Economics

THE WEEK AHEAD

October 9 - 13, 2023

Variable lags

by **Benjamin Tal** benjamin.tal@cibc.com

Quick — what is the lag of monetary policy transmission? You probably don't have to think much before responding 12-24 months or maybe 18-24 months. Google would agree with that answer.

Milton Friedman, who famously stated that monetary policy works with a long and variable lag would actually disagree with this assessment. His objection would be over the variability part of the assertion. On many occasions, the great economist stated that one cannot use any rule of thumb when trying to gauge the speed at which changes in monetary policy impact real economic activity and inflation. If that statement was true over the 18 cycles (between the mid-19th and mid-20th centuries) he studied, it is surely true in today's economy.

The lag occurs due to many reasons such as adjustment costs, sticky prices and wages, nominal contracts and habit persistence in consumption. But each cycle has its own narrative and specific factors that work to impact that transmission speed.

What about the current cycle? First, we have to establish that despite Friedman's objection, many in the market still use that rule of thumb. In fact, the Bank of Canada officially states that the lag is between 18 and 24 months, while in the case of the Fed, it really depends who you ask. Federal Reserve Bank of Atlanta President Raphael Bostic suggested that "it can take 18 months to two years or more for tighter monetary policy to materially affect inflation", while Federal Reserve Governor Christopher Waller stated that the lag is really 9 to 12 months. Obviously for the Fed and the Bank of Canada, those two opposing views are the difference between overshooting and undershooting.

Waller's view represents a growing wave of observers that believe that the transmission mechanism works much faster than perceived by the market and more importantly, by central banks. This view is based more on technical reasons as opposed to structural ones. In most cases, central banks establish their lag estimates based on an impulse response function that captures a causal response of the economy to a policy shock (unexpected change in monetary policy). There are two issues here. The assumption behind the modeling is that the change in monetary policy was unexpected. That's hardly the case in real life. The intention to raise rates during this cycle was telegraphed way ahead of the actual move, with the 2-year rate rising from basically zero to 200 basis points before the first move by the Fed. That suggests that the adjustment process started way before what is assumed in the model. In addition, the models assume that the magnitude of the monetary policy change will not have any impact on the speed of the transmission. That surely is not the case, especially in the current cycle, with the most aggressive tightening trajectory in generations likely working to accelerate the response function of households and businesses.

Now against those technical hawkish claims, we can point to cycle-specific factors that work the opposite direction — that is to extend the lags. In retrospect we know now that the early tightening move by Greenspan in the years leading up to the GFC was largely neutralized by the creative imagination of American bankers (remember the teaser rates?). That led to a cliff type situation in which the full impact of higher rates was felt in a very short period of time when the teaser rates expired. Fast forward to today's situation, and there is no shortage of specific factors that work to slow the transmission speed. The most obvious one is the well documented excess savings held by consumers until recently that clearly worked to delay the response to higher rates. Add to the mix loose fiscal policy, the fact that households and businesses started the tightening cycle from a healthy financial position, and that supply driven inflation dominated the inflationary picture early in the tightening cycle, and you have a sure-fire recipe for a slow moving transmission mechanism.

In the battle between those two opposing forces, we believe that the cycle-specific factors have the upper hand. That is, we haven't reached peak pain from previous hikes yet.

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Priority

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, October 9	-	Markets Closed (Thanksgiving)	-	-	-	-	-
Tuesday, October 10	-	AUCTION: 3-M BILLS $11.6B, 6-M BILLS $4.2B, 1-YR BILLS $4.2B	-	-	-	-	-
Wednesday, October 11	-	AUCTION: 5-YR CANADAS $4B	-	-	-	-	-
Wednesday, October 11	8:30 AM	BUILDING PERMITS M/M	(Aug)	(M)	-	-	-1.5%
Thursday, October 12	-	-	-	-	-	-	-
Friday, October 13	9:00 AM	EXISTING HOME SALES M/M	(Sep)	(M)	-	-	-4.1%

