

## Canadian Core Inflation Has Only Just Begun Its Descent

- Inflation drops to 2009 levels in line with expectations
- Gasoline drove most of the deceleration...
- ...while food prices accelerated
- Core inflation decelerated to a 15 month low
- Much further downside risk to core inflation lies ahead...
- ...as a lagged response to massively wider spare capacity...
- ...but the BoC may need greater evidence this will persist...
- ...beyond expectations in order to expand stimulus further

### Canada, CPI (m/m % NSA ; y/y % NSA), April:

Actual: -0.7 / -0.2

Scotia: -0.7 / -0.4

Consensus: -0.6 / -0.1

Prior: Unrevised from -0.6 / +0.9

### Canada, Core Inflation, y/y %, April:

Average: 1.8 (prior 1.8)

Weighted Median: 2.0 (prior 2.0)

Common Component: 1.6 (prior 1.7)

Trimmed Mean: 1.8 (prior 1.8)

Canada's inflation rate was roughly in line with expectations in April and the underlying drivers offered few surprises. Accordingly, both CAD and the short-term rates complex shook off the release.

In any event, there had been a separate case for largely ignoring the release given that the BoC has already acted while dismissing negative rates as a policy option. The peak rate of decline in core inflation is likely still well ahead of us given the magnitude of spare capacity that has been built up. Key to the future policy bias is whether this is something that begins to mend after the peak spare capacity starts to be curtailed but that's a long way off from here. A single backward-looking inflation reading at the start of the pandemic sheds little light on that debate.

Headline CPI inflation (-0.2% y/y) sank to its lowest since September 2009 largely because of gasoline. Core prices (1.8% y/y) are rising at the slowest rate since January 2019 with much further downside risk ahead (chart 1). The dispersion across the three types of 'core' inflation readings has risen to a widening spread of 0.4% between common component and weighted median (chart 2). That may renew the focus upon whether some measures of 'core' are superior to others which had been a discussion point with clients when there was similar dispersion around the 2016 period.

Gasoline prices drove the year-ago inflation rate negative while pandemic-driven pricing power at grocers helped to keep CPI ex-gasoline in the black. Why hold a

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Chart 1

### Canadian Core Inflation Was Already Falling Before COVID-19

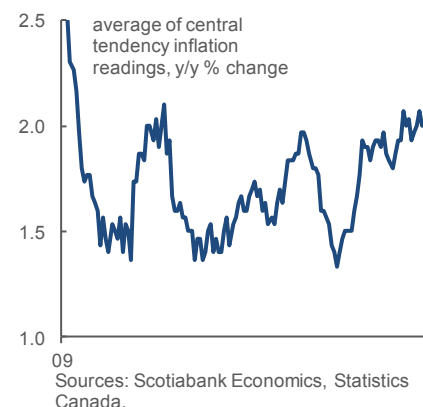
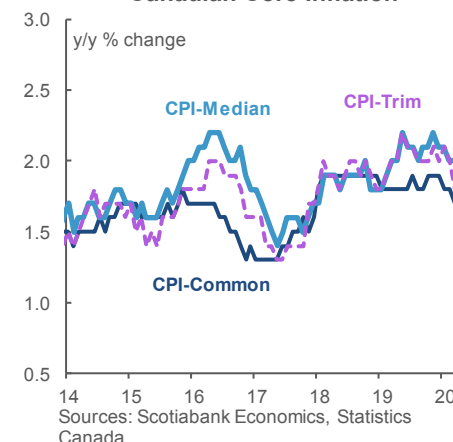


Chart 2

### Canadian Core Inflation



sale when horders are choosing to bang on the doors? It's a free market folks. A 6% y/y record rise in toilet paper prices hit a highly publicized soft spot...but the breadth of gains across grocery prices was nevertheless rather high.

