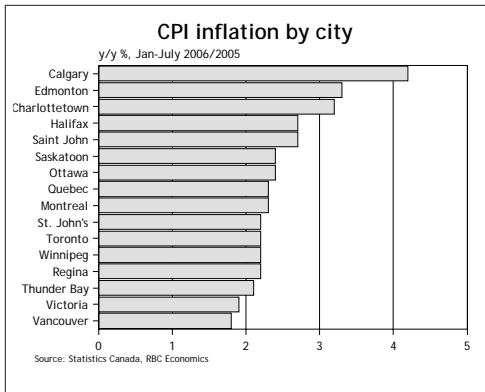


## DRIVERS OF INFLATION IN CANADA'S CITIES

August 2006



Apart from recent mounting inflationary pressures in Calgary and Edmonton, inflation has been well behaved in most other Canadian major urban centres. The strength of the dollar has helped offset inflationary pressures stemming from rising commodity prices, thereby keeping a lid on consumer inflation in most of the country. On a year-to-date basis to July, Calgary led the all-items consumer price index (CPI) with a year-over-year pace of 4.2% (see chart). Edmonton trailed not too far behind with a year-over-year pace of 3.3%.

The next three cities with relatively higher inflation are in Atlantic Canada — Charlottetown (up 3.2%), Saint John (up 2.7%) and Halifax (up 2.7%). In the middle of the pack are several cities from central Canada that are reporting year-to-date inflation just above the 2% mark. At the bottom of the pack are Vancouver and Victoria. Annual inflation in these cities tracked below 2% in the first seven months of 2006.

Since the western economies are booming with widespread wage increases and rapid economic growth, cost-push inflationary pressures would be expected to be the highest there. However, cities in British Columbia have the lowest CPI, while cities in Alberta have the highest. What is keeping inflation contained in some western cities but not in others? And what is driving inflation in parts of Atlantic Canada above rates in central Canada? An analysis of the components of CPI inflation at the city level explains part of the emergence of recent inflation trends that are affecting key Canadian cities differently.

### Consumer inflation on the rise in Calgary and Edmonton

A big driver of the all-items CPI in Calgary and Edmonton in the last year has been the shelter component, which accounts for roughly one-quarter of CPI inflation in Alberta. Feeding into the shelter component of the CPI is rented and owned accommodation and household energy costs. Through the owned accommodation component there are two channels through which house prices affect the CPI — house prices, which affect homeowner's premiums, and homeowners' replacement costs. Calgary, especially since the beginning of the year, has emerged as an extreme outlier in the owned accommodation category with year-to-date growth of almost 15% compared to the same period a year ago. Next, but trailing substantially behind, is Edmonton (up 6.5%).

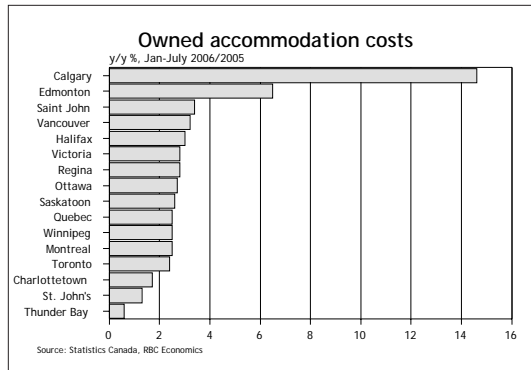
While Albertans have had some relief with prosperity cheques mailed out earlier this year, home prices continue to soar at a sizzling pace. In just one year, Calgary's MLS average house prices have shot up from an annual pace of about 10% to as high as 45% year-over-year as reported in June. A similar trend emerges for Edmonton where house prices have risen from an annual pace of about 8% up to a 12-month increase of 25% in June.

Homeowners' replacement costs (proxied by the new housing price index) in Calgary and Edmonton are also off the charts. At the mid-point of 2006, Calgary's new housing price index was up 39% compared to the first half of the prior year. In

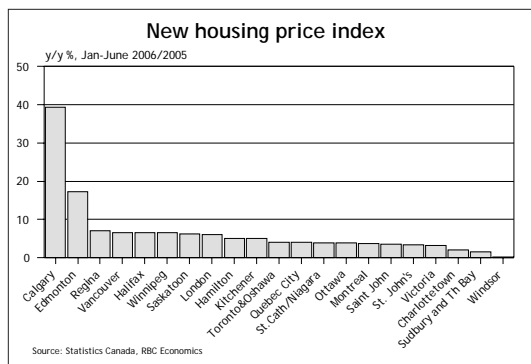
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## Inflation trends

