

Canadian CPI (Apr) up..... sort of.

Headline CPI jumps from 1.4%y/y to 1.8%y/y. Core running at 1.9%

Canada's April inflation report showed a larger than expected pick up in monthly prices with both the core and headline CPI up 0.3%m/m. Market expectations looking 0.2%m/m for both. Year over year CPI is sitting at 1.8% up from March's 1.4% reading. The core inflation rate is running at 1.9% up from 1.7%.

Both the headline and core CPI are sitting just slightly below the Bank's preferred target at 2.0%. Although inflation is running below target there may be some concern that it appears set to hit target a little early on into the economic cycle. So too may some in the market be concerned by the rather steep acceleration. Its quite a jump moving from 1.4% to 1.8%. But just as CPI gathered speed in April, it can be expected to bleed off some of that momentum in both May and June when both core and headline CPI indexes will run into a negative base effect. For illustration purposes, assuming no change in the month over month prices, headline CPI for May and June would decline to 1.1%y/y and 0.8%y/y respectively. For a little context, the UK's monetary authorities are wrestling with a CPI running at a rate of 3.7%, the core a lofty 3.1%y/y.

And of course it is worth noting that Canadian CPI all items x-food and energy is running at 1.2%y/y. X-energy 1.1%y/y. Really not all that troublesome with gasoline prices acting as the primary headache with prices up 16.3%y/y and accounting for 0.8ppt of the 1.8%y/y inflation rate. In April, gasoline prices were largely unchanged while food prices actually fell by 0.2%m/m.

On that basis, Canada's inflation profile becomes a lot less daunting despite some transitory market inclination to make some pricing adjustments to its bets on what happens on June 1 BoC rate meeting. That said, we are still looking for the BoC to hike rates despite our tendency to focus on the CPI x-gasoline and discount the impact of the overall CPI.

Why? Well monetary policy isn't really about what prices are doing in April 2010 so much as what they are expected to be doing in April 2011. Today's CPI is a historical look back on where prices were rather where they are going to be. Once inflation has shown up in the CPI data it is essentially too late, policy has failed. The battle between monetary policy and prices has been lost.

For the June 1st BoC meeting, we would draw your attention towards the inflation expectations component of the BoC's business outlook survey. The findings of the latest survey, released April 12th., coincided nicely with the BoC's dropping of its conditional commitment on April 20 to hold the overnight rate at 0.25% through to the end of Q2/10. In that survey we saw a cluster of respondents inflation expectations move from the 1-2% bucket on into the 2-3% pail which is in the upper half of the BoC operational inflation band of 1-3%. Between Q4/09 and Q1/10 those respondents indicating inflation expectations of 2-3% jumped from 20% of those surveyed to 40%. Although 94% of respondent inflation expectations are still being captured in that 1-3% range, a comforting thought for the BoC, the Bank may be inclined to focus on and worry about the evolving trend amongst respondents to see/expect higher inflation. In the past, changes in the inflation expectations component of this survey has tended to dovetail quite nicely changes in monetary policy.

The other element in play when considering Canadian monetary policy is the status of consumer debt. Monetary policy is about motivating consumer behaviour through the mechanism of prices. Cheap money encourages people to forgo savings and future spending in favor of consumption today. At the zero bound, overnight money doesn't get much cheaper. While much of

the developed world wrestled with stitching up their financial systems in 2008 and 2009, Canadians embarked upon a credit binge, pushed along by lending rates that cascaded lower along with the rest of the G7. At the same time that the Canadian economy was at its cyclical lows in 2009, the housing market was hitting both its cycle and historical highs, pushed along by cheap lending rates and an abundance of mortgage capital. With consumer imbalance looming, aside from the pricing story being told by the inflation expectations component of the business outlook story, monetary policy need consider the pricing signals it is delivering to the consumer and the behavior this is encouraging. In that vein, while it doesn't necessarily fit in with the BoC's single policy mandate - price stability - it is/should be a necessary component of the monetary calculus as we draw towards the June 1st meeting.

Underneath the headlines, gasoline prices in April were flat, auto prices up a moderate 0.2% m/m, food prices on the decline, falling by -0.2%. Higher prices found in the apparel and recreation categories, each up 0.5% m/m, tracking ahead of the overall index. A good slug of the pricing pressure came out of the cost of water fuel and electricity which was up 2.1% m/m. Finally, healthcare prices jumped by 1.6% m/m. Together water fuel and electricity combined with higher health and personal care prices accounted for nearly half the gain in the pricing index, having contributed 0.13ppt of the overall rise of 0.3%.

Disclosure appendix

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