

Canada: Headline inflation stays above target as Nafta deal draws near

Average core inflation, meanwhile, rose to the Bank of Canada's 2% target reaffirming our view that a hike will take place once uncertainty over the Nafta deal clears



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2.2% Headline Inflation
(YoY)

Core inflation at target

Headline inflation for April came in at 2.2% year-on-year, below expectations and last month's reading, following a slowdown in travel services and gasoline prices. However, two out of three core inflation measures increased, leaving the average rate at the Bank of Canada's 2% inflation target.

Recent data has also shown a build-up in wage pressures, which is encouraging after the latest

mixed bag of employment data. These figures, combined with other positive releases such as retail sales (which increased for the third consecutive month in March), mean that the data-dependent BoC will not hesitate to hike rates once the Nafta coast is clear.

BoC to hike once Nafta uncertainty clears

Nafta is still a large source of uncertainty for the Bank of Canada. There have been concerns that the expiry of the Trade Promotion Authority on 30 June could push a deal into next year. The TPA allows President Trump to negotiate international trade agreements which Congress can then reject or approve but not amend. However, given that US mid-term elections are fast approaching and the high risk of Republicans losing control of Congress, Trump will not want to delay a Nafta signing.

For this reason, we believe that the negative noise coming from the US over the last few days regarding the negotiations is just that, noise. We do not see Trump sacrificing a potential political 'victory'. Given there is some "wiggle room" in the timeline for a deal to be approved by the current Congress, according to Paul Ryan, the Speaker of the House of Representatives, we are maintaining our view that some sort of agreement will be made by the end of May, despite the risks.

As such, we see the Bank of Canada continuing with its monetary policy tightening in the second half of the year, and expect a first hike in July.

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