Economics

THE WEEK AHEAD

October 7 - 11, 2024

The Fed's new kink (in the Phillips Curve)

by **Ali Jaffery** ali.jaffery@cibc.com

So you might think that by now, economists and central bankers would have a good handle on the trade-off between slack and inflation. You would be wrong. The debate about how much slack is enough to cure high inflation, or whether inflation expectations dominate, is far from settled. But the trajectory of price growth since the pandemic has certainly reinvigorated that debate, and actually revived an old idea: there is a kink in the Phillips Curve, or a non-linearity in the relationship between slack and inflation.

The thinking goes that there is some threshold of tightness in the labor market, above which, inflation is "supercharged". That view is coming out of some recent academic work featured at the Jackson Hole symposium, and also research coming out of the Fed itself (Eggertsson and Benigno, 2024; Smith et al, 2024). When supply shocks of the sort we saw in 2021 and 2022 hit the economy at a time when the labor market is tight, firms have to pass on those costs much faster than they otherwise would, and we hit the steep portion of the Phillips Curve. But when the labor market is balanced or there is some slack in the economy, firms have less need or ability to pass on costs from shocks and movements in inflation are much more modest — meaning we are on the flat portion of the Phillips Curve.

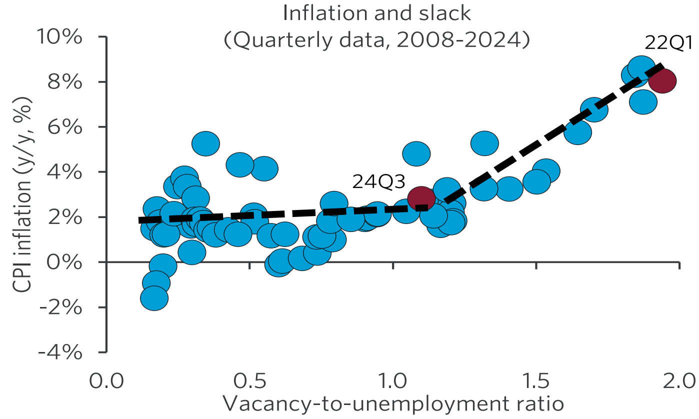
This view is a departure from the two decades prior to the pandemic, where the economy mostly operated only on that flat part of the slack-inflation link. Some even speculated then the Phillips Curve was "dead". Ultimately that led to a new consensus that inflation expectations, rather than slack, ultimately pins everything down (Hazell et al, 2022). Jay Powell was so confident that at one point, he described the inflation-jobs relationship as a "faint heartbeat".

For investors thinking about tomorrow, however, it's not about taking sides in an endless debate on what truly drives inflation, but about understanding how the Fed's reaction function may have changed as result of these new ideas.

As the economy reaches that threshold, which some assess to be when the openings-to-unemployment ratio gets to around 1, the implications for monetary policy shift. Being on the flat part of the curve, which it seems we just recently got on with the vacancy-to-unemployment ratio at 1.1 (Chart), the risk of stoking higher inflation from easing policy diminishes because inflation is less responsive to changes in demand, so long as expectations remained anchored. That gives the Fed ample room to cut rates.

For large disruptive supply shocks, like the port strike we just averted or geopolitical shocks brewing in the Middle East, a far less overheated jobs market also implies a less aggressive inflation response. So these sorts of shocks might not set us as far back as they did in the years immediately after the pandemic. Overall, there are benefits to appreciating this new framework and we're glad the Fed is open to new ideas and kinks (in the Phillips Curve).

Chart: The Phillips Curve — the link between slack and inflation — is kinked



Source: BLS, CIBC

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 7	-	-	-	-	-	-	-
Tuesday, October 8	-	AUCTION: 3-M BILLS $12.8B, 6-M BILLS $4.6B, 1-YR BILLS $4.6B	-	-	-	-	-
Tuesday, October 8	8:30 AM	MERCHANDISE TRADE BALANCE	(Aug)	(H)	-$0.2B	$0.0B	$0.7B
Wednesday, October 9	-	-	-	-	-	-	-
Thursday, October 10	-	AUCTION: 2-YR CANADAS $5B	-	-	-	-	-
Friday, October 11	8:30 AM	EMPLOYMENT CHANGE	(Sep)	(H)	60.0K	34.9K	22.1K
Friday, October 11	8:30 AM	UNEMPLOYMENT RATE	(Sep)	(H)	6.6%	6.6%	6.6%
Friday, October 11	8:30 AM	BUILDING PERMITS M/M	(Aug)	(M)	-	-8.6%	22.1%
Friday, October 11	10:30 AM	BUSINESS OUTLOOK SURVEY	(3Q)	(M)	-	-	-2.9
Friday, October 11	10:30 AM	CANADIAN SURVEY OF CONSUMER EXPECTATIONS	(3Q)	(M)	-	-	-

