if the price on pollution were maintained. More specifically, we now expect year-over-year price growth to advance by 2.1% y/y in April 2025, versus 2.7% in our forecast including pollution pricing.
- ▶ But it should be noted that this is largely a one-time drop in the price level. As such, we expect total CPI inflation to remain below our previous forecast from April 2025 through March 2026, but to then broadly return to its previous path.
- ▶ Our analysis corroborates the conclusions reached by the Bank of Canada—the elimination of the price on pollution will modestly reduce headline inflation for a year. It will also take some marginal pressure off inflation going forward, as the price on pollution was set to increase steadily every year.

With Canada's new Prime Minister having announced that the federal price on pollution will be eliminated, members and clients have asked: what will be the impact on inflation? This note answers that question.

### Our Estimated Impact on Inflation

To estimate the impact on inflation of eliminating the price on pollution, we look to three different components of the Consumer Price Index (CPI): energy, food and total CPI excluding food and energy (from herein referred to as core inflation).

Importantly, we also account for the fact that the price on pollution only applied to eight provinces (Alberta, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan) and two territories (Yukon and Nunavut). As such, eliminating the federal price on pollution on a litre of gasoline won't translate into a one-for-one reduction in the average price of a litre of gasoline in Canada, for

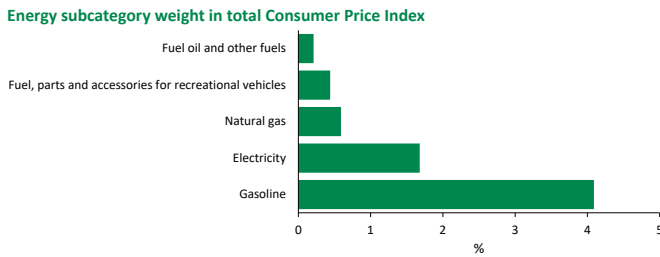
example. That said, the other provinces and territories have their own emissions pricing regimes. If they choose to make changes to their pollution pricing policies, that will further weigh on near-term energy prices.

Lastly, this analysis doesn't explicitly account for the impact on inflation of any change in near-term carbon emissions due to the elimination of the price on pollution. It also doesn't consider the inflationary implications of alternative emissions pricing systems that may replace the price on pollution. These considerations are beyond the scope of this analysis and may be explored at a later date.

### The Impact on Energy CPI

The energy CPI component is comprised of five price subcategories: gasoline; fuel oil and other fuels; fuel, parts and accessories for recreational vehicles; natural gas; and electricity. Together, these make up just over 7% of the total CPI basket, of which gasoline is more than half (graph 1 on page 2).

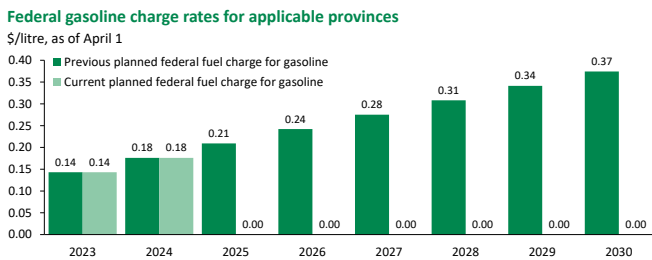
**Graph 1**  
Gasoline is the Largest Contributor to the Energy CPI



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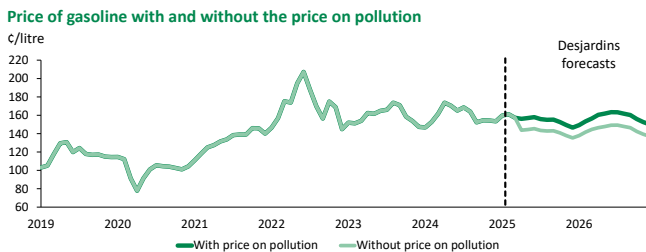
Looking more specifically to gasoline, removing the price on pollution will lower the cost by about \$0.18 per liter on April 1 in provinces where it is applied. In contrast, the price on pollution was previously intended to rise to \$0.21 per litre and continue to increase thereafter (graph 2). As such, we expect the average price of gasoline to fall to \$1.44 per liter on April 1 as opposed to \$1.56, less than \$0.18 per litre as the federal price on pollution doesn't apply in all provinces (graph 3). That means

**Graph 2**  
The Price on Pollution will be Removed on Gasoline in April 2025



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**Graph 3**  
The Price of Gasoline Will be Lower Without the Price on Pollution



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the gasoline CPI should fall by about 8.4% m/m in April relative to March. Consequently, gasoline inflation is likely to be about -16.8% y/y in April over a year earlier, as opposed to the -9.8% previously expected. By the end of 2026, the price of a litre of gasoline should be about \$0.13, or 9%, lower on average in Canada because of eliminating the price on pollution.

