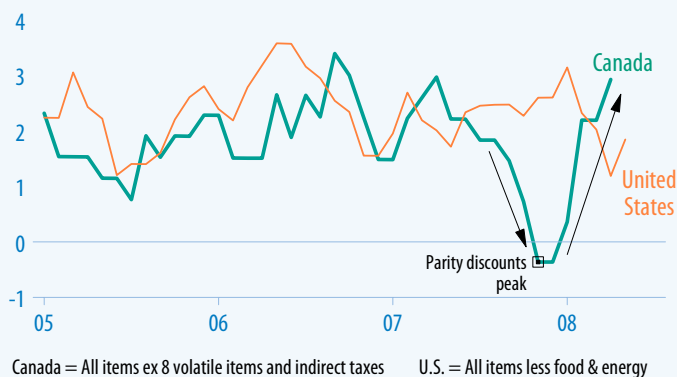


TABLE 1
COMPARISON SHOPPING: STILL NO COMPARISON

	Canadian Price (C\$)	U.S. Price (US\$)	Price Gap (percent)
Original Basket (17 items, initially 24%):			18
Bestseller Books (sample of 6)			
initial price	30.79	25.30	22
discounted	19.27	15.99	21
New Vehicles			
5 mid-range	32,766	27,485	19
8 upper end	67,020	51,423	30
Tim Hortons Large Coffee & Doughnut	2.27	2.13	7
Grand Theft Auto Video Game	59.99	59.99	0
Nintendo Wii	279.99	249.99	12
Apple 16GB iPod Touch	419	399	5
Dell Laptop	774	699	11
All-Clad Copper Frying Pan	225	180	25
Coldplay CD	12.99	9.99	30
Gucci Shoulder Bag	920	830	11
Monopoly Board Game	19.99	13.97	43
Huggies Pullups (40)	18.97	14.97	27
Baseball Tickets (Jays, Tigers – sample of 3)	38.00	37.77	1
Point & Shoot Digital Cameras (sample of 8)	374	297	26
Digital Picture Frames (sample of 4)	203	178	14
Air Conditioners (sample of 4)	330	295	12
Cordless Drills (sample of 5)	134	111	21
Toro Snow Thrower	399	299	33
Homelite Chain Saw	149	129	16
Maytag Washer & Dryer	2,050	1,699	21
BBQs (sample of 3)	663	497	33
Lawn Mowers (sample of 2)	484	369	31
New Items:			19
Total Basket:			18

CHART 1
DOLLAR DISCOUNT DAYS OVER?
 (3-mnth ann % chng : sa)

Core consumer price index


Uh Oh... The Price Is Still Wrong

Douglas Porter, CFA, Deputy Chief Economist

One year ago, we pointed out that retail prices in Canada had been painfully slow to respond to the historic run-up in the Canadian dollar, creating a massive and unsustainable price gap for many goods between the U.S. and Canada. Among the many reasons cited for the gap in the months that followed was that it takes time to adjust for sudden changes in the currency. Well, the loonie has averaged almost parity over the past year (98.8 cents(US) to be precise), so time's up! Looking at a broad basket of items, we find that while there has been some movement in the past year, the price gap remains extraordinarily large, and there are plenty of signs to suggest that the bulk of the discounting is over. In other words, without further pressure, this may be as good as it gets for Canadian shoppers.

We first attempted to update our initial basket of 17 goods from last year, and found that the average price gap had narrowed from 24% in 2007 to 18% now (*Table 1*). The main items that saw serious movement in prices were books, autos and some magazines—arguably the most high-profile items on the list. We broadened the list to take a wider range of products into account this time, and found that this still produced an 18% price gap between the U.S. and Canada on the overall basket. Given that the loonie has dipped below parity again (currently 97.4 cents), this means that prices in Canada are now roughly 16% higher on an average basket of goods than stateside, taking today's exchange rate into account. We would point out that even with the hefty price cuts in both books and autos, we found quite considerable price differences remained even on these headline-grabbing items.