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 7	3:00 PM	CONSUMER CREDIT	(Aug)	(L)	-	$13.4B	$25.5B
Monday, October 7	3:00 PM	TREASURY BUDGET	(Sep)	(L)	-	-	-$380.1B
Monday, October 7	1:00 PM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Monday, October 7	1:50 PM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Monday, October 7	6:00 PM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Monday, October 7	6:30 PM	Speaker: Alberto G. Musalem (St Louis) (Non-Voter)	-	-	-	-	-
Tuesday, October 8	-	AUCTION: 3-YR TREASURIES $58B	-	-	-	-	-
Tuesday, October 8	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Aug)	(H)	-$70.4B	-$71.3B	-$78.8B
Tuesday, October 8	3:00 AM	Speaker: Adriana D. Kugler (Governor) (Voter)	-	-	-	-	-
Tuesday, October 8	12:45 PM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Tuesday, October 8	4:00 PM	Speaker: Susan M. Collins (Boston)	-	-	-	-	-
Wednesday, October 9	-	AUCTION: 10-YR TREASURIES $39B	-	-	-	-	-
Wednesday, October 9	7:00 AM	MBA-APPLICATIONS	(Oct 4)	(L)	-	-	-1.3%
Wednesday, October 9	10:00 AM	WHOLESALE INVENTORIES M/M	(Aug)	(L)	-	0.2%	0.2%
Wednesday, October 9	2:00 PM	FOMC Meeting Minutes	(Sep 18)	-	-	-	-
Wednesday, October 9	8:00 AM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Wednesday, October 9	9:15 AM	Speaker: Lorie K. Logan (Dallas) (Non-Voter)	-	-	-	-	-
Wednesday, October 9	10:30 AM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter)	-	-	-	-	-
Wednesday, October 9	5:00 PM	Speaker: Susan M. Collins (Boston)	-	-	-	-	-
Wednesday, October 9	6:00 PM	Speaker: Mary C. Daly (San Francisco) (Voter)	-	-	-	-	-
Thursday, October 10	-	AUCTION: 30-YR TREASURIES $22B	-	-	-	-	-
Thursday, October 10	8:30 AM	INITIAL CLAIMS	(Oct 5)	(M)	-	-	225K
Thursday, October 10	8:30 AM	CONTINUING CLAIMS	(Sep 28)	(L)	-	-	1826K
Thursday, October 10	8:30 AM	CPI M/M	(Sep)	(H)	0.1%	0.1%	0.2%
Thursday, October 10	8:30 AM	CPI M/M (core)	(Sep)	(H)	0.2%	0.2%	0.3%
Thursday, October 10	8:30 AM	CPI Y/Y	(Sep)	(H)	2.3%	2.3%	2.5%
Thursday, October 10	8:30 AM	CPI Y/Y (core)	(Sep)	(H)	3.1%	3.2%	3.2%
Thursday, October 10	10:30 AM	Speaker: Thomas I. Barkin (Richmond) (Voter)	-	-	-	-	-
Thursday, October 10	11:00 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Friday, October 11	8:30 AM	PPI M/M	(Sep)	(M)	0.1%	0.1%	0.2%
Friday, October 11	8:30 AM	PPI M/M (core)	(Sep)	(M)	0.2%	0.2%	0.3%
Friday, October 11	8:30 AM	PPI Y/Y	(Sep)	(M)	-	1.7%	1.7%
Friday, October 11	8:30 AM	PPI Y/Y (core)	(Sep)	(M)	-	2.7%	2.4%
Friday, October 11	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Oct P)	(H)	-	70.0	70.1
Friday, October 11	9:45 AM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter)	-	-	-	-	-
Friday, October 11	10:45 AM	Speaker: Lorie K. Logan (Dallas) (Non-Voter)	-	-	-	-	-

Week Ahead's market call

by Katherine Judge

In the **US**, we're on consensus for a tame September inflation print, with that release being less consequential than the jobs market data for the Fed these days. A plethora of Fed speakers will be able to add their views on the surprisingly strong payrolls data for September, which now makes a 25bp cut in November our base case, rather than 50bps.

In **Canada**, we're looking for an impressive gain in employment, but that would simply reflect a boost from the seasonal adjustment process and the fact that there were fewer jobs than normal to lose in September by students returning to school, as student employment over the summer was particularly weak. The Bank of Canada will be more focused on the unemployment rate, which we expect will remain steady, but any increase would likely be enough to result in a 50bps cut in October.

