



Economic Flash!

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Canadian July CPI: Crunchy on the Outside But Soft at the Core

% chg	10:Q1	10:Q2	May	Jun	Jul
<i>Year/Year Rate (Unadjusted)</i>					
All Items	1.6	1.4	1.4	1.0	1.8
CPI-X (Ex 8 Volatile & Indirect Taxes)	1.9	1.8	1.8	1.7	1.6
<i>Monthly Rate (Unadjusted)</i>					
All Items			0.3	-0.1	0.5
CPI-X			0.3	-0.1	-0.1
<i>Monthly Rate (SA)</i>					
All Items			-0.2	-0.2	0.6
CPI-X			0.1	0.1	0.1
<i>Three-month Rate (SAAR)</i>					
All Items			-1.0	-1.4	1.0
CPI-X			0.0	1.4	1.0

- Like a candy, Canada's CPI in July was crunchy on the outside but soft at the core. The HST-driven spike in the headline inflation rate was expected, but excluding the effects of taxes, prices were milder as suggested by a soft core inflation rate. Seven of the eight broad CPI categories were up in July, but that was courtesy of the HST implementation in Ontario and BC in July. The estimated HST impacts before the release was around 0.6% and that is exactly by how much headline CPI rose in July (on a seasonally-adjusted basis), causing the year-on-year headline inflation to rise eight notches to 1.8%. The mild inflation report should give the Bank of Canada some comfort in toning down its language about its tightening bias as it contemplates taking a long pause after a September rate hike.
- Core CPI, which excludes volatile items and the HST, was lower than consensus, rising only 0.1% in the month and taking the year-on-year core rate down to 1.6%. Discounting on clothing and footwear items accelerated in July with prices now down 10% annualized in the last three months. Other broad core categories (personal care items, household ops, recreational goods and services) saw the expected price increases, which just offset the drag from clothing. The three-month annualized core rate remains very mild at 1.0%, consistent with ample slack not only in Canada, but abroad.

Implications & Actions

Re: Economic Forecast — The below consensus CPI report for July provides further evidence that Canadian prices remain well under wraps despite the economic recovery underway. The CPI data is also softer than what the Bank of Canada had envisaged (the BoC's estimate for core inflation for Q3 is 1.8%) which should give it

some comfort in ramping down its tightening bias. Canada's Q2 GDP growth should come in at around 2.6%, a touch under the BoC's estimate. But that's still above potential growth, as was the Bank's last outlook for the third quarter as well. We're accordingly still expecting a September rate hike. But the tame core CPI rate, and our expectations that GDP will run below the BoC's outlook over the second half of the year, are consistent with our call for no rate hikes in October and December.

Re: Markets — The softer-than-consensus inflation report was, not surprisingly, positive for bonds and negative for the Canadian dollar.

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