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TD Economics

Data Release: Bank of Canada Still Targeting 2%, With Tweaks

- The Federal Department of Finance and the Bank of Canada today announced the renewal of the Bank of Canada's inflation targeting mandate for the next five years.
- The Bank of Canada will continue to target the year-on-year change in the total consumer price index (CPI). The level of the target remains at 2%, with 1% to 3% inflation-control-range around it.
- Importantly, while the inflation target remains unchanged, the Bank of Canada has changed the measure of inflation that it uses as an operational guideline. CPIX, or 'core inflation', which excludes the eight most historically volatile components of overall inflation, will no longer be used as the Bank's preferred measure. Rather, the Bank will consider 3 measures of core inflation: CPI-common, CPI-trim, and CPI-median.
- CPI-common is a measure of inflation that uses statistics to extract common price changes across categories; CPI-trim is a 'trimmed-mean' measure, which calculates the mean inflation rate once extreme outliers (i.e. series with unusually large movements in a given month) are removed from the sample; CPI-median captures the median price change in terms of CPI sub-component weights. Statistics Canada will begin producing and publishing these new measures in the coming months.

Key Implications

- The Bank of Canada and the government have chosen a fairly conservative path forward. Renewing the target in its existing form is the most appealing of the alternatives, particularly given both the current fragility of the Canadian economy (arguing against a major change, such as a move to price-level targeting, that would require a major shift in market behaviour), as well as the variety of non-traditional monetary policy tools at the Bank's disposal (which reduces the case for a higher inflation target). Moreover, given the success of the current mandate to date, the bar to change was undoubtedly set very high.
- Beneath this conservative path lies a more unusual change: the elimination of CPIX as the 'operational guideline'. This is not terribly surprising, as the Bank had already begun shifting away from this measure in its recent communications. Moreover, communication has become more challenging as the Bank made a variety of adjustments to CPIX to attempt to capture 'underlying inflation'. Indeed, our own analysis from last year pointed to the potential benefits of using more than one measure to gauge inflationary pressure. The new measures should reduce the need for special adjustments in assessing core inflationary pressures.
- The other side of the coin is that assessing the Bank's view of core pressures will likely become more challenging with more inflation measures to choose from. The three measures have diverged significantly from each-other in the past. Such periods of divergence will likely create a communications challenge for the Bank of Canada. There will be a learning curve among market participants as they try to gauge the relative importance the Bank places on each measure at any given meeting.

Brian DePratto, Economist
416-944-5069

@TD_Economics