Week Ahead's key Canadian number: Labour force survey—September

(Friday, 8:30 am)

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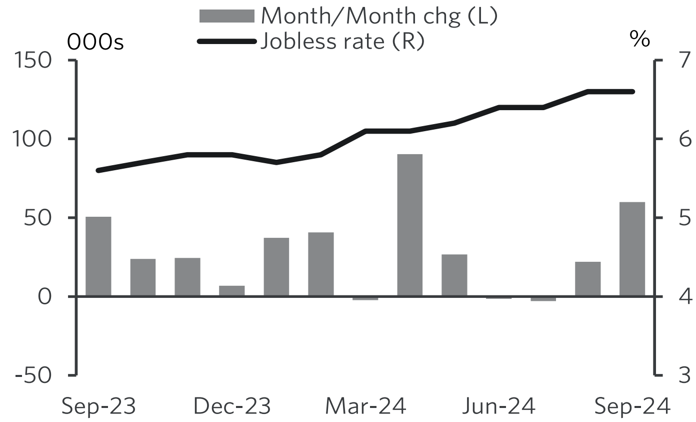
Variable	CIBC	Mkt	Prior
Employment (m/m)	60.0K	34.9K	22.1K
Unemployment rate	6.6%	6.6%	6.6%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Employment growth was sluggish over the summer, in large part because students found it harder than normal to find jobs. September usually marks the time when those students return to their studies, and if there are fewer workers to leave the labour force this year then that could result in an impressive looking seasonally adjusted increase in the job count.

However, because fewer students bothered looking for work in a weak summer job market, the participation rate dropped and could also rebound somewhat in September. Because of that and continued solid population growth, the 60K gain in jobs we project would only keep the jobless rate unchanged at 6.6%. With fewer than normal low wage student workers leaving the employment ranks after the summer, the unadjusted monthly increase in average wages likely won't be as large as normal which would result in a deceleration in the annual pace of wage growth.

Forecast implications — While the headline seasonally adjusted employment gain could look impressive at first glance, the focus should remain on the unemployment rate which has risen markedly over the past year and could inch up a little further still. Any further increase in the jobless rate closer to 7% would likely bring a 50bp rate cut from the Bank of Canada.

Other Canadian releases: Merchandise trade balance—August

(Tuesday, 8:30 am)

Canada's trade balance returned to surplus in July, but that could have proved fleeting as lower oil prices and volumes likely drove a return to deficit in August. We forecast a $0.2bn deficit for the month, which would bring the trade balance back in line with June's figure. As well as the likely smaller surplus in oil, US advance data suggest that Canadian auto imports may bounce back quicker than exports in August, following a down month in July.

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

(Thursday, 8:30 am)

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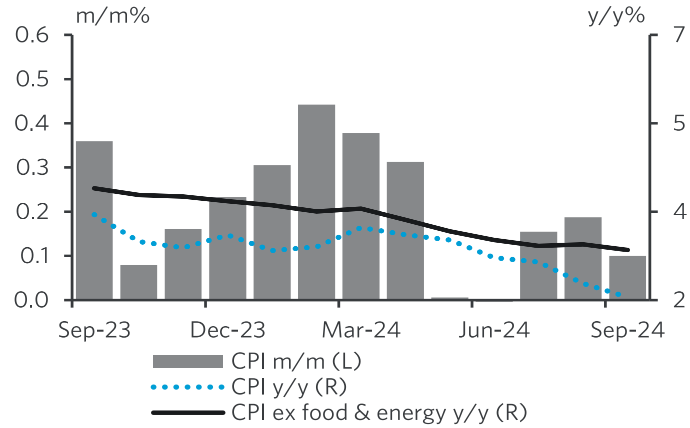
Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.1	0.1	0.2
Headline CPI (y/y)	2.3	2.3	2.5
Core CPI (m/m)	0.2	0.2	0.3
Core CPI (y/y)	3.1	3.2	3.2

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

Inflation likely eased off in September following a temporary bump up in the monthly pace in August. The 0.2% m/m pace expected for the ex. food/energy group would reflect the ongoing deflation in goods prices, coupled with an easing off in transportation services prices, in line with falling fuel costs. Shelter prices, which lag the trend seen in market-based rent measures, will likely resume their decelerating path, after jumping in August.

Forecast implications — Inflation is on track to reach target sustainably by early-2025. But with the labour market unexpectedly hot in September, policymakers are now likely to conduct a 25bp cut at the November meeting, rather than the 50bps cut we previously expected, as the additional ammunition for consumer spending could present a threat to taming inflation in services.

Market impact — We're in line with the consensus which should limit any market impact.

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