Economics

# THE WEEK AHEAD

October 25-29, 2021

## My word is my bond

by **Avery Shenfeld** avery.shenfeld@cibc.com

Forward guidance has been a powerful policy tool for central bankers. By pledging to stick with low rates for either a specified period of time, or more suitably, for as long as certain conditions prevail, they can help drag down longer term rates when they run out of room to further reduce the overnight rate. In effect, it's a cheap and easy alternative to quantitative easing, particularly for central bankers trying to lower yields for terms of five years or less, and of importance to the Bank of Canada given that Canadian mortgage debt lies in that space.

Should a central bank ever renege on such a rate pledge, its loss of credibility would entail throwing away that tool for use in the future. Governor Carney was careful not do so when he made use of his "conditional commitment," since when he first raised rates, the economy had exceeded the path he said it had to stick to in order for rates to be kept on hold.

That's why Governor Macklem should think long and hard about any move to break his word about not raising the policy rate before the output gap is closed. Markets seem to be predicting he'll do just that, because with Canadian Q3 real GDP still more than 1% below its Q4 2019 level, it would be a heroic leap to get back to the upward sloping trend line for potential output by the spring, which is when markets are pricing in a first hike.

The unemployment rate has made better progress, but there's a risk that some of that reflected wage subsidies that are now being replaced by a much more targeted program, and that those being cut off from CRB benefits will be added to the ranks of the job hunters.

Indeed, odds are that the timetable for closing the output gap has gotten a shade longer, rather than moved forward. Remember that real GDP in the last two quarters has run about 3% slower at annual rates than the last Bank of Canada projection.

Sure, the Bank of Canada could try to revise down its estimate of potential, and make the claim that a lacklustre GDP level a couple of quarters from now was still a zero output gap. But that would lack credibility if total hours worked still had a long way to recover to trend (as is currently the case) or if wages were not escalating (also true at this point) or if industrial capacity use showed ample slack (also true).

We see a lot of today's inflation pressures as rooted in global disruptions due to Covid-19 shutdowns at mines, factories and ports, and thereby best cured by world-wide vaccinations that get workers back on the job. It looks much more like a supply shock that can be fixed by getting production and shipping back in gear, not an excess of demand that needs a slowing through higher rates.

But if that proves not to be the case over the course of 2022, and we risk ungluing inflation expectations and wage/price momentum on a more sustained basis, what's a Governor whose word is his bond supposed to do?

Simple. He (or perhaps one day, she) keeps his word about the overnight rate, and uses his other tools to put upward pressure on the market. That could include forward guidance of a different flavour, hinting at a lot of rate hikes to come once the output gap closed. Or it could also include quickly moving from adding to the BoC balance sheet to letting it start to decline, boosting the supply of government bonds to be absorbed by the market, and putting pressure on yields out the curve.

Neither of these moves are likely to be seen just yet, since the Bank of Canada likely shares our view that, even if "transitory" doesn't mean very short lived, the upward spike in inflation can be fixed without early moves to slow Canadian activity. But should that fail, it has options it can use to cool activity without breaking its word on the overnight rate.

## 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 25 | - | Government Bond Purchase Program (GBPP): 2-YR | - | - | - | - | - |
| Monday, October 25 | - | AUCTION: 3-YR CANADAS $3B | - | - | - | - | - |
| Tuesday, October 26 | - | Government Bond Purchase Program (GBPP): 10-YR | - | - | - | - | - |
| Tuesday, October 26 | - | AUCTION: 3-M BILLS $8.6B, 6-M BILLS $3.2B, 1-YR BILLS $3.2B | - | - | - | - | - |
| Wednesday, October 27 | 10:00 AM | BANK OF CANADA RATE ANNOUNCE. | (Oct 27) | (H) | 0.25% | 0.25% | 0.25% |
| Wednesday, October 27 | 10:00 AM | MONETARY POLICY REPORT | (Oct 27) | - | - | - | - |
| Wednesday, October 27 | 11:15 AM | Speaker: Tiff Macklem (Governor) | - | - | - | - | - |
| Thursday, October 28 | - | Government Bond Purchase Program (GBPP): 30-YR | - | - | - | - | - |
| Thursday, October 28 | - | AUCTION: 30-YR CANADAS $2B | - | - | - | - | - |
| Thursday, October 28 | 8:30 AM | PAYROLL EMPLOYMENT, EARNINGS & HRS | (Aug) | - | - | - | - |
| Friday, October 29 | - | Government Bond Purchase Program (GBPP): 5-YR | - | - | - | - | - |
| Friday, October 29 | 8:30 AM | GDP M/M | (Aug) | (H) | 0.7% | - | -0.1% |
| Friday, October 29 | 8:30 AM | INDUSTRIAL PROD. PRICES M/M | (Sep) | (M) | - | - | -0.3% |
| Friday, October 29 | 8:30 AM | RAW MATERIALS M/M | (Sep) | (M) | - | - | -2.4% |