In unweighted terms, the fastest rates of price increases were for air travel, auto insurance, meat and public transportation (chart 3). Go figure for at least some of these. The weakest rates of increase may make more intuitive sense and included gasoline and other fuels, electricity prices after Ontario suspended application of time-of-use rates, and clothing prices.

Weighting the various contributors to the year-over-year inflation rate offers more meaningful results in chart 4. With the nation's automobiles parked in driveways, auto insurance premiums turned out to be the number one driver. Presumably part of the reason for that is that vehicle prices were the number three driver of overall inflation in weighted terms (higher auto prices, higher premiums), although unweighted price increases saw premiums rise by 7.7% y/y and vehicle prices rise at a slower pace of 1.9% y/y.

In weighted terms, gasoline single-handedly knocked 1.2% off the year-ago headline CPI inflation rate such that CPI ex-gasoline would have remained in the black at 1.0% y/y. Food prices added 0.56% to the year-over-year inflation rate.

Chart 5 depicts month-ago seasonally unadjusted price changes. Chart 6 converts this to weighted contributions to month-ago seasonally unadjusted CPI.

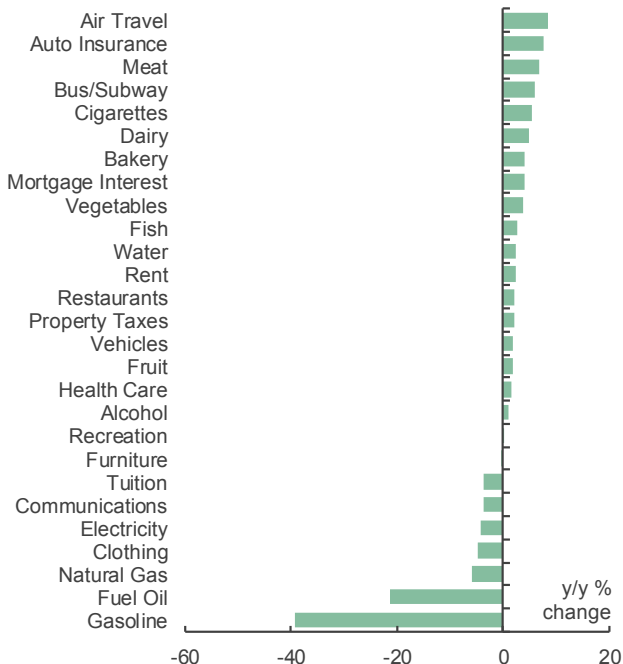
That these were not seasonally normal price swings is conveyed through the 0.7% m/m drop in seasonally adjusted CPI that was driven by a 7% m/m seasonally adjusted drop in clothing and footwear prices, a 2.7% decline in transportation (e.g. gasoline), and smaller declines in shelter, health and personal care prices.

Chart 7 demonstrates the items that were included and the items that were excluded in the calculation of the year-over-year trimmed mean core measure of inflation. Because the top and bottom 20% of the basket are eliminated in the calculation of trimmed mean as a 'core' gauge, the biggest upside and downside movers were kicked out of the basket. I'm still unsure that it's wise to give the boot to 40% of the basket at a major turning point marked by large relative price changes when gauging core measures of inflation.

Lastly, chart 8 is useful as a way of demonstrating what components are included in trimmed CPI by showing the frequency of appearance in each of the twelve months of inflation figures that go into the compounded annual trimmed mean inflation rate. It's useful as a way of showing what measures are most frequently captured.

