

ECONOMIC VIEWPOINT



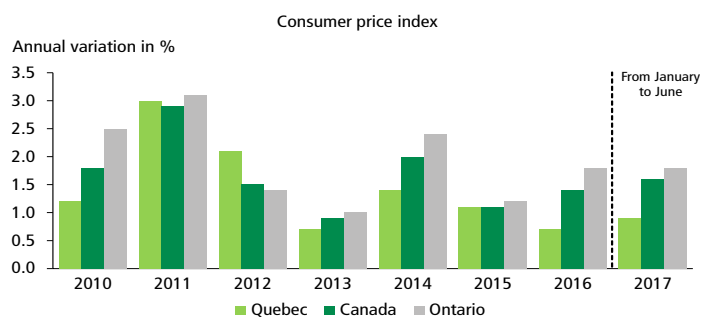
Will Quebec's Weak Inflation Persist?

Quebec's inflation rate has hovered around 1% for the last few years, a pace significantly below that of Ontario and Canada. Price variation excluding energy has fallen significantly in Quebec in the last two years. Several components of the consumer price index (CPI) grew less quickly than elsewhere in Canada in 2016, particularly food, shelter and electricity. Will this weak inflation rate last much longer? While a slow rise is expected in the coming quarters, consumer prices will continue to increase more slowly than in the rest of Canada this year.

Why Is the Inflation Rate So Low?

Since 2013, the change in the CPI in Quebec has been systematically below the changes for of its closest neighbours (graph 1). The 0.7% pace achieved last year was significantly slower than in Canada (+1.4%) and Ontario (+1.8%). Quebec had such a low inflation rate during the 2008–2009 recession. Usually, when the economy goes through a difficult period, household spending is affected, making it more difficult to pass on price increases to consumers. However, the weak inflation seen in 2016 was not due to slow economic growth. In fact, real GDP posted its best performance in five years with growth of 1.7%, primarily due to accelerated household spending.

GRAPH 1
Quebec's inflation is lower than elsewhere

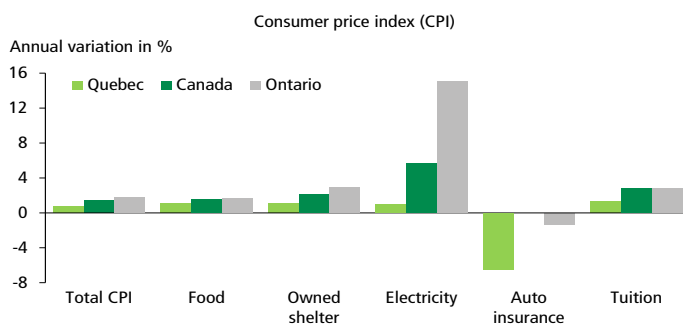


Sources: Statistics Canada and Desjardins, Economic Studies

The CPI rose more slowly in Quebec than elsewhere in Canada in 2016, due in part to the relative weakness of a number of regulated rates, particularly those of Hydro-Québec. The

electricity price component only rose 1.0% in 2016, compared with 5.7% in Canada and 15.1% in Ontario (graph 2). This trend has shifted since the start of 2017: Quebec has seen a certain amount of stability, whereas the electricity rebates granted by the Ontario government have caused prices to fall in that province¹, which has brought down Canada's average. However, less than 3% of household spending goes to electricity bills in both provinces, limiting the impact on the overall inflation rate.

GRAPH 2
Several inflation components grew slower in Quebec in 2016



Sources: Statistics Canada and Desjardins, Economic Studies

Meanwhile, the Société de l'assurance automobile du Québec (SAAQ) reduced the insurance contributions included in driver's licences and vehicle registrations due to an improved road safety

¹ [Will Inflation Eventually Pick Up in Canada?](#), Desjardins, Economic Studies, *Economic Viewpoint*, August 8, 2017, 4 p.