# 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 25 | 8:30 AM | CHICAGO FED NAT.ACTIVITY INDEX | (Sep) | (M) | - | - | 0.29 |
| Tuesday, October 26 | - | AUCTION: 2-YR TREASURIES $60B | - | - | - | - | - |
| Tuesday, October 26 | 9:00 AM | HOUSE PRICE INDEX M/M | (Aug) | (M) | - | 1.5% | 1.4% |
| Tuesday, October 26 | 9:00 AM | S&P CORELOGIC CS Y/Y | (Aug) | (H) | - | 20.1% | 19.95% |
| Tuesday, October 26 | 10:00 AM | NEW HOME SALES SAAR | (Sep) | (M) | 775K | 758K | 740K |
| Tuesday, October 26 | 10:00 AM | NEW HOME SALES M/M | (Sep) | (M) | - | 2.4% | 1.5% |
| Tuesday, October 26 | 10:00 AM | CONF.BOARD CONSUMER CONFIDENCE | (Oct) | (H) | 108.5 | 108.0 | 109.3 |
| Tuesday, October 26 | 10:00 AM | RICHMOND FED MANUF. INDEX | (Oct) | (M) | - | 4 | -3 |
| Wednesday, October 27 | - | AUCTION: 5-YR TREASURIES $61B | - | - | - | - | - |
| Wednesday, October 27 | - | AUCTION: 2-YR FRN $28B | - | - | - | - | - |
| Wednesday, October 27 | 7:00 AM | MBA APPLICATIONS | (Oct 22) | (L) | - | - | -6.3% |
| Wednesday, October 27 | 8:30 AM | ADVANCE GOODS TRADE BALANCE | (Sep) | (M) | -$88.4B | -$88.2B | -$87.6B |
| Wednesday, October 27 | 8:30 AM | WHOLESALE INVENTORIES M/M | (Sep P) | (L) | - | - | 1.2% |
| Wednesday, October 27 | 8:30 AM | RETAIL INVENTORIES M/M | (Sep) | (H) | - | - | 0.1% |
| Wednesday, October 27 | 8:30 AM | DURABLE GOODS ORDERS M/M | (Sep P) | (H) | -1.2% | -1.0% | 1.8% |
| Wednesday, October 27 | 8:30 AM | DURABLE GOODS ORDERS EX-TRANS M/M | (Sep P) | (H) | 0.5% | 0.4% | 0.3% |
| Thursday, October 28 | - | AUCTION: 7-YR TREASURIES $62B | - | - | - | - | - |
| Thursday, October 28 | 8:30 AM | INITIAL CLAIMS | (Oct 23) | (M) | - | - | 290K |
| Thursday, October 28 | 8:30 AM | CONTINUING CLAIMS | (Oct 16) | (L) | - | - | 2481K |
| Thursday, October 28 | 8:30 AM | GDP (annualized) | (Q3 A) | (H) | 2.6% | 2.4% | 6.7% |
| Thursday, October 28 | 8:30 AM | GDP DEFLATOR (annualized) | (Q3 A) | (H) | 5.3% | 5.5% | 6.1% |
| Thursday, October 28 | 10:00 AM | PENDING HOME SALES M/M | (Sep) | (M) | - | 1.0% | 8.1% |
| Friday, October 29 | 8;30 AM | EMPLOYMENT COST INDEX | (Q3) | (M) | - | 0.8% | 0.7% |
| Friday, October 29 | 8;30 AM | PCE DEFLATOR Y/Y | (Sep) | (H) | 4.5% | 4.4% | 4.3% |
| Friday, October 29 | 8;30 AM | PCE DEFLATOR Y/Y (core) | (Sep) | (H) | 3.7% | 3.7% | 3.6% |
| Friday, October 29 | 8;30 AM | PERSONAL INCOME M/M | (Sep) | (H) | -0.5% | -0.1% | 0.2% |
| Friday, October 29 | 8;30 AM | PERSONAL SPENDING M/M | (Sep) | (H) | 0.4% | 0.5% | 0.8% |
| Friday, October 29 | 9:45 AM | CHICAGO PMI | (Oct F) | (M) | - | 63.1 | 64.7 |
| Friday, October 29 | 10:00 AM | MICHIGAN CONSUMER SENTIMENT | (Oct F) | (H) | - | 71.4 | 71.4 |

