

Canadian Core CPI Will Keep The BoC Sidelined, But Drivers May Be Transitory

- Core CPI increased to 2.2%, highest since the recession
- Drivers of inflation could prove to be transitory...
- ...but this will take time to inform...
- ...keeping the BoC sidelined as activity readings sour
- A modest widening in spare capacity could soften price pressures...
- ...but the bigger argument rests upon idiosyncratic factors...
- ...such as mortgage interest, auto prices, insurance...
-meat, utilities and gasoline

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

Actual: -0.1 / 2.2

Scotia: -0.3 / 2.3

Consensus: -0.1 / 2.2

Prior: 0.3 / 1.9

Canada, Core Inflation y/y %, November:

Average: 2.2 (2.1)

Weighted Median: 2.4 (2.3)

Common Component: 1.9 (1.9)

Trimmed Mean: 2.2 (2.1)

'Core' inflation edged up a tenth to 2.2% y/y in November for the highest reading since June 2009 when the country was in recession (chart 1). Breadth across contributors was significant but skewed toward several idiosyncratic factors that may prove to be transitory as 2020 unfolds. This adds to concern about what weak growth and slightly widening slack into 2020 will do to inflation. Regardless the BoC is likely to stay on the sidelines into at least the early part of the new year even as activity readings including broad GDP growth sour. There are decent reasons to question the durability of the acceleration not least of which being whether momentum across activity readings continues to sour and what the lagging implications for inflation point to, but they will take time to inform and the BoC is rarely proactive in this regard. For now, data dependence with an eye on inflation will keep it parked.

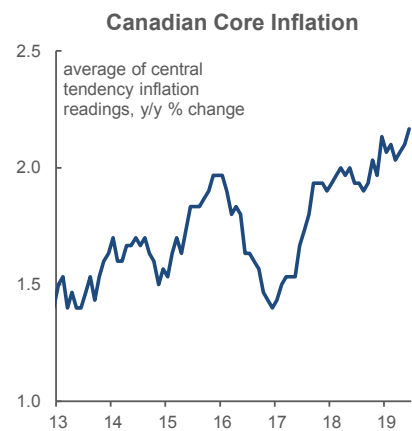
Breadth across the major components is shown in charts 2 and 3 in terms of weighted contributions to the year-ago headline CPI rate and the month-ago seasonally unadjusted inflation rate. Breadth was significant but several of the highest contributors to the year-ago rate may not prove to be durable.

The biggest upside contributor to the year-ago rate was the transportation component due to rising vehicle prices (+2.9% y/y) that StatsCan fingered as driven by "the greater availability of higher-priced 2020 model-year vehicles compared with October." This also probably played a role in driving auto

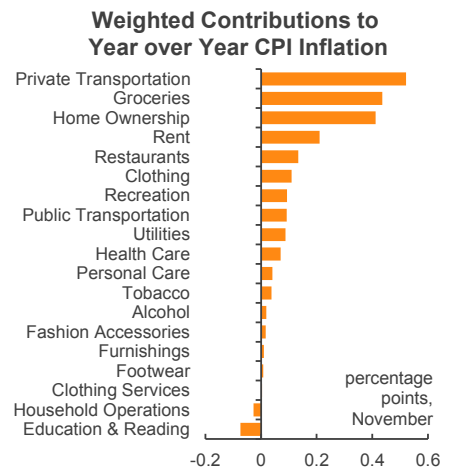
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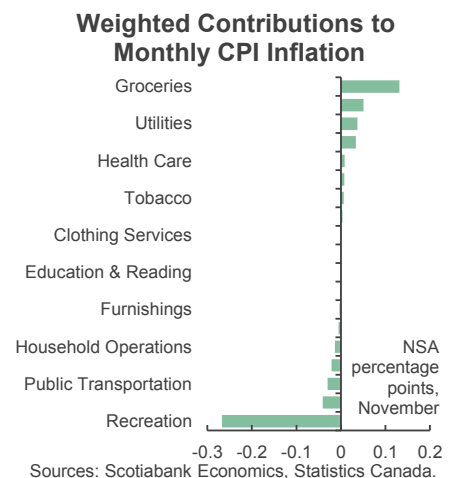
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Sources: Scotiabank Economics, Statistics Canada.



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insurance premiums up by 7.6% y/y (higher priced cars mean higher premiums). If so, that's a compositional issue that may not be durable into 2020.

An added consideration, however, is the effect of the currency on vehicle prices (chart 4); the depreciation of the C\$ over 2018 from the 1.23 USDCAD mark in January 2018 to 1.36 at the end that year is likely putting upward pressure on sticker prices with the historical one-year lag effect on model year pricing. This effect, however, should drop out into the next model year as the C\$ has slightly appreciated by about a nickel to the USD this year and so we shouldn't see vehicle prices repeat as a leading upside contributor to inflation in the coming year.

