BBVA Research Flash

Canada

Canada: December inflation coalesces expectations

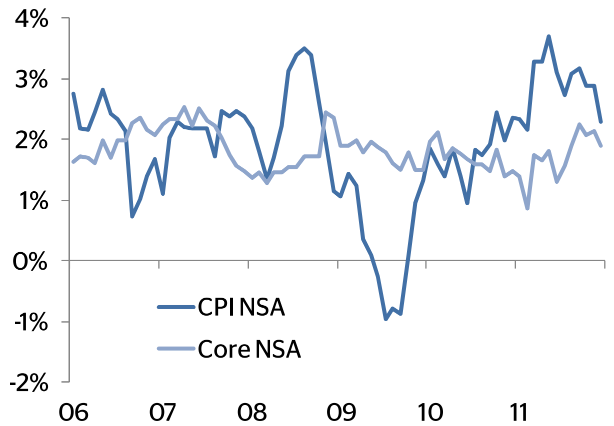
- **Gasoline prices eased in December, helping to pull down headline inflation to 2.3%YoY**
- **The quarterly average is consistent with BoC's and BBVA's headline inflation forecasts**
- **Given that core inflation is well below forecasts and headline is softening, the BoC will enjoy greater interest rate flexibility if exogenous shocks materialize**

Today's CPI report is in line with BBVA's and the Bank of Canada's (BoC) forecast for 4Q11 (Actual: 2.7%, BoC:2.8%, BBVA: 2.8%) and should assuage fears of accelerating inflation following a uptick in early 2011. Core inflation for the quarter also finished similar to our expectations. Transient factors including commodity price run-ups and indirect tax increases are lessening, thus bringing headline inflation in line with BoC's expectations. For example, in November, headline inflation and headline ex-indirect taxes converged, which suggest that the headline figure is now more representative of the long-run trend. In addition, the 7.6% increase in gasoline prices is 5.9pp less than the November increase. Shelter prices did edge up 1.8% YoY although this was an anticipated uptick given the favorable credit climate and robust consumer demand. Nevertheless, exogenous price shocks still dominate the Governing Council's agenda, and include global demand contraction, European contagion, and commodity price acceleration. The December inflation decline, if not an exaggerated seasonal effect, should allow the BoC greater flexibility in future rate decisions, although today's report does favor the more predominant downside risk scenario given weakening global demand and robust commodity supply forecasts for 2012.

Chart 1

Canada Headline and Core Inflation

In YoY % Change, Not Seasonally-Adjusted



Source: Haver Analytics