## Week Ahead's market call

by Avery Shenfeld

In the **US**, Q3 GDP looks to be only middling, as we've been steadily marking down our estimates for the components of final demand as the recent monthly indicators rolled in, and we're counting on a lesser reduction in inventories than in the prior quarter for much of the gain. Durable orders could disappoint on the headline due to weakness in the transportation component, but looks to be close to consensus ex-transport. Monthly figures for the PCE price index will mirror what we already learned from the CPI, while the personal income and spending numbers will be coming out after the GDP data that provide the full quarter estimates, and will therefore have less impact.

In **Canada**, GDP continues to see-saw, with August showing a rebound, but other than employment, some disappointments in early readings on September from retailing and manufacturing flash estimates. The Bank of Canada will mark down its 2021 growth forecast (likely implying a slightly longer wait to close the output gap), raise its near term inflation forecasts, keep rates on hold, and announce a cut in its secondary market bond purchases to $1 bn per week. As our rates strategist Ian Pollick pointed out, that's not a low enough pace for bond buying to mark the start of the "reinvestment phase", since adding in purchases in the primary market, the BoC's holdings of Government of Canada bonds will still be climbing.

## Week Ahead's key Canadian number: GDP—August

(Friday, 8:30 am)

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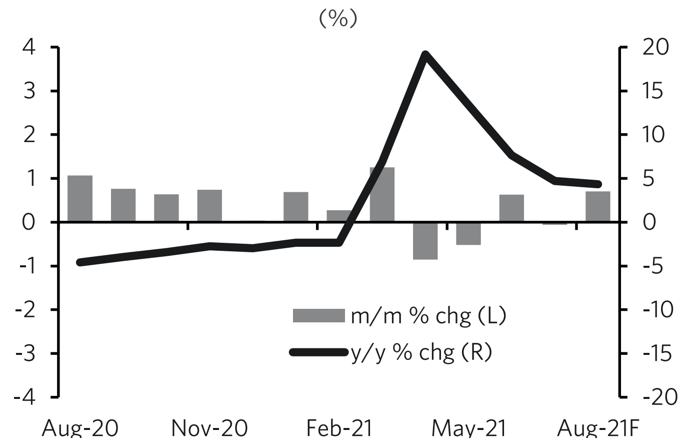
| GDP (%) | CIBC | Mkt | Prior |
|---|---|---|---|
| GDP m/m (Aug) | 0.7% | - | -0.1% |

Chart: Canadian GDP at basic prices (%)




Source: Statistics Canada, Haver Analytics, CIBC

After a tough month of July for the Canadian economy, GDP looks to have bounced back in a big way. Services sectors likely led the way higher, with a number of industries benefiting from the low numbers of new Covid cases and increasingly relaxed public health restrictions. The solid print will be no surprise, however, since Statistics Canada already lets the cat out of the bag in its flash estimate. So the real news will come from the early look at September GDP growth, which should prove to be a bit less robust.

