ECONOMIC VIEWPOINT

This report was updated on January 15, 2025, to reflect new information from Statistics Canada.

How Will the GST/HST Holiday Impact Canadian Inflation?

By Randall Bartlett, Deputy Chief Economist

HIGHLIGHTS

- In mid-December 2024, the Government of Canada introduced a two-month GST/HST holiday on a select group of consumer goods and services, which comprise as much as 12% of the total Consumer Price Index (CPI) basket.
- Depending on the assumptions used, the level of total CPI could be reduced by anywhere from 0.1% to 1.1% in January 2025—the only full month of the tax holiday. We've assumed this measure will reduce the level of CPI in the first month of 2025 by 0.6%—the average of our estimates—as not all the savings are likely to be passed on to consumers.
- We expect total CPI inflation to fall from 2.4% to 1.8% y/y in January 2025 because of the GST/HST holiday. This is modestly above the "around 1½%" forecast that accompanied the Bank of Canada's December 2024 interest rate announcement.
- We now expect total CPI inflation for the first quarter of 2025 to come in at 2.2%. But the lower base effects in early 2025 will push the reported year-over-year inflation rate higher in early 2026, and this may be further exacerbated by tariff-induced higher import prices.
- Given the temporary nature of the GST/HST holiday and its modest impact on inflation, we expect the Bank of Canada to look through it when deciding on the level of interest rates. That said, if interest rates continue to decline in line with our forecast, a short-lived resurgence in inflation in early 2026 could pose a communications challenge for the Bank of Canada.

Christmas came early for Canadians last year, with the Government of Canada bringing in a two-month federal sales tax holiday on select goods and services starting in mid-December. This is the only element of a $6.3B package of proposed consumer-friendly measures that passed the House of Commons before the end of 2024. We dug into the economic impacts of the full package of measures, plus other similar measures announced by the Ontario government, in late November. But our analysis of the implications of the sales tax holiday for inflation was relatively scant on details. In this report, we explore those details and the potential consequences for monetary policy.

What's Included in the Sales Tax Holiday

To determine the implications of the sales tax holiday for inflation, we first need to estimate the share of the CPI basket made up of the newly tax-exempt items. Fortunately, the federal government provides a helpful list of those goods and services. However, the list of included and excluded items is so strangely specific that it is difficult to find the weight of each item in the CPI basket (table 1).

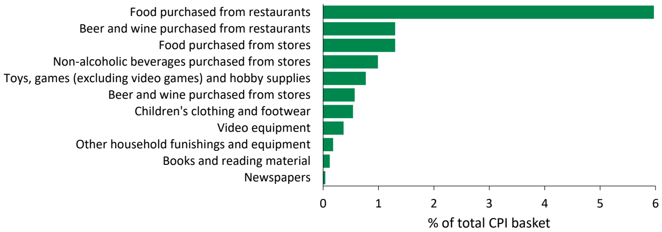
Table 1
Examples of Items Included and Excluded in the GST/HST Holiday

Categories of goods and/or services	Examples of items that qualify	Examples of items that do not qualify
Food	Prepared foods; snacks; energy bars or protein bars; a gift basket with 90% or more of items are untaxed	Food sold from a vending machine; dietary supplements; gift basket with less than 90% of items untaxed
Beverages	Non-alcoholic drinks; beer and malt beverages; wine, cider and sake that are 22.9% alcohol by volume or less	Beverages sold from a vending machine; alcoholic spirits and liqueurs; dietary supplements
Restaurants, catering, and other food or drink establishments	Prepared meals; food delivery; mixed drinks that include only eligible beverages (e.g. a mimosa); catering	Mixed drinks that include an alcoholic beverage (e.g. a sangria); non-food-related catering costs
Books and newspapers	Printed books; printed newspapers	E-books; audiobooks; magazines
Christmas and similar decorative trees	New and used natural and artificial trees; Hanukkah trees and bushes	Decorations for or unrelated to a Christmas tree; mistletoe; wreaths

Government of Canada

We can at least get a broad sense of the share of consumer items impacted by the sales tax holiday. Food purchased from restaurants comprises the largest share of the exempt goods and services, followed by beer and wine purchased from restaurants and food purchased from stores (graph 1). Together with beverages purchased from stores (including beer, wine and non-alcoholic beverages), these items alone make up nearly 10% of the CPI basket. Add the remaining dog's breakfast of newly tax-exempt items, and the total could be closer to 12% of consumer spending. However, this is likely an overestimate as there is minimal information on the exact consumption weight of some of the tax-exempt items.