Chart 3

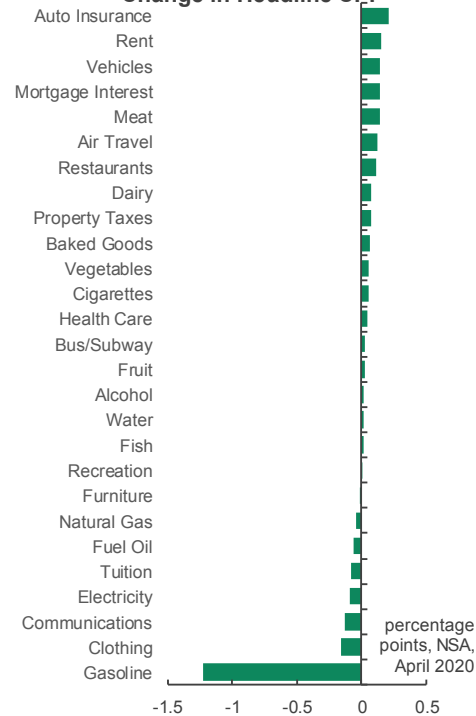
### Annual Changes in April Headline CPI Components



Sources: Scotiabank Economics, Statistics Canada.

Chart 4

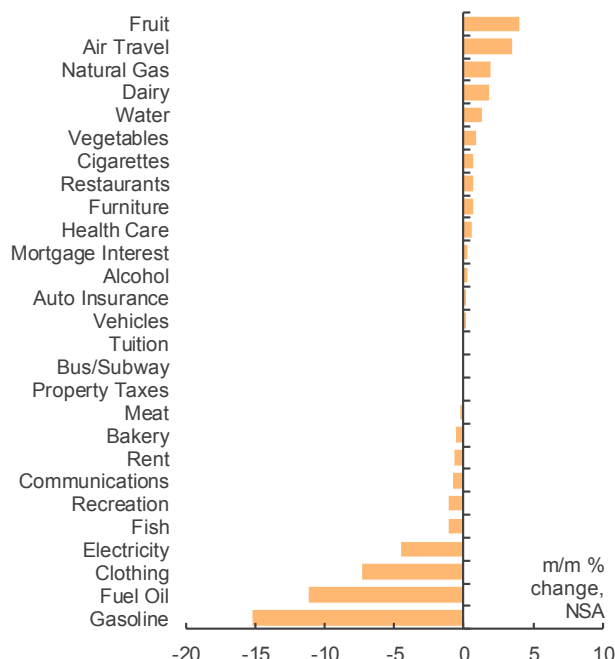
### Weighted Contributions to Annual Change in Headline CPI



Source: Scotiabank Economics, Statistics Canada.

Chart 5

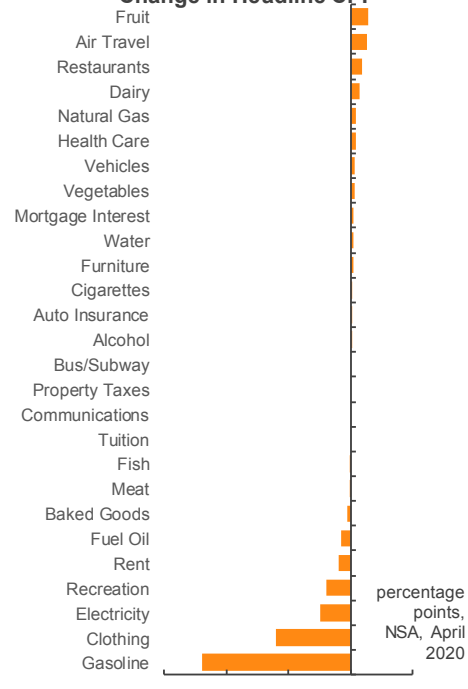
### Monthly Changes in April Headline CPI Components



Sources: Scotiabank Economics, Statistics Canada.

Chart 6

### Weighted Contributions to Monthly Change in Headline CPI



Source: Scotiabank Economics, Statistics Canada.