Still, while there was much divergence across the country in terms of the virus, and a new holiday introduced for some workers, the return of school for children and warm weather seemed to have boosted activity further across a number of services sectors, at least according to the hours worked data.

**Forecast Implications** — A couple of solid monthly performances would have us tracking roughly 3.5% annualized growth for the third quarter. While growth is likely to decelerate as the weather gets colder and some services are forced back indoors in the coming months, Covid cases seemed to have peaked at the national level. That leaves scope for a further relaxation of some of the harsh restrictions that prevailed across Canada earlier this year.

## Week Ahead's key US number: Real GDP—Q3 (Advance)

(Thursday, 8:30 am)

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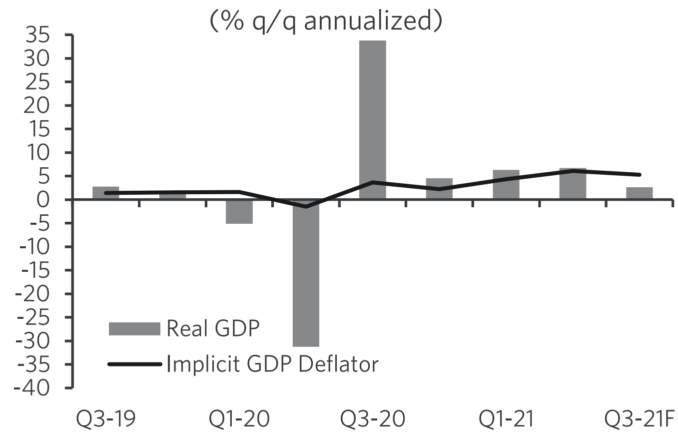
| GDP (%) | CIBC | Mkt | Prior |
|---|---|---|---|
| GDP q/q annualized | 2.6% | 2.4% | 6.7% |
| GDP deflator | 5.3% | 5.5% | 6.1% |

Chart: US GDP




Source: BEA, Haver Analytics, CIBC

All signs point to a deceleration in GDP growth in the US in the third quarter as consumer spending on goods was stifled by supply chain bottlenecks, and momentum in services spending faded with the spread of the Delta variant. The expected drop in business investment in equipment is in line with the lack of progress in capital goods imports as supply chain issues weighed, while residential investment also looks to have been a drag on growth as labor and material shortages held back housing starts and construction spending. Exports appear to have been soft relative to imports, leaving our 2.6% annualized growth forecast driven by inventories. Excluding inventories, the economy would have contracted by nearly 1% annualized.

Forecast implications—Our forecast leaves the economy 2.7% behind where the pre-pandemic trend growth rate would have taken it. Activity in the fourth quarter is poised to close that gap further, with an acceleration in growth on a rebound from Hurricane Ida impacts imminent. There could also be less caution for services spending along with the deceleration in Covid cases, but supply chain bottlenecks remain a downside risk to the outlook.

Market impact— We're slightly above the consensus forecast, which could support the greenback and see bond yields rise.

## Other US Releases: Durable goods order—September

(Wednesday, 8:30 am)

Durable goods orders likely fell by 1.2% in September on lower transportation orders, as supply chain bottlenecks could have eaten into vehicle orders, while commercial aircraft orders looked lackluster after jumping in the prior month. Excluding transportation, orders likely advanced by 0.5% on demand for goods to replenish inventories. Still, the delivery of goods continues to be at risk given supply chain issues, and these orders could therefore show up with a lag in GDP.

## Personal income and outlays—September

(Friday, 8:30 am)

Household incomes likely tumbled by 0.5% in September as the remaining expanded unemployment benefits expired, offsetting gains in labor market income. Still, ample excess savings should have driven growth in spending on goods, in line with the retail sales data, but a slowdown in services spending in line with the spread of the Delta variant likely resulted in total spending decelerating to 0.4%. The Fed's preferred prices measure, core PCE, likely heated up to 3.7% y/y, or 2.7% annualized in comparison to its pre-pandemic level, supporting the Fed's pending decision to begin tapering bond purchases.

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