Graph 1
The GST/HST Holiday Will Largely Impact Food Purchased from Restaurants
Broad Consumer Price Index (CPI) basket categories impacted by GST/HST holiday



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The calculation becomes more complicated still, as the Government of Canada collects not just the 5% federal Goods and Services Tax (GST), but also the Harmonized Sales Tax (HST) on behalf of Ontario (13% including the GST), New Brunswick (15%), Newfoundland and Labrador (15%), and Prince Edward Island (15%). Former Deputy Prime Minister and Finance Minister, Chrystia Freeland, had hoped provinces that participate in the HST rebate would absorb that hit to their coffers in the spirit of the season. To date, none of the four provinces impacted have taken that step, which puts the burden of this additional cost on the Government of Canada. In part for that reason, the Parliamentary Budget Officer (PBO) has determined the GST/HST holiday could cost the federal treasury $1.3B more than estimated by the Government of Canada—an increase of more than 80% over the initial official estimate of $1.6B.

Finally, there is an issue of timing. Price data is collected the first week of every month to ensure consistency. That normally means the December portion of the GST/HST holiday wouldn't affect December's CPI. Instead, the impact wouldn't show up until January 2025 and will continue into February before coming off in March. However, correspondence with Statistics Canada has led us to conclude that they will be including a portion of the CPI impact in December. We have adjusted our forecasts accordingly.

At the high end, if all the savings outlined above are passed on to consumers, the tax reduction could pull down the level of total CPI by as much 1.1% when fully implemented in January 2025—the only full month of the tax holiday. That could bring total CPI inflation down to as low as 1.3% y/y in the first month of the year, not far below the Bank of Canada's forecast of "around 1½% in January."

Not All Savings Will Be Passed On to Consumers

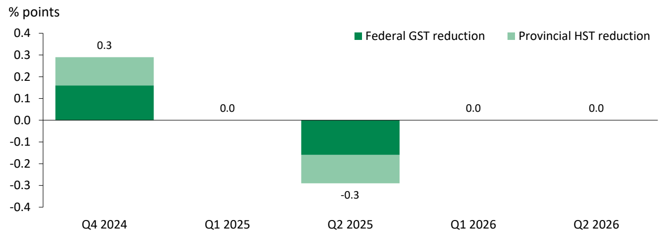
However, not all the savings are likely to be passed on to consumers. For instance, some retailers and restaurateurs may use the opportunity to raise prices or offer fewer seasonal discounts to further recover from the COVID hangover. Indeed, businesses in these sectors were most likely to say they were struggling to repay their Canada Emergency Benefit Account (CEBA) loans last year.

There are also costs associated with the temporary tax change itself that some businesses may want to recoup. For instance, a survey by the Canadian Federation of Independent Business (CFIB) found that "small firms report a median of $1000 in additional costs to reprogram their point-of-sale systems to remove and then reinstate the tax." Additionally, while the CFIB has asserted that "competitive pressure will push most retailers and restaurants into participating … many manufacturers and distributors will not participate, which will cause cash flow issues for small business owners." Consequently, subsequent guidance from the Canada Revenue Agency has suggested that if a business continued to collect GST/HST on the exempt items, it would continue to remit sales tax as normal without penalty.

Finally, there is the question of how much additional demand will be generated by a temporary sales tax cut, and how that will impact inflation. Permanent sales tax changes are known for having a minimal impact on consumption and growth. Time-limited tax cuts have even less impact (graph 2). According to the CFIB, "Only 4% of small business owners believe they will have stronger sales as a result, with 66% of respondents suggesting

Graph 2
New Stimulus Will Boost Growth Now but Will Quickly Fade Away

Contribution to the change in Canadian real GDP growth from GST/HST holiday



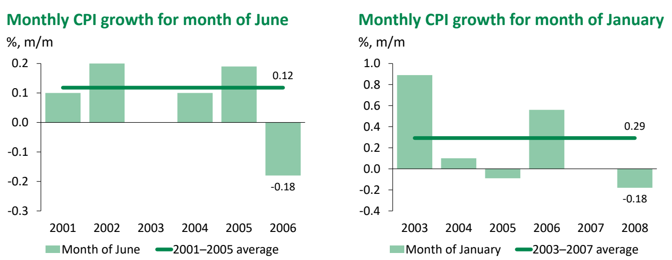
Government of Canada, Parliamentary Budget Officer and Desjardins Economic Studies it will simply shift sales into the tax holiday period." But the direction of travel is clear—even if only during the period of the GST/HST holiday, increased demand should lead to higher inflation excluding taxes.

Alternative Inflation Impact Projections

For these reasons, a 1.1% reduction in the level of the January 2025 CPI could be a significant overestimate. As such, we can alternatively look to the GST cuts of one percentage point (ppt) each that occurred in June 2006 and January 2008 as a guide. Each of those times, Statistics Canada estimated that those cuts permanently reduced the level of the total CPI by 0.6%, under the "assumption that the entire amount of the decrease will be transferred to consumers and that the industrial structure that underlies the way that prices are determined will remain the same." Applying that relative impact to the current GST cut on 10% of the inflation basket gets you a reduction in the level of January 2025 CPI inflation of about 0.5%.

