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Flash

Canada

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Economic Analysis

US
Jeffrey Owen Herzog
jeff.herzog@bbvacompass.com

Canada: Inflation higher than expected, adds to constraints on BoC

- **Both underlying and headline inflation rise more than expected**
- **The source of headline's rise largely in volatile components of inflation**
- **Rhetoric so far has been about pauses, not action**

The Consumer Price Index rose 3.1% YoY (BBVA: 2.6%) in August, an increase of .4pp over the previous month's figure. The core or underlying rate of inflation increased 1.9% YoY (BBVA: 1.7%), following a 1.6% gain in July. Both figures were above consensus' expectations. The strongest impulses on headline inflation were higher gasoline prices and food purchased from stores. For core inflation, the increase was mainly due to rising passenger vehicle insurance premiums and food purchased at restaurants. Our sentiments prior to the release were for more rapid reductions in the rate of inflation given our very pessimistic scenario for Canadian growth. As such, today's data reveals that core inflation has almost converged to the Bank of Canada's (BoC) target, while headline inflation has been above target for nine months. Although above target, headline inflation continues to be impacted by volatile components of inflation rather than more sticky – and therefore more worrying – elements. We take this data as evidence of a more complicated environment for the BoC in the near term, casting doubt on some market participants' estimations of a rate cut soon. On the contrary, we regard the data as more indicative of a strategy of pause. Government officials' public statements suggest fiscal reform could be paused if economic conditions deteriorate. The BoC's last statement clearly indicated a pause to interest rate changes. As such, we remain focused on a next rate hike in June 2012.