

Canadian CPI Is Tracking Below The BoC's Q4 Forecast

- October's readings were generally on consensus
- Core inflation tick up to 2.1% only because of revisions...
- ...but it remains range bound
- Travel and food prices were weaker than expected
- Q4 inflation is tentatively tracking below the BoC's forecast

Canada, CPI m/m % / CPI y/y %, NSA, October:

Actual: 0.3 / 1.9

Scotia: 0.4 / 2.0

Consensus: 0.3 / 1.9

Prior: Unrevised from -0.4 / 1.9

Canada, Core Inflation y/y %, October:

Average: 2.1 (revised down to 2.0 from 2.1)

Weighted Median: 2.2 (revised down to 2.1% from 2.2)

Common Component: 1.9 (prior 1.9)

Trimmed Mean: 2.1 (prior 2.1)

While inflation readings were on consensus and little changed, the Bank of Canada would have to see a material pick-up in inflation over the last two months of the year in order to hit their Q4 forecast. The Canadian dollar and short-term rates were largely unaffected by the release.

Recall that the BoC forecast 1.9% y/y for headline inflation in Q3 and 2.1% for Q4 in the October MPR. We still have 1.9% for Q3 with no headline revision but the first print for Q4 at 1.9% needs a pretty strong acceleration over the duration of the quarter in order to land at their 2.1% Q4 average. Inflation would have to jump from 1.9% to start the quarter toward 2.2 in December on an interpolated path to average around 2.1% for the quarter. That may be a stretch.

Average core CPI was 2.1% y/y. Technically after rounding that's an up-tick from the prior month, but only because the prior month's reading rounded down to 2.0% due to a small downward revision to the weighted median CPI measure. The broad point that core inflation has been bouncing around 2.0–2.1% y/y since May remains valid. See chart 1.

The durability of staying on the inflation target into 2020 remains a worthwhile debate. By the average of the BoC's two output gap measures, Canada had a modest amount of slack at mid-year equal to around ½% of potential GDP. If GDP growth comes in line with the BoC's forecast for 1.3% in Q3 and Q4, then slack might widen a touch into year-end. Persistent or widened slack could need a bit of a shove by way of an insurance cut in order to stay on the 2% inflation target. Further, the BoC seems to treat 2% as a ceiling unlike the Fed's symmetry message. Since the start of 2010 on a monthly basis, the BoC has fallen short of its 2% inflation target using the average of the core measures 89% of the time. You wouldn't know that given all the back patting going on in Ottawa. Bygones be bygones is the policy bias but it leaves the BoC indirectly vulnerable to the possibility that the Fed further embraces symmetry arguments with its policy review into next year.

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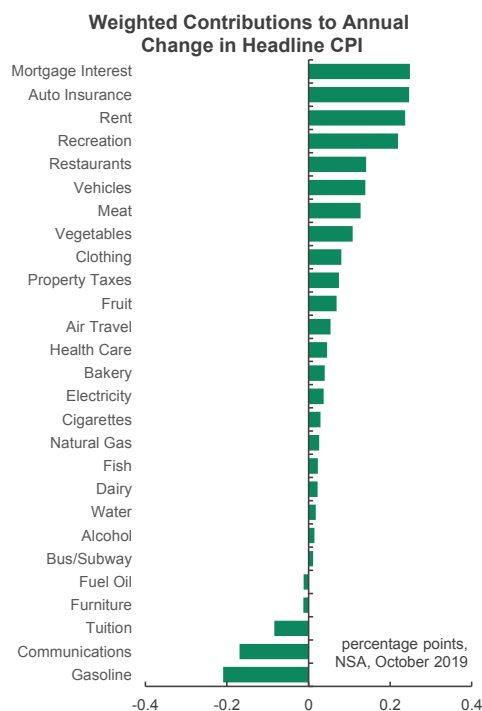
Canadian Core Inflation



