



TD Economics

Commentary

June 19, 2007

CORE INFLATION SLOWS BUT REMAINS ABOVE TARGET

- Overall (all-items) inflation unchanged at 2.2%
- Marked slowdown in core inflation to 2.2%

With today's release, Statistics Canada has updated its basket of goods & services from 2001 to 2005 weightings to better reflect Canadian household spending patterns. The immediate impact of this update, which is an overall inflation rate that is 0.1 percentage points higher than it would have been without this change, did not move markets.

Comparing the inflation readings for May to those for April, the overall inflation rate was left unchanged at 2.2% while Canada's core inflation rate slowed to a matching 2.2% from a four-year high of 2.5% in May. Offsetting a decline in the price of natural gas, increases in owned accommodation costs and rising gasoline prices accounted for most of the overall prices increases across the country. Although the contributions of owned accommodation and shelter costs to the rise in the overall index are substantial, it has continued to dissipate slowly since late 2006. Household operations & furnishings (2.7%), along with transportation costs (2.5%), which together account for over 30% of the consumption basket, also continue to push up overall inflation readings.

The regional distribution of price increases shows that Alberta (5.0%), Saskatchewan (2.7%), and Manitoba (2.3%) all posted overall inflation figures above the national average while every other province recorded much lower inflation rates ranging from 0.7% in Newfoundland & Labrador to 1.9% in Ontario. Alberta's inflation rate continues to significantly outpace that of every other province, running at more than twice the national average.

While a quick reading of headline numbers might suggest that core inflation is back down to a comfortable level, note that it has remained above 2.0% since July 2006 and,

CONSUMER PRICE INDEX - CANADA				
	May.07 % Chg. M/M	Apr.07 % Chg. M/M	May.07 % Chg. 12-mth.	Apr.07 % Chg. 12-mth.
All-items*	0.3	0.3	2.2	2.2
Core ex. indirect taxes*	0.1	0.3	2.2	2.5
Goods	0.4	0.4	1.1	1.0
Services	0.5	0.4	3.2	3.3
Energy	2.1	2.4	1.6	0.1
Food*	0.1	0.1	3.5	3.8
Shelter*	-0.2	0.7	2.7	3.6
Transportation*	1.8	0.8	2.5	0.6
Clothing & Footwear*	-1.4	2.2	-0.1	2.0

*M/M uses seasonally adjusted data; Source: Statistics Canada, Haver Analytics

more importantly, had been trending upwards until May. Markets may be tempted to interpret today's CPI release as casting doubt on the overnight rate increase expected by the Bank of Canada's (BoC) at its next rate-setting meeting in 3 weeks. We caution against such a reading of the data. The marked slowdown of 0.3 percentage points observed in May does not necessarily indicate that inflation is coming back down to the BoC's target on its own. Furthermore, due to base effects from a year ago, the slowdown in core inflation in May hides a monthly increase that is larger than that of April. After increasing by 0.1% in April, the non seasonally-adjusted core index was up by 0.3% in May. We expect seasonal and base effects to push core inflation back up to 2.4-2.5% in June. Needless to say, then, that the outlook for inflation remains an overarching concern. We continue to expect the overnight rate to increase by 25 basis points come July 10th.

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