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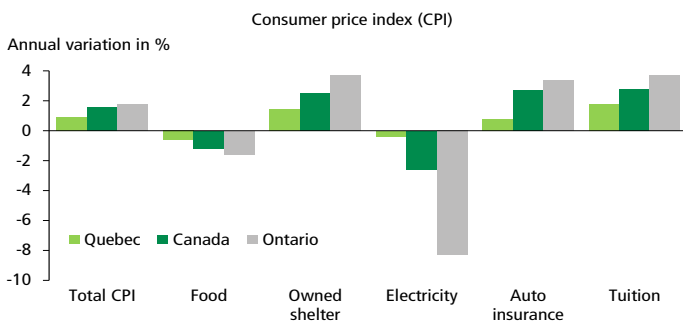
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record in the last few years.² Tuition also rose less in Quebec than in Canada and Ontario. In short, several government-regulated prices helped keep the inflation rate low in Quebec in 2016.

Housing Prices Tip the Scales

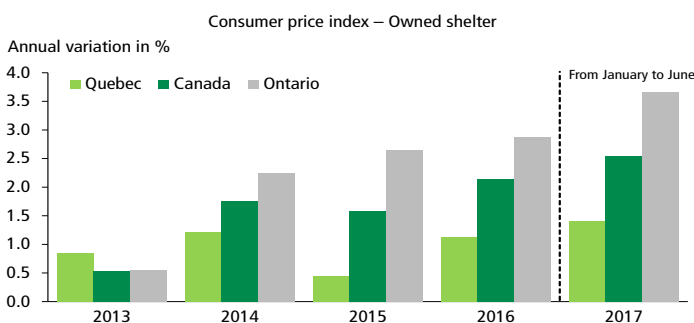
Total inflation continued to be weaker in Quebec in the first half of 2017 (graph 3). This was mainly the result of a slower increase in the cost of shelter, which accounts for 20% of household spending. The owned accommodation price index, which varies according to changes in home prices and mortgage interest rates, has risen more quickly in Ontario and Canada in the last several years (graph 4) due to soaring prices in Toronto and Vancouver. Excess demand and an insufficient pool of properties for sale has caused those markets to overheat for an extended period. In Quebec, the average price of a home grew more modestly, as the real estate market remained balanced. This was reflected in the CPI's shelter component and enabled total inflation to remain at around 1%.

GRAPH 3
Several inflation components in Quebec rose slightly or fell in the first half of 2017



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 4
The "owned shelter" component has grown slightly in Quebec



Sources: Statistics Canada and Desjardins, Economic Studies

Food Prices Fall in 2017

Price increases for certain food items have made headlines, leaving the impression that all food prices have shot up quickly. However, the overall picture is quite different. It is true that during certain periods, weather conditions or changes in livestock farming can cause prices to fluctuate widely. The value of the Canadian dollar also impacts several food product categories, particularly fruit and vegetables. For example, the loonie's plummet in 2015 increased the cost of food imported from the United States, causing the food price index to surge 3.5% (graph 5). The inflation rate for food purchased in Quebec then slowed to 1.1% in 2016, compared with 1.5% in Canada and 1.6% in Ontario. Given that approximately 12% of household spending in Quebec is dedicated to food, this helped maintain the slow growth of overall consumer prices.

GRAPH 5
Quebec food price increases have varied widely in recent years



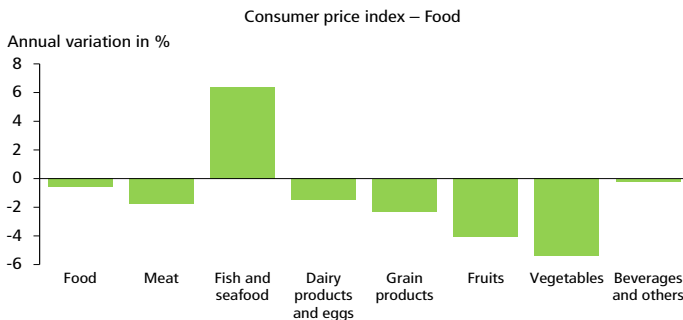
Sources: Statistics Canada and Desjardins, Economic Studies

However, food prices have been trending down since September 2016. Due to the strong U.S. dollar, several European and Asian economies have cut back on their purchases from the United States. The supply of food products in the North American market is therefore higher than demand, which is putting downward pressure on prices. In this climate, the industry's main distributors in Canada have asked their suppliers to lower their wholesale prices by 1.0% to 1.5%.³ Stiffer competition among big-box stores has also helped drive down prices across the country. As a result, the CPI for food decreased in Quebec, Canada and Ontario in the first half of 2017. In Quebec, all categories except fish and seafood have seen a drop in prices (graph 6 on page 3) since the start of the year. Fruit and vegetables posted the most significant decreases, 4.1% and 5.4% respectively.

