Data Release: As low gas prices battle a weaker loonie, an inflation divide emerges

- Total CPI inflation clocked in at just 1.0% y/y in February, pulled down by a sharp 21% annual drop in gasoline prices. Excluding the impact of lower gas prices and other volatile prices, the Bank of Canada's core measure of inflation rose 2.1% from year ago levels – topping the Bank of Canada's target for a 7\textsuperscript{th} consecutive month.
- Roughly 0.9 percentage points of the pace of overall inflation in February can be tied to items proving to be most sensitive to movements in the Canadian dollar. Overall gains in food prices slowed to a still lofty 3.9% year-over-year, while prices for vegetables were up a hefty 7.5%. Clothing and footwear prices (+2.5% y/y) accelerated in the month, while reading material prices grew a hefty 7.7%. Beer prices rose 4.4% year-over-year, a deceleration from last month's gain but still a quick pace.
- Meanwhile, the sharp depreciation in the Canadian dollar since 2013 ebbed disinflationary pressures in many other categories. For instance, furniture prices were flat relative to a year ago, but following 10 months of price declines. Computer and equipment prices were down 0.5% from year ago levels – the slowest pace of annual price declines for these items in almost 20 years. Computer and equipment prices have fallen by an average of 12 percent per year for the last two decades.
- The inflation picture was widely different by province. Ontario posted the sharpest gain in overall inflation (+1.3% y/y) as shelter costs rose sharply, while the Atlantic provinces saw an outright contraction in prices in February. Overall consumer prices rose 1% y/y just about everywhere else.

Key Implications

- The inflation outlook in 2015 can best be described as a battle of the forces. More specifically, as the combination of the drop in gas prices and a weak Canadian dollar continue to drive a wedge between headline consumer prices and the Bank of Canada's core measure of inflation. Headline inflation is expected to average just 0.4% in 2015, with core inflation expected to clock in at 1.8%. For more inflation on the impact of the Canadian dollar on consumer prices, please see a recent TD Report: http://www.td.com/document/PDF/economics/special/CanadianInflation.pdf
- Outside of the Canadian dollar, inflationary pressures remain relatively benign. In particular, the 55% plunge in oil prices since 2013 is expected to slow economic momentum in the first half of 2015. Real GDP growth estimated to have slowed to an average pace of about 1% annualized over the first two quarters of the year. Growing economic slack will likely bring the core measure of inflation below the Bank of Canada's target for the rest of 2015.
- At the moment, the Bank of Canada appears to be more focused on the downside risks to the Canadian economic outlook due to the drop in oil prices than the current pace of inflation. Softening economic growth is the dominant story likely to keep the central bank on the sidelines through the rest of 2015.

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