

## Canada: Inflation spikes but few signs of tariff impact

Sharply higher energy prices saw Canadian inflation unexpectedly spike in July. But so far, the impact of tariffs has been fairly modest and this is a key reason why we expect further rate hikes from the Bank of Canada



Source: Shutterstock

### Inflation should be propped up for a little while longer

Canada's July CPI release has caught markets quite off-guard. At 3% year-on-year, the latest data is significantly higher than the 2.5% figure investors were looking for.

Admittedly, energy costs drove the majority of gains, following a 25.4% YoY rise in gasoline prices. But given that oil prices have stabilised, we suspect this represents something of a peak. In principle, this should see inflation ease off over coming months, but there are a few reasons to expect headline CPI to remain elevated for a little while longer.

Firstly, while July's wage growth was somewhat 'softer' (3% YoY, down from 3.9% a few months before), recent increases in Canada's minimum wage should start to translate into higher consumer prices. This, along with a modest depreciation in the Canadian dollar over recent

months, should help to keep inflation aloft throughout the rest of the year.

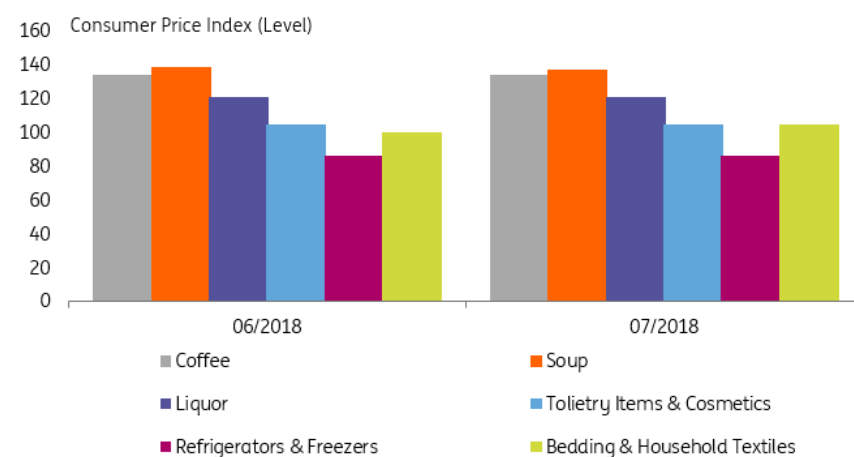
## Canada's retaliatory US tariffs see minimal inflationary impact so far

Then there's the issue of tariffs - arguably the Bank of Canada's biggest headache at the moment.

In response to the US steel and aluminium tariffs, Canada retaliated with its own list of duties in early July - not only on metals but also 10% taxes on over 80 consumer products - including coffee, whiskey and bedding. This latest inflation report was the first to include the impact of these fresh tariffs.

In theory, these should immediately lift consumer prices, depending on the extent to which businesses absorb the extra costs. So far though, the impact appears to have been minimal.

## Month-on-month change in consumer prices affected by the tariffs



Source: Macrobond

## The Bank of Canada may face a difficult 2019

However, the threat of further US tariffs on Canadian goods, for example on the auto industry, is still a risk. In a more extreme scenario, the anticipated slowdown in inflation during 2019 could easily be offset by any fresh retaliatory tariffs from Canada, pushing prices up.

Further trade escalations would not only be a major risk to Canada's economic growth prospects, but would also likely dampen sentiment, which so far has been fairly resilient. For the Bank of Canada, it is the risk to growth, rather than inflation, that is likely to drive future policy decisions.

That said, the recent advance in Nafta talks shows that the negotiations are beginning to regain some momentum, which could potentially reduce uncertainty over coming months - although this is dependent on the 'type' of agreement that gets finalised ([Take a look here to see what that could mean](#)).

We still think the direction of Canadian interest rates is up, but the risk of further rounds of

tariffs, or an undesirable Nafta outcome, could easily alter that.

## Author

**James Smith**

Developed Markets Economist

[james.smith@ing.com](mailto:james.smith@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.