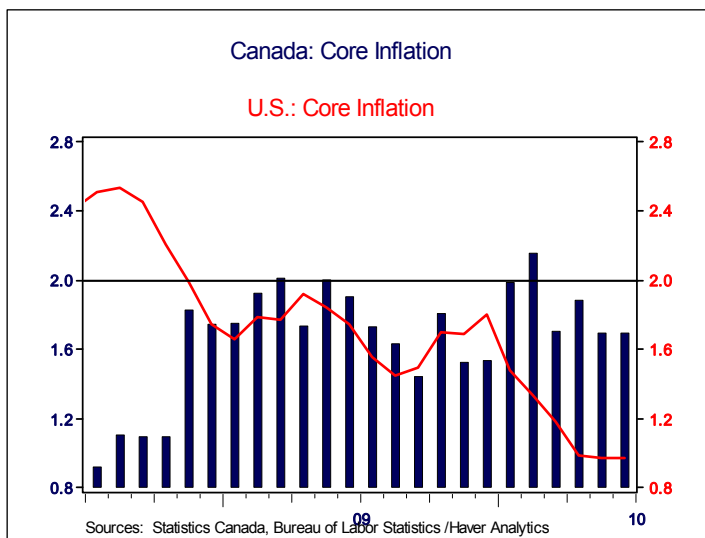
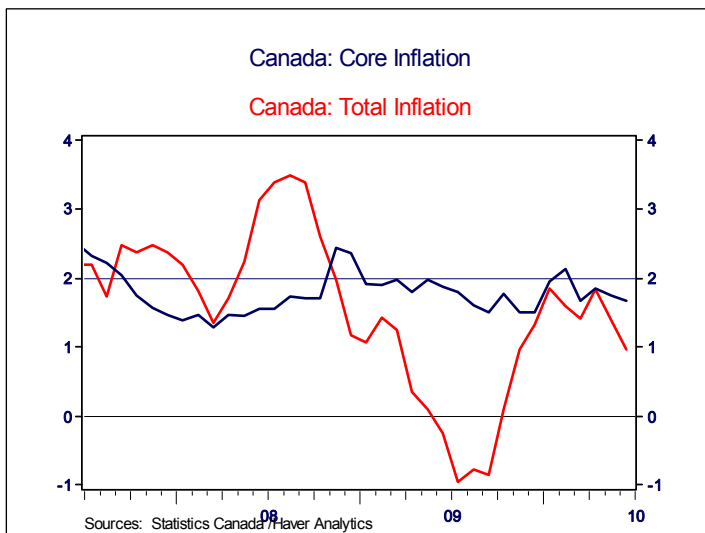




July 23, 2010

## Modest inflation in June



Canadian households paid 1% more for their basket of consumer products in June, compared with June 2009. This is the smallest price increase since November 2009. Excluding the most volatile components, the index rose by 1.7%. On the other hand, the variation in prices compared with May 2010 is slightly negative (-0.1%), and the same holds true for the Bank of Canada's core index. This is rather surprising, since negative variations normally occur just once per year, on average, whereas this is the second time in 2010.

First of all, the slowdown in the housing market is being reflected in the shelter CPI, whose growth has decelerated (0.6% m/m in April, 0.5% in May and 0.2% in June), as well as household furnishings and appliances (-0.2% in June after four months of increases). In addition, lower prices for new automotive vehicles (-1.0%) and gasoline (-2.9%), together with a significant decline in prices for clothing and shoes (-3.2%) put downward pressure on the CPI. Apparently retailers are finding it more difficult to sell off their inventory (as shown by the downturn in retail sales in April and May) and are holding bigger end-of-season sales. The price cuts in May and June were also larger than in previous years, a trend that may well extend into July and even into the next end-of-season sales period—good news for bargain-hunters!

Contrary to the United States, where prices have been falling for several months, the slight pullback in prices in June (m/m) in Canada is obviously temporary and is not raising any concerns. In fact, the introduction of the Harmonized Sales Tax in Ontario and British Columbia will propel prices up in July (0.7% m/m). We would point out that, in setting its monetary policy, the Bank of Canada "as has been the case with previous changes in indirect taxes, [...] will look through the first-round effect of these tax changes." Furthermore, the core inflation is still slightly below the 2% target, as the Bank has anticipated for 2010 and 2011; whereas in the United States, it has been languishing below the threshold of 1% for th

ree months now and is stoking fears of deflation. In Canada, the expectations of inflation are "well anchored" as stated by the Bank of Canada in its Monetary Policy Report, released yesterday. Moreover, the economic indicators are testifying to the good health of the Canadian

economy, despite the appearance of some signs of a decelerating economic recovery (GDP by industry, retail sales, housing market and concerns about the American economy). Nevertheless, *LBS Economic Research* is predicting that Governor Carney will raise the policy rate by another quarter of a point (25 bp) in September.

Marie-Claude Guillotte, Economist