While gasoline may be the largest contributor to the energy CPI, it is not alone. Fuel for recreational vehicles makes up 0.44% of the total CPI basket. This CPI category closely tracks the price of gasoline. Consequently, we expect it to fall to a similar extent, dropping by -2.1% m/m in April. On a year-over-year basis, we expect the price of fuel for recreational vehicles to fall by 8.7% y/y in April, as opposed to -6.7% when including the price on pollution.

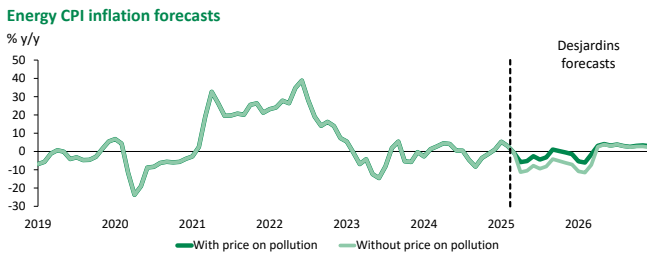
In contrast to gasoline and fuel for recreational vehicles, the federal government temporarily suspended the price on pollution for home heating oil in late 2023. As such, the announced elimination of the price on pollution will have no impact on the price Canadians pay for this specific heat source. However, there are other types of fuel used to heat homes which are still subject to the price on pollution, such as propane. Consequently, there will still be an impact of the price reduction on this energy CPI subcategory. However, it will be relatively minor compared to other fuel CPI subcategories.

Turning to other utilities, natural gas makes up nearly 0.6% of the total CPI basket. Based on our analysis, removing the price on pollution will cause the price of natural gas to fall by 12.8% m/m in April from March. If the price on pollution would have remained in place, the cost of natural gas would have edged modestly higher in the month, by around 0.5%.

In contrast to the other series that make up the energy CPI, electricity prices won't be drastically affected by the elimination of the price on pollution given extensive regulation in different provinces. In addition, industrial emitters are covered under the Output-Based Pricing System, and it remains unclear whether this policy will be removed.

All in all, we are projecting the energy CPI to fall by -6.0% m/m in April once the price on pollution is removed, compared to -0.2% if it were to remain in place. On a year-over-year basis, energy CPI is forecast to fall by 11.3% y/y in April, more than double the anticipated 5.8% decline if the price on pollution were to remain in place. However, it's important to note that much of the impact of eliminating the price on pollution on energy CPI inflation will be short lived, being largely unnoticeable in price growth after a year (graph 4 on page 3).

**Graph 4**  
**Energy Inflation Should be Weaker without a Price on Pollution**



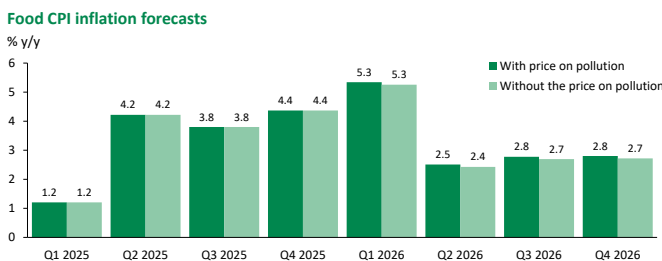
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The Cost of Food

When considering how energy prices feed into food inflation in Canada, there are two key channels by which they affect prices households pay at stores and restaurants. The cost of fuel for transportation is the main channel (although the Canada Carbon Rebate for Small Businesses means some of the price on pollution was ultimately reimbursed). Another is the Farm Products Price Index (FPPi), which measures the change through time in prices received by farmers from the sale of agricultural products.

