



# Economic Flash!

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## Canadian CPI: Inflation Stays Benign

% chg	09:Q3	09:Q4	Oct	Nov	Dec
<i>Year/Year Rate (Unadjusted)</i>					
All Items	-0.9	0.8	0.1	1.0	<b>1.3</b>
CPI-X (Ex 8 Volatile & Indirect Taxes)	1.6	1.6	1.8	1.5	<b>1.5</b>
<i>Monthly Rate (Unadjusted)</i>					
All Items			-0.1	0.5	<b>-0.3</b>
CPI-X			0.1	0.4	<b>-0.3</b>
<i>Monthly Rate (SA)</i>					
All Items			0.4	0.5	<b>-0.1</b>
CPI-X			0.3	0.2	<b>0.1</b>
<i>Three-month Rate (SAAR)</i>					
All Items			3.2	4.3	<b>3.5</b>
CPI-X			1.8	2.1	<b>2.1</b>

- Even in a recovery, inflation does not seem to be a problem for Canada. Excess capacity and the strong currency are allowing Canadians the benefit of low prices and therefore low interest rates for longer. Six of the eight broad CPI categories were either flat or down in December, causing a 0.1% drop in the seasonally adjusted CPI (or -0.3% NSA) taking the year-on-year headline inflation rate to 1.3%. Cheaper gasoline, household furnishings and clothing were among the primary drivers of the below-consensus CPI print for December. The persistence of subdued inflation supports the Bank of Canada's conditional pledge to keep interest rates on hold through June of this year.
- Core prices rose marginally (+0.1 on a seasonally adjusted basis) as hotter new house and vehicle prices among others, offset price drops in a variety of core categories such as recreation, household operations and furnishings, and clothing and footwear. While Q4 as a whole ends up a touch above the Bank of Canada's forecast for the quarter (1.6% vs. 1.4%), underlying inflation remains soft in Canada as demonstrated by the relatively stable and low year-on-year core rate at 1.5% in December.
- Following a period of relative softness, food inflation is back with the third consecutive seasonally-adjusted monthly increase. Much of the increase in December was driven by prices of fresh vegetables, which, following a 16% increase in November, ramped up another 5.7% in the month. The 3-month annualized food inflation rate now stands at 2.3%.
- The shelter component of the CPI was flat with lower mortgage interest costs offsetting increases in replacement costs (which is proxied by new home prices). We will likely continue to see mortgage interest costs provide a partial offset to gains in other shelter components through 2010.

- Besides food CPI, transportation was the only other broad category to see a seasonally adjusted increase, and that despite the gasoline price drop in December. Higher prices for the purchase and leasing of new vehicles more than offset cheaper pump prices, taking the 3-month annualized transportation inflation rate to almost 7%.

## Implications & Actions

**Re: Economic Forecast** — While Q4 core inflation has been slightly hotter than the Bank of Canada expected back in October, that small deviation does not affect the current stance of keeping rates unchanged through mid-2010, as reiterated by the Bank just yesterday. The year-on-year inflation rate will continue to rise as we move further into the recovery and make comparisons to depressed year-ago prices, but excess capacity should keep a lid on prices and prevent inflation from straying too far from the Bank's 2% target. Still, with strong economic growth in the first half of the year, we suspect that the Bank may be tempted to raise rates in the third quarter, before taking another pause in the face of a slower second half.

**Re: Markets** — The lower-than-consensus CPI numbers expectedly provided a lift to bonds and took some steam out of the C\$ this morning.

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