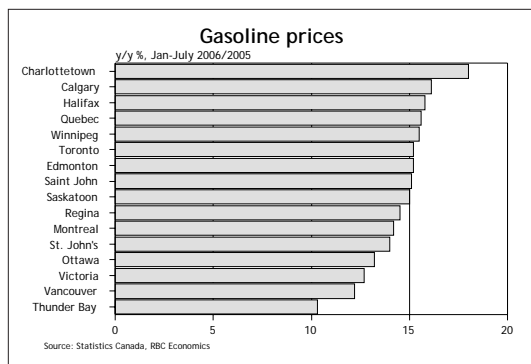
### OWNED ACCOMMODATION COSTS RISING OUT WEST



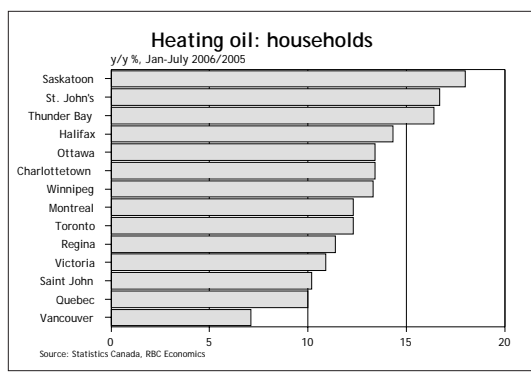
### NEW HOUSING PRICE INDEX SOARS IN CALGARY



### GASOLINE PRICES UP SHARPLY IN ATLANTIC REGION



### VANCOUVER GETS RELIEF IN HOUSE HEATING FUEL



Edmonton, this index soared to 17% in the first half of the year with the latest 12-month increase reaching 27% in June. Labour and construction materials continue to be in short supply, driving up input costs of construction and these effects are now becoming noticeable as they filter through to the consumer. The price index of non-residential building construction provides an indication of changes in construction costs. Currently, both Calgary and Edmonton are tracking the fastest-paced increases among key Canadian cities.

### Higher prices at the pump hurting Atlantic consumers

Three cities in the Atlantic provinces — Charlottetown, Saint John, and Halifax — have CPI inflation tracking so far this year above the nationwide rate of 2.5%. These cities are also located in the three provinces that have the highest relative dependency on consumer spending as a share of their economy, which makes them more susceptible to fluctuations in consumer prices. Contrary to the key driver of inflationary pressures in Alberta's key cities (soaring housing costs), these Atlantic cities have been largely affected by the recent pick-up in the pace of the price of gasoline and household heating.

All three cities have experienced significant growth in the cost of household heating fuel during the past year, with Halifax leading the increase at 14.3%. Furthermore, pump prices tend to be higher out east and higher pump prices have been an added burden on consumers. In the past seven months all of these cities have experienced year-over-year price increases of more than 15% at the pump. Charlottetown has experienced the sharpest increases with gasoline prices up 18% this year compared to last.

Higher pump prices have obviously become a cross-country phenomenon, but the point here is that the fastest-paced increases are occurring in some of the most vulnerable cities. While gas prices account for roughly 4.5% of Canada's CPI inflation, the gas CPI weights are relatively higher in the Atlantic region, with New Brunswick's weight at 6.5%, PEI's at 6.1% and Nova Scotia's at 5.6%.

### Inflation well-contained in central Canada

Inflationary trends in central Canada's cities have been fairly balanced and remain in the middle of the pack, with prices growing in the 2-2.5% range this year. Central Canada has experienced a mix of offsets. Housing markets have already entered a widely expected cooling phase in which price growth has retreated to a more sustainable pace. The new housing price index has moderated into the 3-5% year-over-year growth range and MLS house prices have pulled back to a pace more in line with 5% annual growth rather than 10%.

The electricity rate hike approved by the Ontario Energy Board took effect in May and continues to influence the 12-month increase in prices. Annual electricity prices in Ontario have climbed by roughly 10% for the past three months affecting household energy bills. Ottawa, Thunder Bay and Toronto have all had water, fuel and electricity price increases this year in the 12-14% range. This pace is well above all other cities and emanates from the spike in electricity prices. Montreal and Quebec have had some relief with more mild energy price increases of around 4%, but gas prices in Quebec have been growing sharply.