The loonie-led price cuts on many items have played a key role in keeping overall Canadian inflation in check at a time when the rest of the world is grappling with soaring food and energy costs. Next week's May CPI report is expected to reveal that Canada's inflation rate will pick up to around 2% (or about 2½% excluding the impact of the GST cut), but that will still be half the U.S. pace and the second lowest in the world aside from Japan. The most significant price declines since the 1950s for vehicles, books, and clothing—and all with much deeper drops than in the U.S. over the past year—have played a big part in keeping

**TABLE 2
INFLATION AND DEFLATION**

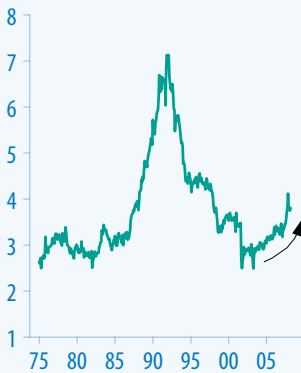
Consumer price index – Canada (y/y % chng : as of April 2008)

Deflationary		Inflationary	
Vegetables	-12.7	Bread	16.9
Books	-8.3	Gasoline	11.6
Video equipment	-7.6	Water charges	9.4
New cars	-6.6	Mortgage interest	8.7
Clothing	-5.1	Housing (New homes)	4.6
Tools	-4.7	Home insurance	3.9
Household appliances	-1.3	Milk	3.6

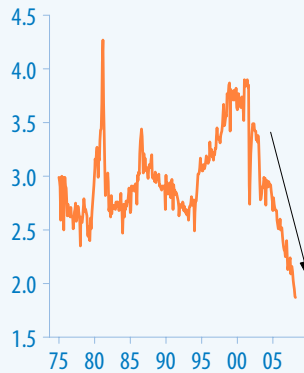
**CHART 2
TRAVEL IMBALANCE**

(mlns)

Canadians visiting the U.S.



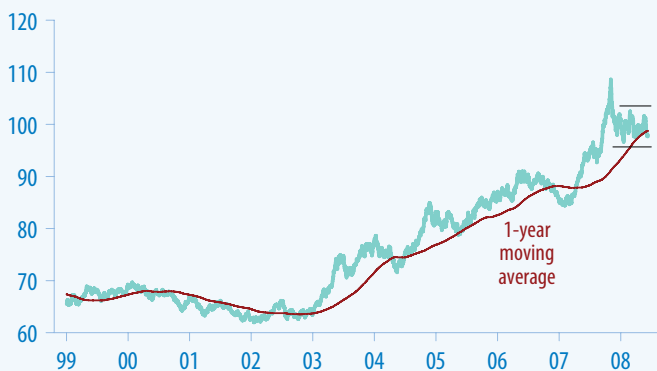
Americans visiting Canada



**CHART 3
LOONIE GROUNDED**

(US¢/C\$)

Canadian dollar



Canadian inflation under wraps (*Chart 1 and Table 2*). So, Canadian consumers clearly have reaped some rewards from the loonie's surge.

Still, those gains could be even larger. Against a backdrop of rampaging energy prices, growing Bank of Canada inflation concern, sagging consumer confidence and a reeling manufacturing sector, it is arguably more important than ever that Canadian consumers see a more complete pass-through of the strong currency to lower retail prices, to help cushion the blow from other global economic forces. However, if anything, it seems that the days of the deepest price cuts are already behind us. The three-month pace of core consumer prices has now risen faster in Canada than in the U.S., in sharp contrast to the deep discounts late last year (*Chart 1 again*).

The modest narrowing in the Canada/US price gap since last year has apparently been just enough to staunch the wave of cross-border shopping, with sky-high gasoline prices playing a loud second fiddle. (Note that when the currency peaked in early November, the price gap was more than 30%, and that month coincided with the peak in Canadian visits to the U.S.) Even so, visits to the U.S. have risen almost 14% so far this year, even as Americans have almost stopped coming to Canada (*Chart 2*). The strong loonie (and the associated price gap), the hassle of crossing the border and record pump prices have dealt a hammer blow to tourism across most of Canada.

Meantime, the loonie has conspicuously failed to rise since the start of 2008, despite a 40% sprint in oil prices and a 20% increase in broader commodities over that period (*Chart 3*). With the currency stuck in the doldrums, and many predicting it could even retreat in the year ahead, it seems unlikely that there will be another big spontaneous push to drive Canadian prices considerably lower.

Endnote: We discovered that the exercise of price comparisons across borders has become a bit more challenging. Many published materials no longer openly show both Canadian and U.S. prices, while a number of products have tiny differences in specifications between Canada and the U.S. Wherever possible we compared apples to apples, all from similar retail outlets. Thanks to the team of intrepid shoppers – Jennifer Lee, Benjamin Reitzes, Carl Campus and Robert Kavcic.

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