Economic News
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June 20, 2014

CANADA

Surprising rise in consumer prices and retail sales

HIGHLIGHTS

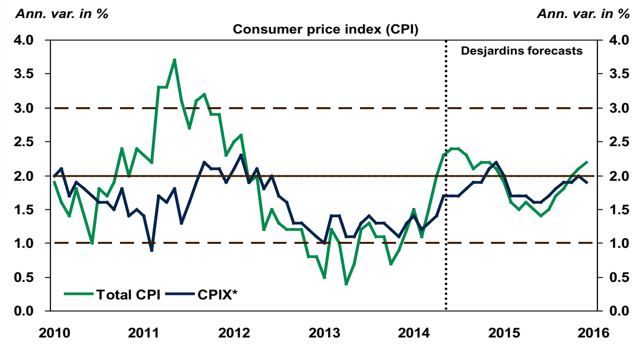
- The 0.5% increase in the total consumer price index (CPI) was slightly above expectations.
- The components playing the biggest role in the increase were traveller accommodation (+13.9%), electricity (+3.1%), meat (+3.3%), gas (+0.8%) and telephone services (+1.3%).
- In contrast, the main components reining in monthly total CPI growth were women's clothing (-1.5%), natural gas (-2.2%), expenses for maintenance and repairs by homeowners (-1.4%), tools and other household items (-2.1%) and tour packages (-1.2%).
- The total annual inflation rate crept up from 2.0% to 2.3%.
- The Bank of Canada's core index (CPIX) also increased 0.5% in May. Its annual variation is now 1.7%, compared with 1.4% in April.
- The jump in retail sales also beat expectations, gaining 1.1% in April.

COMMENTS

Inflation continued to advance in May, and all signs point to some upside pressures continuing to be present in the coming months. Among other things, gas prices will undoubtedly suffer from the effects of heightened uncertainties in the world, particularly in Iraq. The weekly survey of prices at the pump already indicate a more than 1.5% increase in gas prices in June. Under these conditions, we can expect total inflation to stay slightly above 2% in the coming months. The annual change in core inflation will continue its upward trend, but at a more moderate pace. A return to 2% is still possible by the end of 2014.

For retail sales, April's rebound most likely stems from weaker sales in March. This lag in sales is another example of the impact of a particularly tough winter in North America. It will take next month's result to see if retail sales will continue to grow at a satisfactory pace. That said, the conditions for this are fairly favourable, with consumer confidence slightly above the historic average and income growing at a faster pace.

Rising inflation should stabilize soon



* Bank of Canada core index.
Sources: Statistics Canada and Desjardins, Economic Studies

Implications: The recent rise in inflation raises questions about where the country's monetary policy is headed. If the trend holds, Bank of Canada leaders will not be able to ignore the faster-than-expected growth in prices, even if the rise in core inflation is slower. However, this upward trend should lose steam soon; domestic demand is not very robust and the Canadian dollar has appreciated slightly. Our projections indicate that total inflation should stay below 2.5%, allowing the monetary authorities to be patient before ordering an increase in key interest rates, which will likely happen in fall 2015.

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