However, looking at the actual inflation data, Statistics Canada's estimate of a 0.6% impact on the level of total CPI may be high. Taking the average of the five Junes and Januarys that preceded the 1ppt GST cuts, the impact looks to be closer to 0.3% and 0.5% (graph 3). That would mean the impact this time around on the level of January CPI could be in the range of 0.25% to 0.45%. This could also be more realistic than assuming all the savings are passed on to consumers.

Graph 3
Past GST Cuts Saw a Moderate Reduction in Monthly CPI Inflation



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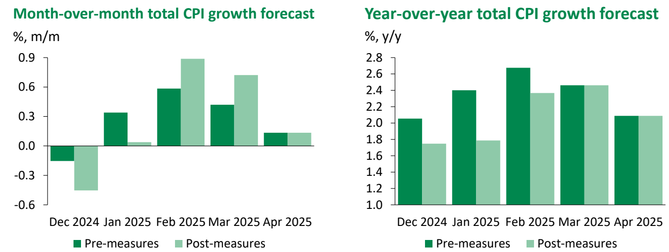
That said, these alternative projections likely underestimate the impact of the GST/HST holiday on the January 2025 CPI. That's because not all goods and services are subject to sales tax, so a 1ppt reduction in the GST would only have impacted a subset of purchases. By contrast, the entirety of the 10-12% of goods and services purchased will have the sales tax removed. This means that the share of taxable items in this concentrated subset is larger than the share of taxable items in the broader CPI, on which the historical estimates mentioned earlier were based. As a result, we think the impact on the January 2025 CPI will land higher than the 0.25% to 0.45% range.

What This Means for the Bank of Canada

With the predicted impact of the GST/HST holiday varying widely depending on the assumptions used, we've baked into our forecast the average reduction in the level of January 2025 CPI of 0.6%. Assuming the partial-tax-holiday months of December and February experience half that reduction and the March level is unchanged, total CPI inflation in January would fall from our initial forecast of 2.4% y/y to 1.8% (graph 4). That's modestly above the roughly 1.5% forecast that accompanied the Bank of Canada's December 2024 interest rate announcement.

Graph 4
GST Reduction Should Reduce Headline Inflation in January 2025



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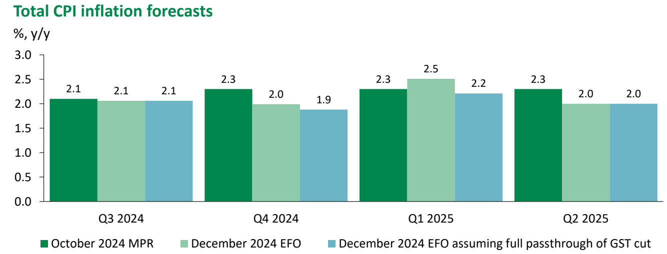
On a quarterly basis, we expect total CPI inflation in Q1 2025 to fall from 2.5% y/y to 2.2% after accounting for the GST/HST holiday (graph 5). That's higher than what we expect the Bank of Canada's 2.3% total CPI inflation forecast for the first quarter of 2025, published in its October 2024 Monetary Policy Report (MPR), could be marked down to in its upcoming January 2025 MPR.

Graph 5
The GST Holiday Should Have a Modest Impact on Q1 2025 Inflation



MPR: Monetary Policy Report; EFO: *Economic and Financial Outlook*
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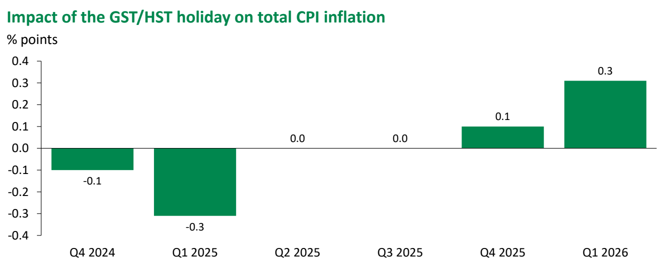
Despite the GST/HST holiday, inflation is likely to remain around 2% because of base effects. Uncharacteristically weak month-over-month price growth in early 2024 is expected to push year-over-year inflation higher in early 2025. Importantly, as the GST/HST holiday will be temporary, what is subtracted from total CPI inflation in early 2025 is likely to pop up again in early 2026 (graph 6). This effect could be similar for the Bank of Canada. However, the Bank doesn't incorporate the inflationary impacts of possible US tariffs, reciprocal tariffs applied by Canada, and the resulting impact on the Canadian dollar into its inflation forecast. These factors could further fuel inflation in late 2025/early 2026, as we indicated in our December 2024 *Economic and Financial Outlook*.

Graph 6
Lower Inflation Now but Higher Inflation in Late 2025 and Early 2026



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Given the temporary nature of the GST/HST holiday and its relatively modest impact on inflation, we expect the Bank of Canada to look through it when deciding on the level of interest rates. That said, if interest rates continue to decline toward 2% in line with our latest forecast, a short-lived resurgence in inflation in early 2026 could pose a communications challenge for the Bank of Canada.