Chart 7

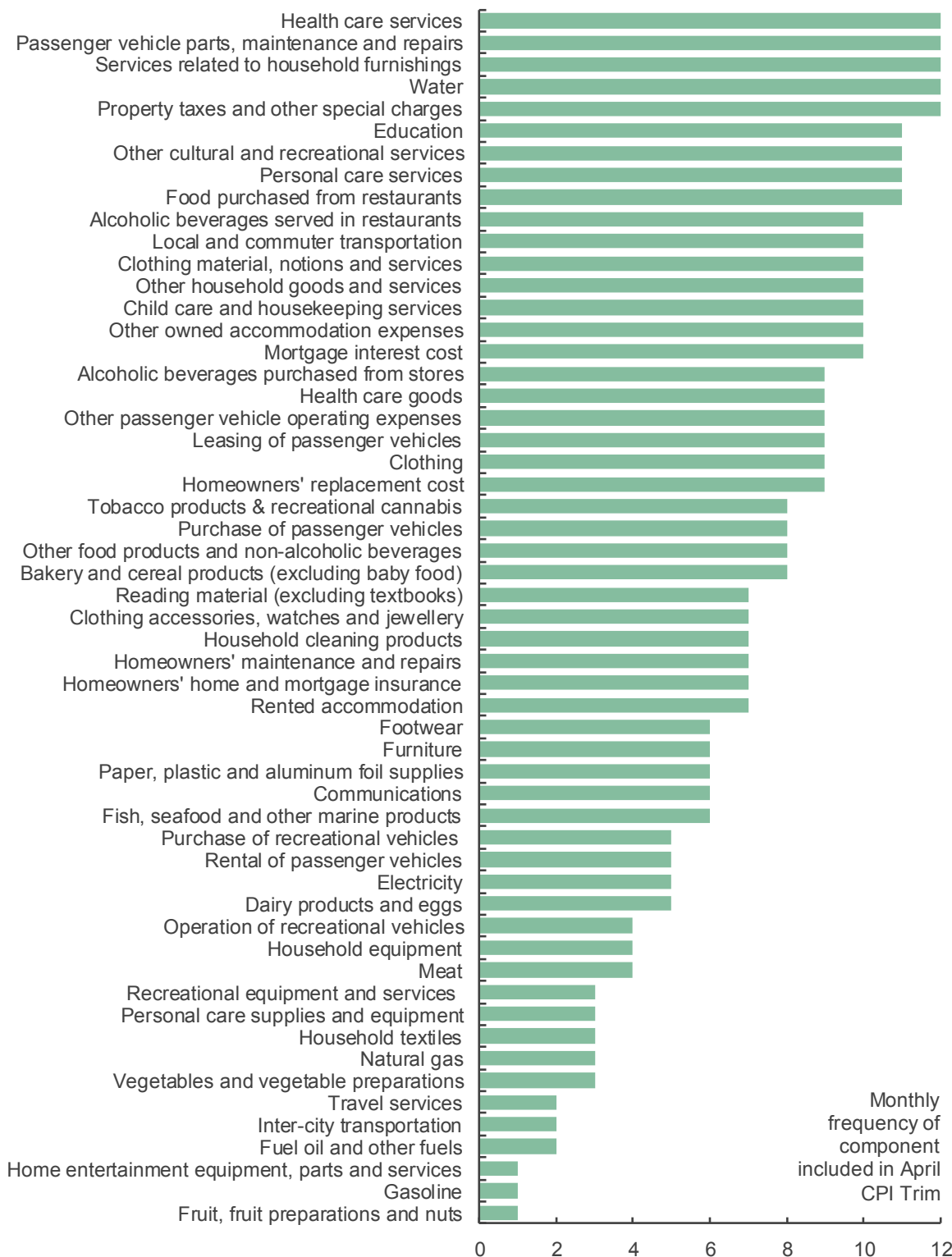
## April Components Included and Excluded from Bank of Canada CPI Trim Measure



Sources: Scotiabank Economics, Statistics Canada.

Chart 8

## Frequency of Components Included in Monthly Trimmed Inflation Rate Used in Calculating April's Annual CPI Trim Measure



Sources: Scotiabank Economics, Statistics Canada.

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