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Priority

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, October 9	-	Bond Market Closed (Columbus Day)	-	-	-	-	-
Monday, October 9	8:00 AM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Monday, October 9	9:00 AM	Speaker: Lorie K. Logan (Dallas) (Voter)	-	-	-	-	-
Monday, October 9	12:50 PM	Speaker: Philip N Jefferson (Governor) (Voter)	-	-	-	-	-
Tuesday, October 10	-	AUCTION: 3-YR TREASURIES $46B	-	-	-	-	-
Tuesday, October 10	10:00 AM	WHOLESALE INVENTORIES M/M	(Aug)	(L)	-	-	-0.1%
Tuesday, October 10	9:30 AM	Speaker: Raphael W. Bostic (Atlanta) (Non-Voter)	-	-	-	-	-
Tuesday, October 10	1:00 PM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Tuesday, October 10	3:00 PM	Speaker: Neel Kashkari (Minneapolis) (Voter)	-	-	-	-	-
Tuesday, October 10	6:00 PM	Speaker: Mary C. Daly (San Francisco) (Non-Voter)	-	-	-	-	-
Wednesday, October 11	-	AUCTION: 10-YR TREASURIES $35B	-	-	-	-	-
Wednesday, October 11	7:00 AM	MBA-APPLICATIONS	(Oct 6)	(L)	-	-	-6.0%
Wednesday, October 11	8:30 AM	PPI M/M	(Sep)	(M)	0.3%	0.3%	0.7%
Wednesday, October 11	8:30 AM	PPI M/M (core)	(Sep)	(M)	0.2%	0.2%	0.2%
Wednesday, October 11	8:30 AM	PPI Y/Y	(Sep)	(M)	-	-	1.6%
Wednesday, October 11	8:30 AM	PPI Y/Y (core)	(Sep)	(M)	-	-	2.2%
Wednesday, October 11	2:00 PM	FOMC Meeting Minutes	(Sep 20)	-	-	-	-
Wednesday, October 11	4:15 AM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Wednesday, October 11	12:15 PM	Speaker: Raphael W. Bostic (Atlanta) (Non-Voter)	-	-	-	-	-
Wednesday, October 11	4:30 PM	Speaker: Susan M. Collins (Boston)	-	-	-	-	-
Thursday, October 12	-	AUCTION: 30-YR TREASURIES $20B	-	-	-	-	-
Thursday, October 12	8:30 AM	INITIAL CLAIMS	(Oct 7)	(M)	-	-	207K
Thursday, October 12	8:30 AM	CONTINUING CLAIMS	(Sep 30)	(L)	-	-	1664K
Thursday, October 12	8:30 AM	CPI M/M	(Sep)	(H)	0.4%	0.3%	0.6%
Thursday, October 12	8:30 AM	CPI M/M (core)	(Sep)	(H)	0.2%	0.3%	0.3%
Thursday, October 12	8:30 AM	CPI Y/Y	(Sep)	(H)	3.7%	3.6%	3.7%
Thursday, October 12	8:30 AM	CPI Y/Y (core)	(Sep)	(H)	4.0%	4.1%	4.3%
Thursday, October 12	2:00 PM	TREASURY BUDGET	(Sep)	(L)	-	-	$89.3B
Thursday, October 12	1:00 PM	Speaker: Raphael W. Bostic (Atlanta) (Non-Voter)	-	-	-	-	-
Thursday, October 12	4:00 PM	Speaker: Susan M. Collins (Boston)	-	-	-	-	-
Friday, October 13	8:30 AM	IMPORT PRICE INDEX M/M	(Sep)	(L)	-	0.6%	0.5%
Friday, October 13	8:30 AM	EXPORT PRICE INDEX M/M	(Sep)	(L)	-	0.5%	1.3%
Friday, October 13	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Oct)	(H)	-	67.5	68.1
Friday, October 13	9:00 AM	Speaker: Patrick Harker (Philadelphia) (Voter)	-	-	-	-	-

Week Ahead's market call

by Ali Jaffery and Katherine Judge

In the **US**, our forecasts are one tick lower than consensus on core CPI and a tick higher on headline. Should our views on core be on the mark, we expect the Fed to stay on hold. However, if core inflation comes in above a 2% annualized pace, we think it would be enough for the Fed to hike in November. At this point, inflation is the only way for the committee sort through the net effect of the strength in demand and the recovery in supply. The release of the minutes from the September meeting and a range of Fed speakers next week should provide some welcomed clues about the FOMC's thinking.

In **Canada**, it's a light week for economic news, with the September existing home sales data likely to show caution amongst buyers as the Bank of Canada didn't declare that interest rates had peaked at their meeting early on in that month. The previous softness in home sales has weighed on new housing construction this year, and the building permit data for August will likely continue to show that issuance remains below year-ago levels in the residential sector, working to compound the supply deficit of homes.

Globally, next week marks the start of the IMF and World Bank Fall meetings, this time in Morocco, where the IMF will release its latest global growth forecast as part of the October edition of the World Economic Outlook (WEO). Near-term global consensus forecasts have edged up slightly since the July WEO update was published, mainly on account of stronger US and Japanese growth, while growth expectations for China have been revised down. In particular, we'll be interested in the global risks the IMF chooses to flag, its updated view on the rocky the recovery in China and how well emerging markets can weather high real rates for longer.

There are no major Canadian data releases next week.

Week Ahead's key US number: Consumer price index—September

(Thursday, 8:30 am)

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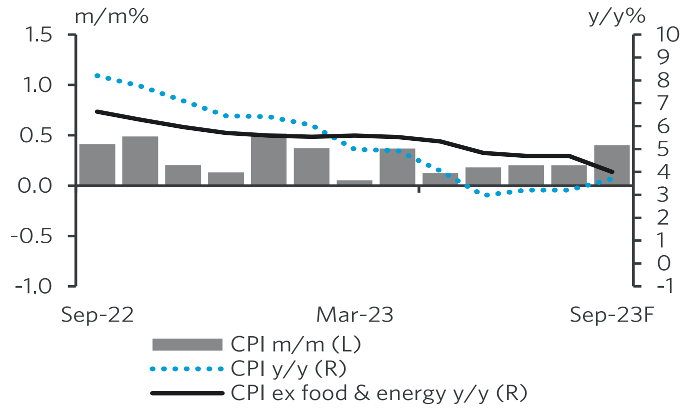
Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.4	0.3	0.6
Headline CPI (y/y)	3.7	3.6	3.7
Core CPI (m/m)	0.2	0.3	0.3
Core CPI (y/y)	4.0	4.1	4.3

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

As usual, all eyes will be on US CPI this week, with the Fed firmly focused on core inflation rather than headline. We expect a clear trend to emerge with core CPI expected to come in at 0.2% m/m as the easing supply chain pressures will weigh further on core goods prices. Shelter should continue to inch its way down but services ex shelter inflation will likely remain firm given solid consumer demand and tightness in the labour market. Another energy surge will keep headline CPI unchanged at 3.7% in yr/yr terms.

Forecast implications — To stay on the sidelines, a necessary condition for the Fed has to be for the recent soft inflation readings to continue especially after today's payroll data. However, an inflation reading above an annualized 2% pace, would likely be enough for the Fed to hike in November.

Market impact — Our view on core inflation is weaker than the market, likely because we believe core goods disinflation has more room to run. That outcome could amplify the volatility at the long-end of the curve that we've been seeing. An upside surprise on core inflation would likely cement the case for the Fed to hike in November.

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