Consequently, the impact of eliminating the price on pollution likely won't show up in food prices as quickly as it will in the cost of fuel. Beyond a temporary boost in Q1 2026 which relates to the GST/HST holiday, food inflation is only likely to be negligibly lower in 2026 as a result of the elimination of pollution pricing (graph 5).

**Graph 5**  
**Food Inflation Should Barely Reflect the Elimination of Pollution Pricing**

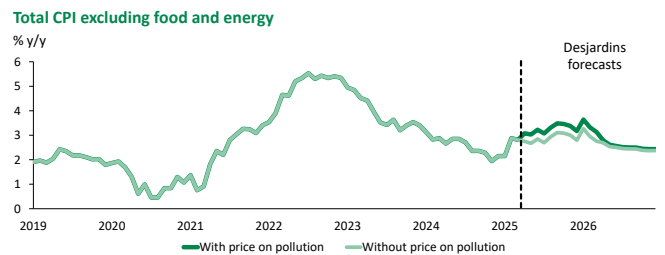


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Other Prices Canadians Pay

The measurable impact of changes in energy prices on other inflation categories tends to be even more limited. Lower energy prices will weigh primarily on the prices of the transportation categories that are outside of gasoline; footwear and apparel; and alcohol, tobacco and cannabis among underlying inflation categories. Taken together, we expect core CPI inflation to end 2025 modestly below where it would have been if the price on pollution had remained in place (graph 6).

**Graph 6**  
**Underlying Inflation Should be Weaker without a Price on Pollution**



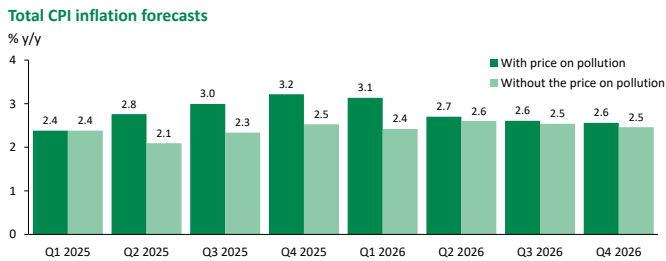
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However, it should be noted that there is significant uncertainty around our forecast for core CPI inflation after the pollution price is eliminated. That's because, while demand is likely to be spurred by lower prices, thereby pushing inflation higher, this should be largely offset by the end of the Canada Carbon Rebate. Indeed, given the rebate goes disproportionately to lower-income households, cancelling it could lead to a greater share of the savings being invested rather than spent. Some businesses may also keep their prices relatively unchanged, where possible, and absorb the tax cut as additional revenue.

The Full Impact

Putting these impacts together, we've estimated that total CPI inflation will be about 0.7 percentage points lower in April 2025 than it would have been if the price on pollution were maintained. More specifically, we now expect year-over-year price growth to advance by 2.1% y/y in April 2025, versus 2.7% in our forecast including pollution pricing. But it should be noted that this is largely a one-time drop in the price. As such, we expected total CPI inflation to remain below our previous forecast from April 2025 through March 2026, but to then broadly return to its previous path (graph 7 on page 4).

**Graph 7**  
**Total Inflation Should be Lower Without the Price on Pollution**



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Of course, without the price on pollution rising incrementally every April 1, inflation will be about 0.1 percentage points lower every year of the forecast than it would have been otherwise. That's also true even after the one-time price drop is long in the rearview mirror.

### How Our Estimate Compares to Others

To get a sense of how reasonable our estimated impact on inflation is of removing the price on pollution, we can look to other literature on this topic. For instance, during a [House of Commons Finance Committee Meeting](#) on May 2, 2024, Governor Macklem shared that the Bank of Canada's estimated that eliminating the carbon tax would result in inflation being 0.7 percentage points lower for a year, and normalizing thereafter.

With this in mind, our estimate of a 0.7 percentage point downshift in total CPI inflation in April because of eliminating the price on pollution is in line with other estimates. So is the conclusion that the resulting drag on headline inflation will be time limited, and only minimally reflected in the inflation numbers after March 2026.

### Conclusion

Our analysis presented here corroborates the conclusions reached by the Bank of Canada—the elimination of the price on pollution will modestly reduce headline inflation for a year. It will also take some marginal pressure off inflation going forward, as the price on pollution increased steadily every year.