**CANADA**

**Inflation returns to the median target**

**Retail sales fell sharply in December**

**HIGHLIGHTS**

- The total consumer price index (CPI) rose 0.2% in January.
- The main components contributing most to the rise are fresh vegetables (+9.7%), motor vehicles (+1.5%), electricity (+2.6%), fresh fruit (+6.3%) and air transport (+4.5%).
- Conversely, the main factors reining in total CPI growth are gas (-6.0%), automobile insurance premiums (-2.0%), women's clothing (-2.6%), natural gas (-5.8%) and tour packages (-2.8%).
- The total annual inflation rate has gone from 1.6% to 2.0%.
- The Bank of Canada’s core index (CPIX), which excludes eight volatile components, rose 0.3% in January. Its annual change goes from 1.9% to 2.0%.
- Statistics Canada also released retail sales results for December this morning. The 2.2% decrease recorded was steeper than expected.
- Expresssed in real terms, retail sales fell 2.3%.

**COMMENTS**

January saw a stronger-than-expected advance in consumer prices. The tumble in gas prices no doubt hampered total CPI growth, but the sharp rise in fresh fruit and vegetables, as well as in motor vehicles, particularly offset the impact. This clearly illustrates the effect a depreciating Canadian dollar has on the price of certain imported goods. Under these conditions, total inflation and core inflation converged on the Bank of Canada’s median target (2%) in January. According to our projections, total CPI’s annual change could still fall below the 2% mark as early as next month.

While not much of a surprise, December’s sharp decline in retail sales is disappointing. Black Friday sales in November led to early holiday shopping, and the current seasonal adjustment process struggles to accurately gauge the increasing popularity of this phenomenon. Along the same lines, there is also a question of whether gift card purchases contributed to slowing sales growth in December. Remember, transactions are not actually accounted for until the gift card is exchanged for a good or service. In addition, certain purchases were postponed due to particularly mild temperatures and the lack of snow in several parts of the country.

**Implications:** With several temporary factors at play, December’s sharp decline in retail sales is not too worrisome. January’s results for inflation clearly show the upside risk of a depreciating Canadian dollar. This is obviously a concern that the Bank of Canada should consider in managing monetary policy. As such, despite certain signs of weakness in the Canadian economy, monetary authorities will likely maintain the status quo on key rates in the coming quarters.

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