

NAFTA uncertainty dwarfs higher inflation for Bank of Canada

A pick-up in core inflation measures will reassure policymakers but we think uncertainty surrounding NAFTA will keep the central bank on hold for now



Further signs of underlying inflationary pressure

After a particularly bad run of Canadian data, policymakers will be reassured by the latest inflation data.

While headline inflation came in at 1.7% year-on-year, this is almost entirely down to base effects, with transportation costs rising less rapidly than they did the same time last year. More importantly, several of the Bank of Canada's core measures picked up. In particular, the "common" rate of core inflation – which uses statistical analysis to extract common underlying trend across the inflation basket – is now rising at the fastest rate since 2012.

We expect inflation to continue fluctuating around the target over the next few months as various temporary factors unwind – a view shared by the Bank of Canada. The diluted relationship between global oil prices, which have recently been on the rise, and Canadian oil prices may also limit upside inflation risks.

1.8

Core CPI (Common)
(YoY%)

Better than expected

NAFTA, still the main concern for the Bank of Canada

For the Bank of Canada, today's data is unlikely to change much.

Near-term monetary policy changes from the Bank will depend heavily on the direction of the North American Free Trade Agreement which is currently 'clouding the economic outlook'.

The seventh round of NAFTA talks are set to begin in Mexico this Sunday (25 February) with the controversial 'rules of origin' topic set to be discussed heavily. An eighth-round is also being scheduled to take place in April, the details of which are still to be officially confirmed.

Until the NAFTA outlook becomes clearer, we expect the Bank to take a step back for the next few meetings. The disappointing string of activity data may also take some short-term pressure off policymakers to hike rates again imminently.

But while negotiations will undoubtedly be choppy over the coming weeks, we still see a future for NAFTA and think an agreement can be reached. We expect the BoC to resume its tightening cycle with two rate hikes in the second half of the year.

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