

Petrol, prices and policy.

Disinflation. Canadian CPI (May) drops from 1.8% down to 1.4%y/y

Canadian CPI lands with in market tolerances, albeit a just slightly higher than expected. Market median had been looking for 1.3%, ourselves included. Month over month prices are up 0.3%. At 1.4%y/y, the headline rise in the CPI is well back of last month's 1.8%, courtesy of the base effects associated with the large fluctuations in gasoline prices. Year over year, gasoline prices are up 6.9%, well back of the high of 25.6% in December of last year and considerably changed from April's rate of 16.3%.

Removing the impact of energy from the index drops headline CPI down to 1.0%, right on the cusp of the lower arm of the BoC's 1 - 3% inflation band. Core prices however, are likely providing a more practical view on inflation in Canada. At 1.8%y/y, core CPI is down from April's 1.9%y/y and just about spot on the BoC preferred target of 2.0%.

Goods prices are running at 1.2%y/y (flat on the month) while services are up 1.6%, having risen by 0.5% m/m.

Really little in the way of price inflation for Canada in May. Quite the contrast to the letter writing campaign out of the UK's monetary authorities who are forced to explain why CPI is running above the 3% tolerance (3.4% in May). Looking ahead into June, declining gasoline prices over the month along with the base effect will very nearly push headline CPI below 1.0%y/y.

Shelter costs were again on the rise after having gained 0.6% m/m in April, tacked on another 0.5% m/m in May. Although most will chalk this up to the impact of the HST coming to bear on the cost of a new home. Home owners replacement costs rose 4.4%y/y in May, up from April's 2.9% increase according to Statcan. Water, fuel and electricity costs were also on the march rising by 2.5% m/m following a 2.1% m/m increase in the previous month. Electricity prices jumped 4.2% m/m in May.

On the down side, clothing prices plunged by 1.5% m/m (unadjusted) as seasonal effects come to bear. Notoriously thrifty Canadian consumers reticent to buy anything not on sale. Yet with total household debt to disposable income levels running near to 150% it would appear that discriminating consumption has moved on over to conspicuous consumption.

For Canada and the direction on central bank policy it is not so much about the historical look back on prices afforded by the May CPI report, but rather, a matter of the pricing signals the BoC is delivering to the consumer through the historically low cost of funds and the consumer behavioral response that this is fostering. Cheap money has encouraged the Canadian household to gorge on debt. Whether it is cars or cash, in a market system, price is the clearing agent. As you reduce the cost of a good, you encourage more of its consumption. And while Canada seemingly has little to fear from inflation at this juncture - particularly given the deflationary forces emanating out of Europe and the looming fiscal austerity that invariably will come to bear in the US at some point - the rate cycle kicked off with the June 2nd rate hike, is none the less expected to continue rolling forward as the BoC seeks to curb consumer enthusiasm for consumption and debt.

While the BoC will continue to suggest that it views everything through its inflation prism, the experiences of the lead up to the subprime crisis in the US and the associated fallout has indeed provided some precedent supporting the adoption of a more macro prudential approach to monetary policy. In the current phase of monetary policy in Canada, we would suggest that policy is more about targeting consumer behavior than it is about targeting prices.

Disclosure appendix

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