The consumer price index (CPI) drops again!
For 2012, the total annual inflation rate is just 1.5%

HIGHLIGHTS

- The total consumer price index (CPI) fell 0.6% in December.
- The main components of the drop are clothing (-4.4%), gas (-2.4%), motor vehicle purchases (-1.2%), traveller accommodations (-5.3%), and mortgage interest costs (-0.7%).
- In contrast, the components making the biggest upside contribution to the total CPI are fresh vegetables (+4.2%), electricity (+0.7%), financial services (+1.1%), food purchased in restaurants (+0.2%) and rent (+0.2%).
- Between December 2011 and December 2012, the total CPI is up 0.8%.
- The Bank of Canada’s core index (CPIX) also fell by 0.6% that month; its annual change goes from 1.2% to 1.1%.
- For 2012 as a whole, the total annual inflation rate is 1.5%, compared with 2.9% in 2011 and 1.8% in 2010.

COMMENTS

December’s drop by total CPI was bigger than anticipated. This is largely due to much greater seasonal effects than usually seen at this time of year, especially in clothing, food and transportation. In fact, the results for December 2012 are very similar to the results seen in December 2011. Clearly, the seasonal price discounts noted during the holiday season have seemed to be greater in the last few years.

Accordingly, instead of rising gradually, as anticipated, the annual change in the total CPI stayed where it was, at 0.8%. This is below the lower end of the Bank of Canada’s (BoC’s) target range for a second month in a row. Unless prices shoot up in the coming months (which would be surprising in this economy), the situation could persist until next spring. The trend for inflation is very weak, as well. The annual change in the Bank of Canada’s core index (CPIX) also closed in on the lower end of the target range in December. According to our projections, core inflation could stay between 1% and 2% for much of 2013.

Implications: We must conclude that inflation will remain fairly weak in the coming quarters. In this context, we can see why the monetary authorities softened their stance last Wednesday, mentioning, among other things, that a more subdued inflation outlook suggested that some withdrawal of monetary stimulus was less imminent than previously thought. On one hand, this confirms that weak inflation is giving the BoC a lot of leeway; the Bank could be very patient before proceeding to a first key interest rate increase. On the other, Canada’s monetary authorities remain clearly oriented towards an eventual rate increase over the longer term. Therefore, while prices are soft, a cut to the target for the overnight rate seems very unlikely, failing an unforeseen economic disaster.