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Economics Group

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Soft CPI Not Likely to Influence Monetary Policy in Canada

Canadian consumer prices picked up in March, but not enough to lift the year-over-year rate as the consensus had expected. Consumer spending picked up in March, though the strength was concentrated in autos.

Recent Soft Inflation Not Likely to Influence Monetary Policy

After an unexpected slowing in Canadian CPI in March, consumer prices picked up in April, but not as much as expected. The monthly increase of 0.4 percent kept the year-over-year rate of CPI inflation unchanged at 1.6 percent. Headline CPI inflation had been running at 2.0 percent earlier this year, spot-on the midpoint of Bank of Canada's (BoC) 1.0 percent to 3.0 percent target range.

Still, we do not expect the latest inflation figures to substantively influence the BoC's policy at its meeting next week. In fact, the inflation story is more or less living up to the Bank's expectations. Following its April 12 meeting the BoC said that "CPI inflation is expected to dip in the months ahead, as the temporary factors unwind, and then return to 2 per cent later in the projection horizon as the output gap closes."

Strength in Retail Sales Concentrated in Autos

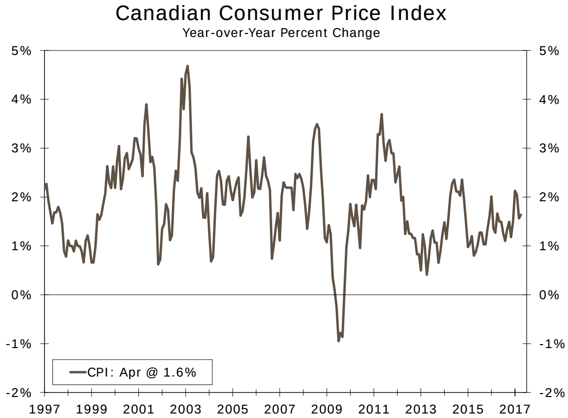
In a separate report also released this morning, Canadian retailers reported a 0.7 percent improvement in March sales after a drop in sales the prior month. The better-than-expected rebound was mostly a function of the strength in motor vehicle sales. Excluding autos, sales were actually down 0.2 percent. On balance we remain cautious on the outlook for the ability of consumer spending to sustain Canadian economic growth in the way that it has thus far in this expansion.

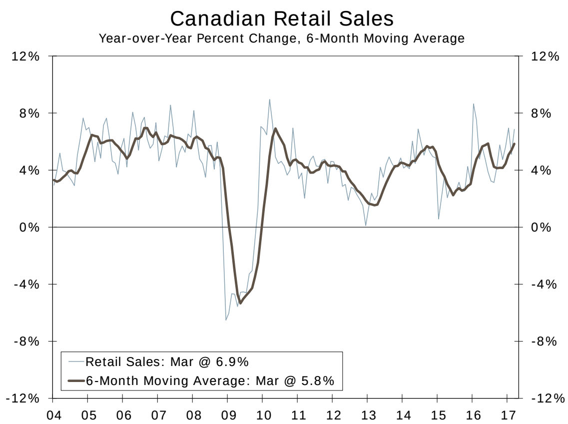
Consumer spending has added to GDP growth in Canada for 31 consecutive quarters. That is almost eight years without a miss. Understandably, that spending growth has been accompanied by a run-up in aggregate measures of consumer debt. As the bottom chart at right shows, households in Canada have been leveraged more than they have been historically. Fast-growing home prices (arguably overheated in some markets) are compelling many Canadians to take on more debt as prices continue to rise.

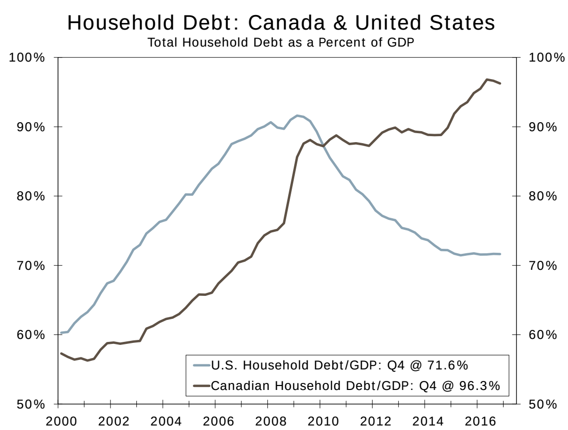
Somewhat counter-intuitively, the cost of living in the country's hottest real estate markets is not holding back the pace of retail sales locally. On a provincial basis, retailers in Ontario reported a 0.9 percent increase in sales during March and British Columbia saw a pick-up of 2.3 percent.

Together, the store sales in these two provinces comprise roughly half of all retail sales in Canada. Both markets have seen year-over-year increases in retail sales (7.5 percent in Ontario and 8.9 percent in British Columbia) that are above the national average of 6.9 percent.

On the brighter side, the labor market remains supportive of consumer spending. Yesterday, Statistics Canada reported a 0.5 percent decline in unemployment insurance claims in March in the latest affirmation of job market strength in Canada.







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