Economic News

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CANADA

Inflation stays at the bottom target

HIGHLIGHTS

- The total consumer price index (CPI) rose by 0.9% in February, a slightly larger increase than expected.
- The main items that contributed to the upturn were gasoline (+9.4%), tour packages (+25.2%), women's clothing (+3.8%), Internet access services (+3.6%) and furniture (+3.3%).
- On the other hand, the main components that most reined in monthly CPI growth were purchases of motor vehicles (-0.6%), natural gas (-1.6%), electricity (-0.6%), toys and games (-3.6%) and alcoholic beverages (-1.4%).
- The all-items annual inflation rate held steady at 1.0% in February.
- The Bank of Canada's core index (CPIX), which excludes eight volatile components, edged up by 0.6% in February. Its annual change slipped from 2.2% to 2.1%.

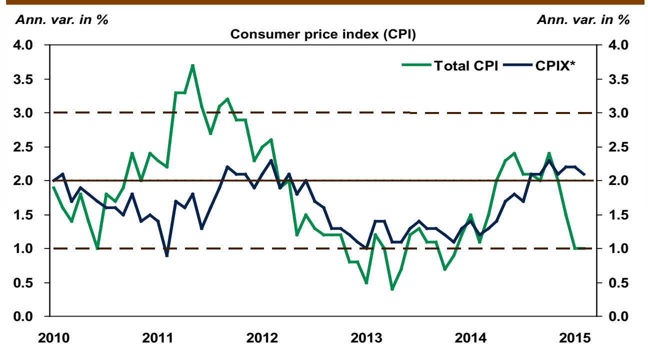
COMMENTS

Some significant disturbances affected inflation in February. For one, gasoline prices reversed course, with a monthly increase of 9.4%. For another, the seasonally adjusted version of the total CPI for February 2015 was up by 0.24%, which represents a definite acceleration compared with previous months. This raises some concerns about the underlying inflation trend.

In addition, the February numbers shine a spotlight on some upwards pressure stemming from the effect of a depreciating Canadian dollar on prices of imported goods. The increase in tour package prices is a good example, along with those in clothing and furniture.

Implications: Clearly, inflation is proving quite resilient. Even though some base effects stemming from the slump in gasoline prices, which occurred between the summer of 2014 and January 2015, may temporarily push the total annual inflation rate below the bottom target in the months to come, some upwards pressure on prices is unmistakable. In fact, the annual variation of the CPIX is still around 2%.

Core inflation is fairly stable, close to the median target



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

This resistant inflation could limit the Bank of Canada's (BoC) freedom of action. Even though the latest economic data paint a rather negative picture of the Canadian economy, the inflation trend could lead the monetary authorities to bide their time before deciding on a second cut in key interest rates. For such a cut to happen, the BoC would have to be convinced either that the economic slowdown will prove to be far more severe than expected (and it is still too early to reach that conclusion, despite January's poor numbers), or that oil prices will keep heading down.

Benoit P. Durocher
Senior Economist

François Dupuis
Vice-President and Chief Economist

514-281-2336 *or* 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

Hélène Bégin
Senior Economist

Benoit P. Durocher
Senior Economist

Francis Généreux
Senior Economist

Note to readers: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.