## Current economic indicators

Latest month available, year-over-year % change unless otherwise indicated

Cities are ranked in descending order by population size

Census metropolitan area	Job growth Sep-06	Jobless rate Sep-06 (Level)	Res. permits <sup>1</sup> Aug-06	Non-res. permits <sup>1</sup> Aug-06	MLS prices Aug-06	MLS sales Aug-06	Housing starts Aug-06	Downtown office vac (%) Q2 2006	CPI Aug-06	Consumer bnkrpts <sup>1</sup> Aug-06	Business bnkrpts <sup>1</sup> Aug-06	Retail sales Jul-06 (Est.)
Toronto	0.6	7.3	9.4	-1.0	1.8	-7.4	3.2	8.9	1.3	-8.5	-9.0	-0.8
Montréal	1.9	8.1	-14.3	14.7	3.6	-3.3	2.9	12.0	1.5	7.2	9.2	1.6
Vancouver	4.7	4.7	5.4	27.2	20.5	-20.2	-23.8	4.7	2.1	-7.1	-43.4	10.0
Ottawa-Gatineau	5.3	5.7	-16.5	-33.7	2.0	1.3	50.5	3.9	1.4	6.7	-11.4	na
Calgary	8.7	3.6	37.3	73.4	50.0	-4.8	51.6	0.3	5.9	-45.9	-47.1	na
Edmonton	2.8	4.3	32.5	-17.2	36.4	9.2	-3.4	5.0	3.5	-28.6	-42.7	na
Quebec	-0.1	4.9	-15.2	14.7	12.0	-1.4	-5.6	na	1.6	-6.0	28.3	na
Hamilton	1.1	6.6	5.8	-23.1	11.1	-13.8	-23.2	na	na	-11.0	31.3	na
Winnipeg	3.1	5.0	32.5	-2.4	na	na	-32.7	na	2.0	-17.4	-4.5	na
London	-0.5	7.2	32.0	-31.1	8.1	-9.4	23.7	na	na	6.5	4.9	na
Kitchener	0.0	6.1	-29.9	-23.8	4.6	-3.9	-39.8	na	na	-6.7	na	na
St. Catharines-Niagar	2.6	5.8	8.7	25.5	12.9	-7.6	-12.6	na	na	-3.5	8.3	na
Halifax	0.7	5.3	-21.0	67.9	9.9	-7.3	-70.1	7.2	2.3	-5.1	-26.5	na
Windsor	5.8	8.8	-30.3	-37.6	2.0	-18.0	-49.2	na	na	3.2	-8.3	na
Victoria	1.7	4.1	64.4	15.2	5.3	-5.6	259.6	4.4	1.8	-26.1	-46.7	na
Oshawa	2.1	7.2	11.1	-3.9	na	na	-21.5	na	na	10.1	-13.3	na
Saskatoon	1.7	4.3	17.2	37.5	8.1	12.4	-14.3	8.9	3.0	-21.5	-13.6	na
Regina	3.5	5.2	9.6	117.4	1.2	-4.3	-14.3	5.9	2.5	-24.2	-54.5	na
St. John's	5.9	7.7	7.7	-18.5	1.4	9.3	-11.7	na	2.5	4.6	-25.0	na
Sherbrooke	1.7	7.7	-9.5	-65.8	18.4	-19.1	-15.4	na	na	-2.5	-66.7	na
Greater Sudbury	5.5	7.9	47.2	-15.0	8.7	2.0	31.6	na	na	7.7	na	na
Abbotsford	5.6	4.1	-31.9	-26.8	na	na	-37.6	na	na	na	na	na
Kingston	-3.4	7.0	9.0	91.5	3.3	-9.5	9.2	na	na	-18.8	33.3	na
Saguenay	1.1	8.8	6.3	135.6	na	na	-8.1	na	na	na	na	na
Trois-Rivières	-5.6	8.3	-9.3	189.4	7.9	-22.5	218.5	na	na	-4.0	85.7	na
Saint John	0.7	6.8	-1.0	83.6	-2.0	-16.8	-20.5	na	2.0	14.0	-100.0	na
Thunder Bay	-3.6	8.3	-9.5	63.5	-2.5	45.8	4.8	na	1.3	-17.5	-61.5	na
Canada	1.9	6.4	20.8	4.9	10.6	-7.3	4.6	na	2.1	-7.0	-10.6	5.8

<sup>1</sup> Three-month trend

Source: Statistics Canada, Industry Canada, Canada Mortgage and Housing Corporation, Colliers International, Canadian Real Estate Association

### Lowest rates of city inflation found in one of the west's hottest economies

Headline inflation shows that both Vancouver and Victoria currently have the lowest inflation rates among key cities. The all-items CPI is up this year just under 2% in each city compared to a year ago. Since the shelter component is composed of both owned accommodation and household energy costs, the breakdown of these categories reveals that there has been extraordinary growth in owned accommodation costs in both Vancouver and Victoria. Comparable to Calgary and Edmonton in this regard, MLS prices in the first half of 2006 are up 23% year-over-year in Vancouver and 15% in Victoria. However, the price of water, fuel and electricity (the household energy cost component) in British Columbia is growing at a rate well

below the national average of 8%. In particular, since the start of 2006, electricity prices have been almost completely flat, while such prices in Ontario have been rising rapidly. This relief in home energy costs is a big savings for homeowners and helps to balance out inflationary pressures coming from rising home costs. Furthermore, while natural gas started the year with lofty price increases, the cost has come off in the last three months, bringing further relief to utility bills. As well, Vancouver and Victoria have enjoyed contained growth in the price of gasoline compared to other Canadian urban centres.

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