Canadian inflation preview

We expect December's inflation figure (released on Friday) to continue the string of strong data releases in Canada, but NAFTA fears will keep monetary policy stable until 2H18

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1.9% Canada CPI forecast

December, YoY%

Inflation has been slow to respond to the global pick-up in economic activity and Canada was no exception. The economy grew 3% last year, but inflation was just 1% as of June. There has been a rebound more recently with headline CPI picking up to 2.1% as of November. Despite undershooting the 2% target for several years, core inflation seems to be on the rise with the all-item index excluding gasoline rising to 1.5% versus October's 1.3% reading.

We expect the December figure (released on Friday) to be lower than November's as a result of the base-year effects of gasoline prices, but this is likely to be temporary. Markets are forecasting headline inflation to come in at 1.9% and we think this looks likely. We believe core inflation could creep a little higher, probably heading up to 1.6%, but a 1.7% figure is possible.

These inflation developments, alongside the narrowing of economic slack, were key reasons behind January's interest rate hike of 25bp up to 1.25%. There is scope for the Bank of Canada to increase rates further and we believe there will be two more by the end of 2018. However, this is unlikely to happen before we have much greater clarity on the future of the North American Free Trade Agreement. Given that US-Canada trade flows are equivalent to 32% of Canadian GDP, any disruption here would have huge ramifications for economic activity and jobs. We remain upbeat on the prospect for a deal, as we wrote last week, but clearly, there are risks with President Trump's America First trade policies. Trump's speech at Davos on Friday will be a key barometer of the prospects of progress as the sixth round of negotiations gets underway in Montreal on January 28.

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