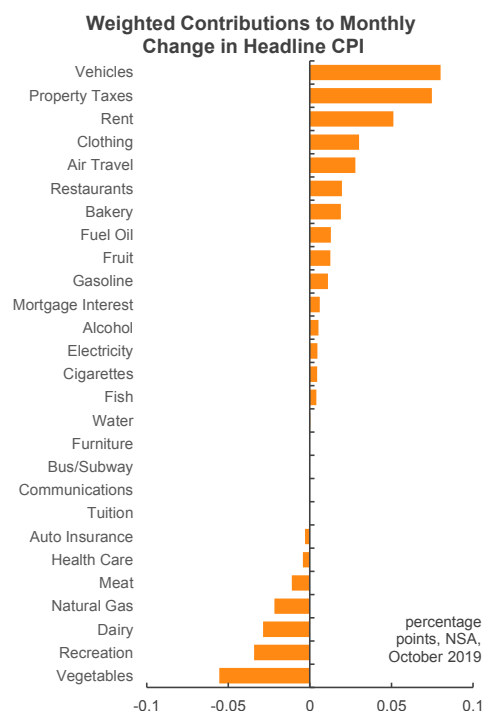
Sources: Scotiabank Economics, Statistics Canada.

As for details, two things threw off my higher than consensus estimate. Charts 2 and 3 show weighted contributions to the change in CPI on a year-ago and month-ago NSA basis to highlight the drivers. One was that food prices were down 0.2% m/m NSA and recreation/reading fell 0.3% m/m. Combined with their weights, those categories knocked -0.1 off my expectations for m/m NSA CPI rounded up and that flowed through to a lower than expected year-ago headline rate. Other categories generally performed as expected.

What drove the rec/reading/education category lower? See charts 4 and 5 for break downs of this category in year-ago and month-ago NSA terms. Among the bigger drags came from traveler accommodation. Travel tours pricing is leading the pack which makes some sense given where CAD at least for anyone with USD. The decline in traveler accommodation was pinned on idiosyncratic factors including year-ago concerts in Vancouver but the breadth of the regional weakness was high.

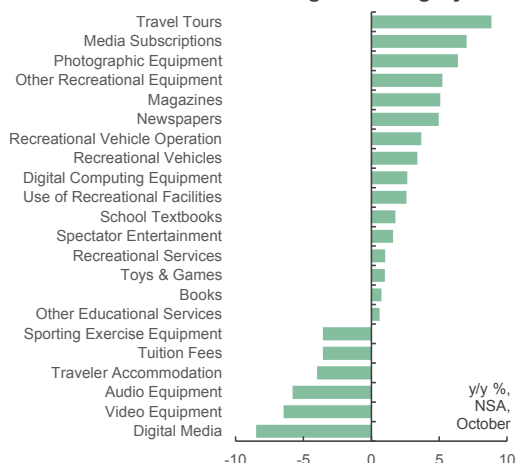


Source: Scotiabank Economics, Statistics Canada.



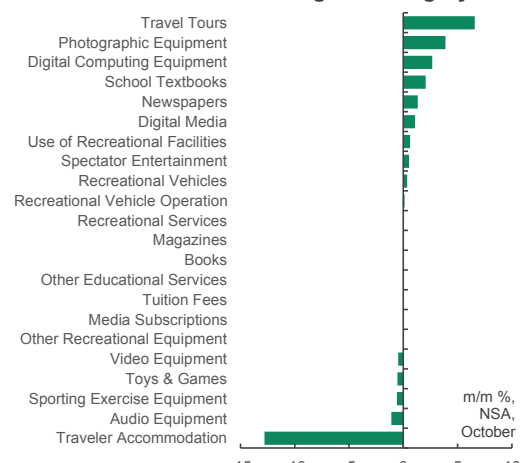
Source: Scotiabank Economics, Statistics Canada.

Breakdown of Annual Changes within Recreation Education and Reading CPI Category



Sources: Scotiabank Economics, Statistics Canada.

Breakdown of Monthly Changes within Recreation Education and Reading CPI Category



Sources: Scotiabank Economics, Statistics Canada.

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