² *The Québec Economic Plan*, ministère des Finances du Québec, Budget 2017–2018, March 28, 2017, 598 p.

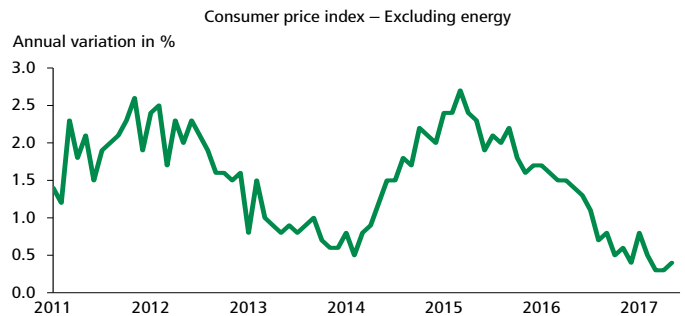
³ *Canada's Food Price Report 2017*, Dalhousie University, 7th edition, December 6, 2016, 22 p.

GRAPH 6
Prices for several food items fell in Quebec in the first half of 2017



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 8
Inflation excluding energy has dropped significantly in Quebec

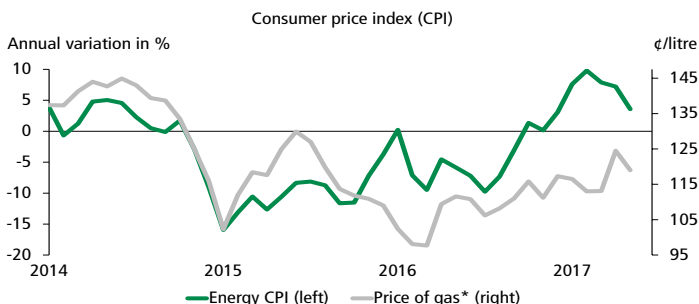


Sources: Statistics Canada and Desjardins, Economic Studies

Energy: Prices Seem to Have Stopped Falling

Energy prices, particularly gas prices, are often blamed for sudden fluctuations in the cost of living. While they certainly have an impact on significant increases or decreases, this component accounts for a much smaller portion of the household budget than housing and food. It is worth noting that in the last two years, the price of oil has fallen significantly due to weaker global demand, and especially due to excess supply on international markets. After peaking at US\$100 per barrel in mid-2014, the price for WTI (West Texas Intermediate) oil tumbled to around US\$30 per barrel by early 2016. As a result, the CPI's "energy" component fell into negative territory for several quarters (graph 7), which helped slow total inflation in 2015 and 2016. The gradual recovery in prices has enabled the energy price index to begin to rise. However, the weakness of several other inflation components, such as shelter and food, as well as a number of government-regulated prices, helped keep the growth of the CPI excluding energy below 1% in Quebec (graph 8).

GRAPH 7
Energy prices rose in Quebec after falling for two years



* Average price in Montreal.

Sources: Statistics Canada and Desjardins, Economic Studies

Conclusion

While it is difficult to predict future changes to the CPI's main components with certainty, we have based our forecasts on a few assumptions. First, the price for WTI oil should rise to close to US\$60 per barrel by the end of 2018, which will put upward pressure on the CPI's "energy" component. Food prices could also firm up due to improved economic conditions in several industrialized countries. Meanwhile, the strong U.S. dollar, which makes food products in the United States more expensive, will limit demand and prevent a quick drop in supply. However, the whims of Mother Nature could compromise these forecasts. In addition, NAFTA negotiations, set to begin in mid-August, may have an impact on certain prices.

Lastly, the average price of a home in Quebec grew nearly 5% in a few months, which should be reflected in the CPI's "shelter" component. However, the housing market is expected to calm somewhat next year, as cumulative interest rate hikes slow demand and price increases slightly. In short, if the price index for owned shelter firms up in Quebec by the end of the year, the situation should be temporary.

Even though a gradual increase in inflation is expected in the next few quarters, primarily due to energy prices, overall consumer price growth will be close to 1.5% next year after remaining at around 1.0% for several years in Quebec.

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