



Economic Flash!

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Canadian December CPI: Inflation Crumbles

% chg	11:Q3	11:Q4	Oct	Nov	Dec
<i>Year/Year Rate (Unadjusted)</i>					
All Items	3.0	2.7	2.9	2.9	2.3
CPI-X (Ex 8 Volatile & Indirect Taxes)	1.9	2.0	2.1	2.1	1.9
<i>Monthly Rate (Unadjusted)</i>					
All Items			0.2	0.1	-0.6
CPI-X			0.3	0.1	-0.5
<i>Monthly Rate (SA)</i>					
All Items			0.3	0.1	-0.2
CPI-X			0.2	0.0	0.0
<i>Three-month Rate (SAAR)</i>					
All Items			4.4	3.4	1.0
CPI-X			3.8	2.1	0.7

- As Canadians kissed 2011 goodbye, they may not have known that they were also bidding farewell to a thorn on their side—elevated inflation. Consumer prices fell by 0.2% in December (-0.6% NSA) slashing the inflation rate to 2.3% from the 2.9% pace seen just a month ago. That came as a surprise to analysts who were expecting only a downshift to 2.7% year-on-year. While falling gasoline prices contributed to the drop, ex-volatile prices were similarly weak, with core CPI holding steady (-0.5% NSA) taking the core inflation measure to a tame 1.9% annual pace. Today's data are likely softer than what the Bank had been expecting for inflation in December (based on their latest MPR), but with the focus of BoC policy turning more closely to real-side economic indicators as well as developments in Europe/US, today's data should have limited policy implications.
- Relative to the street's call for slightly firmer core inflation, a surprise drop in vehicle costs helped keep a cap on prices that month. Car prices have been quite volatile lately, and the introduction of new model-year vehicles along with the earlier roll-off of vehicle discounting has added to noise in this measure. Public transportation costs also declined mildly, although urban transportation fare hikes at the start of 2012 in some regions could prove that trend temporary.
- Other categories of core inflation were more or less flat, including level prices for household operations and furnishings. That's the first flat print for that category in several months, which up until now has been boosted by rising prices of household goods, internet/communication and domestic services. Recreation and education-related costs were also flat. Note that prices in this category have been weakening after a long run-up, owing to falling home entertainment equipment costs offsetting higher tuition/educational costs. Clothing costs also declined in December.

- Gasoline prices fell in December, and the drop in that category tipped the CPI measure to a decline in seasonally adjusted terms. Food prices rose by a tame 0.1% seasonally adjusted monthly pace, downshifting from monthly increases that were several times that tempo earlier in the year. Meat and fish prices were up; however, dairy and cereal costs fell. With monthly increases in food prices clearly tapering off, it appears that consumers have already largely borne the brunt of the raw food commodity price pass-through earlier in the year. The month's softer food price dynamics took inflation in that category to 4.4% from the prior month's 4.8% pace.
- At the provincial level, Atlantic Provinces again felt the hottest pace of inflation. Consumer prices in New Brunswick rose at a hot 3.3% year-on-year pace, while Newfoundland and Labrador was close behind, with 3.2% inflation. British Columbia again registered the lowest pace of inflation at 1.7%.

Implications & Actions

Re: Economic Forecast — The sharp downshift in inflation is welcome news to the Bank of Canada, that for months had been insisting global and domestic economic slack would keep inflationary pressure under wraps. With today's surprise drop in headline inflation, the Bank's recent upward revision in the inflation trough to 1.5% in Q2 2012 looks premature, with good odds the rate could trend closer to 1.0% if pump prices hold steady. While that gives the BoC more wiggle room with policy, with the focus remaining external risks (as articulated in the latest MPR) today's data point shouldn't have measurable implications on policy.

Re: Markets — The weaker inflation reading hit the C\$ this morning and supported fixed income.

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