Economic News

Desjardins Economic Studies
www.desjardins.com/economics

August 5, 2014

UNITED STATED – CANADA

Price corrections for certain commodities limit runaway inflation risks

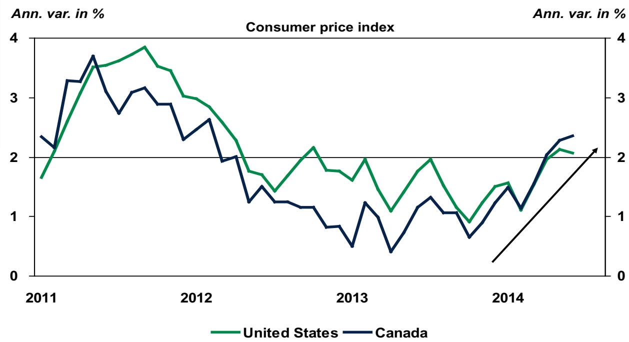
One of the most surprising developments in North America since the start of 2014 has been the marked rise in inflation, despite the fairly difficult economic environment. Inflation rates were very weak last year—inflation fell to 1.0% in the United States and 0.7% in Canada in October 2013. This worrisome period of weak inflation is now clearly behind us, with the annual inflation rate now reaching 2.1% in the United States and 2.4% in Canada.

The Federal Reserve (Fed) and the Bank of Canada (BoC) have recently had to adjust their stance, acknowledging that the risks of sustainable low inflation were no longer a concern. At the same time, both central banks emphasized that the recent run-up in prices primarily reflect temporary factors, including surging energy and food prices. Thus, they expect this period of accelerating inflation to be winding down, an analysis that we share. Nonetheless, the risk that inflation could continue to accelerate for some time was high early on this summer, especially since the deteriorating situation in Iraq threatened to push oil prices to sky-high levels.

Things have changed since then. Even if the situation in Iraq remains highly complex, oil production in that country has not been significantly affected and price of West Texas Intermediate (WTI) oil recently fell under US$100 per barrel. In addition, prices for natural gas and several grains, which jumped at the start of the year due to a very harsh winter that created fears of a shortage, have significantly dropped these past few months. The impact on consumer prices may not be felt immediately, especially for grains, but the risks of a widespread and long-lasting run-up in prices have clearly subsided.

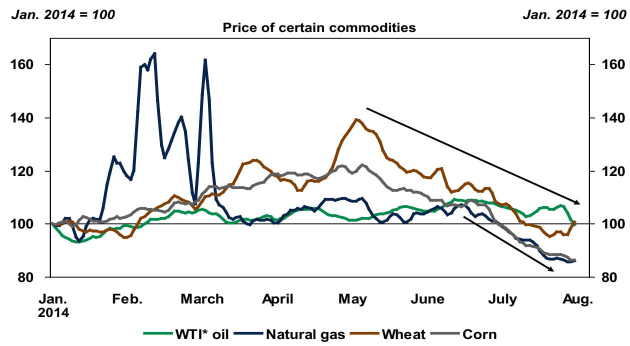
Implications: Significant price declines for several commodities will reassure the central banks, confirming their ability to tolerate above-target inflation temporarily.

Inflation quickly climbed above 2% in the United States and Canada



Sources: Bureau of Labor Statistics, Statistics Canada and Desjardins, Economic Studies

After jumping, some commodity prices are now correcting



* West Texas Intermediate
Sources: Datastream and Desjardins, Economic Studies

The Fed and the BoC still have some leeway and we expect them to wait until the second half of 2015 before raising their key rates.

Mathieu D'Anjou
Senior Economist

François Dupuis
Vice-President and Chief Economist

514-281-2336 *or* 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

Mathieu D'Anjou Senior Economist
Benoit P. Durocher Senior Economist
Francis Généreux Senior Economist
Jimmy Jean Senior Economist
Hendrix Vachon Senior Economist