Grocery prices also climbed and contributed the second most to the headline year-ago inflation rate with a 5.2% y/y rise in meat prices a contributor especially for beef after prior disruptions to North American supply chains and ham & bacon prices. Some of these effects are likely to be transitory as the shock to beef supply chains stabilizes.

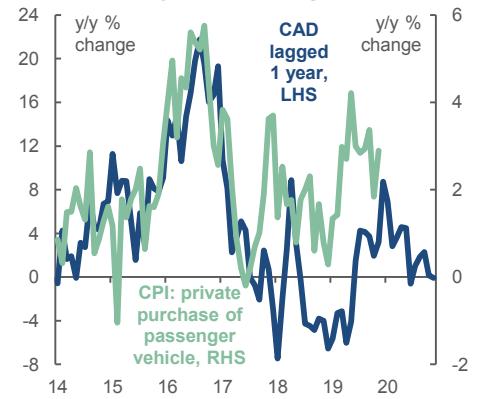
Mortgage interest costs were another upside contributor as they rose by 6.6% y/y for the single biggest upside contributor. This reflects the lagging effects of the BoC's tightening campaign last year given the movements between mortgage interest and the overnight rate as variable rate products are repriced (chart 5). Going forward, one should expect the mortgage interest component to come under downside pressure as the lagging effect of the variable rate repricing drop out and the effects of lower fixed mortgage rates pass through.

Gasoline prices did not rise as much in CPI as they might have given past correlations with the street price of regular unleaded gasoline (chart 6). One possibility is that other grades did not rise by the same magnitude. Still, however, gasoline went from being down by 6.7% y/y in October to up by 0.9% y/y in November and with a 3.1% weight in CPI added about a quarter point to headline inflation on its own in November relative to October.

The impact of the housing market's rebound this year and whether it sticks into next year is perhaps the most uncertain part of the influences. Overall shelter costs had multiple drivers beyond the aforementioned mortgage interest cost component. Mortgage insurance was up 5.5% y/y and probably driven in part by improved house prices but facing the issue of how durable the sales rebound will be into 2020; note, however, that the three month moving average of seasonally adjusted home sales has slowed to a crawl at 0.4% y/y versus 1.5–3% monthly SA gains over the Spring and Summer. Tight rental markets are also driving a 3.1% y/y rise in rent on average across the country.

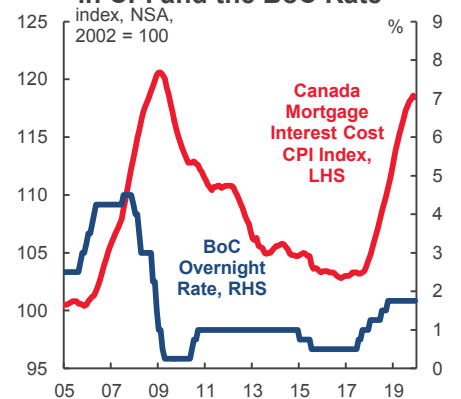
There were multiple other contributors that also may have been transitory. For example, there was a 2.6% y/y increase in Ontario's electricity prices due to a one-off time-of-use rate increase that was only partly offset by higher subsidies. Also, Alberta hiked its tax on cigarettes at the end of October and that contributed to a swing in the 'sins' category that swung from +0.4% y/y in October to +1.2% in November. Also note that other utilities costs are rising above the rate of inflation including water (+2.7% y/y).

Auto Price Inflation Bottoming on Currency Pass-through Effects



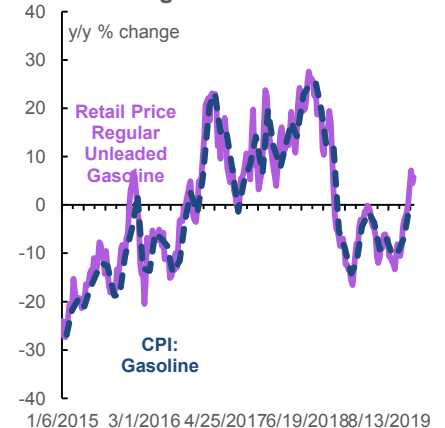
Sources: Scotiabank Economics, Statistics Canada, Bank of Canada.

Canadian Mortgage Interest in CPI and the BoC Rate



Sources: Scotiabank Economics, Bank of Canada, Statistics Canada.

Gas Prices Will Drag CPI Higher Into Year-End



Sources: Scotiabank Economics, Statistics Canada, Natural Resources Canada.

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