BBVA Research Flash

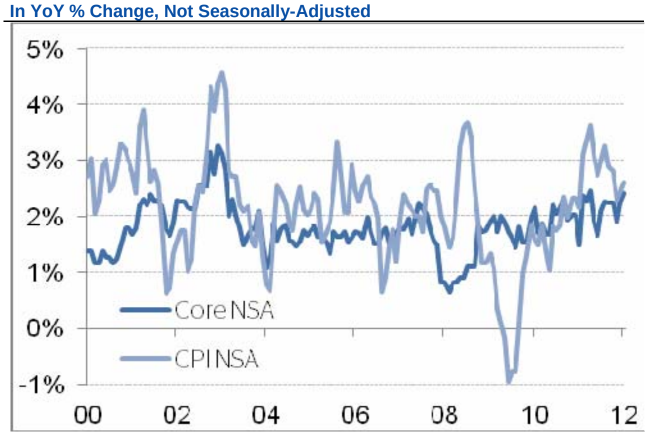
Canada

Canada: Transitory Pressures in February Report

- **Non-Seasonally adjusted inflation (BBVA: 2.4% YoY, Consensus:2.7%YoY) increased 2.6% due to an anticipated jump in gasoline costs (2.6% MoM)**
- **As current energy price pressures are expected to be transitory and domestic growth is slowing, inflation is expected to reverse trend over the next few months**
- **BoC will communicate its expectation of transitory energy prices and focus on "looking through" to core trends, but will also note the potential for an unexpected upturn in global growth conditions to present upside risk to inflation**

For interest rate hawks, today's announcement that headline inflation increased 2.6%YoY on a non-seasonally adjusted (NSA) basis and that nearly all expenditure categories accelerated will bolster the argument for tightening. Major contributors to the February increase in NSA consumer prices were transportation and gasoline which increased 4.2%YoY and 8.9%YoY, respectively. In addition, clothing prices increased 2.9%MoM since January on a NSA basis. On aggregate, NSA core prices, although rather volatile over the past three years, have trended upward (2.3%YoY). On the other hand, seasonally-adjusted core prices, particularly core prices ex food and energy, have displayed a more ameliorative trend. For example, CPI ex food and energy has settled to a low-level of inflation (1.5%YoY 0.1%MoM) since February 2010. Additionally, by the Bank of Canada (BoC) definition, core consumer prices increased 2.3% in the same period. Although slightly above the long-run target of the BoC, the recent increase is likely due to the temporary oil price pressures. Higher-trending inflation would trigger expectations of an early rate increase, but recent movements in the CPI are expected to be temporary. Additionally, Canada's GDP growth is slowing and employment has been morbid. Given uncertainty over the strength of global and North American growth, the BoC is likely to wait on further data developments. However, we do expect BoC to highlight the potential of unexpectedly-improving external demand, which serves as a contrast to its expectations in October than the output gap would persist to 2013. We therefore maintain our expectation of a next rate increase in 2013Q3, with risks more evenly balanced going forward.

Chart 1
Canada Headline and Core Inflation
In YoY % Change, Not Seasonally-Adjusted



Source: Haver Analytics