

# WEEKLY COMMENTARY



## Lessons from October 1979

By Francis Généreux, Principal Economist

On Saturday, October 6, 1979—almost 43 years ago to the day—the Federal Reserve (Fed) made a dramatic move to halt the wage-price spiral then afflicting the US economy. During a special meeting, the Federal Open Market Committee (FOMC) chaired by Paul Volcker decided the Fed needed to change strategy and tactics to restore its credibility. What followed was a monetary tightening campaign and two recessions, one in early 1980 and another from summer 1981 to fall 1982. This fight triggered a long cycle of disinflation and has some useful lessons for us today.

### Restore Credibility

That special meeting in October 1979 took place against a unique financial and economic backdrop. The oil shock, inflation above 10%, growing inflation expectations, a falling US dollar, rising gold prices, surging commodity prices, and hesitation and disagreement at previous FOMC meetings were all top of mind for Fed officials aware that their credibility had been tarnished. According to the [meeting transcript](#), Volcker wanted to break this vicious cycle, saying officials couldn't "walk away today without a program that is strong in fact and perceived as strong in terms of dealing with the situation." So they decided to change their strategy and tactics by setting money supply growth targets that would be compatible with lower inflation and letting federal funds rates rise to meet those targets. In hindsight, monetary supply targeting wasn't a resounding success for a number of reasons. But the key takeaway was the Fed's determination to restore the confidence of the markets and the public at all costs. It also needed to keep inflation from worsening, and monetary policy tweaks weren't doing the trick. It needed to shock the markets, knowing it would cause economic pain.

So with this year's rate hike spree featuring successive 75-point increases, the Fed is sending a clear message that it's committed to restoring its shaky credibility.

### Be Consistent and Persistent

The only way for the Fed to fully restore its credibility is to stay the course. That was one of the main topics of discussion in October 1979 and at subsequent meetings. Fed decisions are pretty straightforward when the economy is holding up because everyone sees inflation as a problem. When the economy is struggling, however, it's easy to waver. Both the government and the public pressure the Fed to shift its focus from inflation to the economy and the labour market. But as one participant at the 1979 meeting said, "our credibility will really suffer if we announce a change in procedure and then fail to have the guts to go through with it."

The Fed continued to pursue restrictive policy with high interest rates from 1979 to 1982. And though not directly targeted, policy rates fluctuated with supply and demand for money. But in real terms, rates remained positive. The Fed also hesitated somewhat, which probably kept inflation expectations higher for longer. The main takeaway here is that despite two recessions, it had to keep monetary policy restrictive to finally lower inflation and inflation expectations. You can't claim victory when you hit the target; you also need to anchor the public's expectations and behaviours at target. The problem is, things could go south before your efforts start to pay off.

### Don't Over-Rely on Volatile Indicators

One of the monetary policy mistakes made in October 1979 was to base the new strategy on monetary aggregates, which are moving targets. To complicate matters further, regulatory, statutory and technological changes were having a huge effect on financial institution reserves, the interbank market, and the borrowing and saving habits of economic agents. The Fed therefore had to repeatedly adjust its targets and its range for the federal funds rate, confounding both markets and the public.

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The Fed's approach is much better these days. It now targets a very narrow range for the federal funds rate and a rate of 2% for inflation. However, you can't claim victory over inflation once monthly CPI starts to improve. We have already had false hopes in the summer of 2021 and last July.

### **The Goal of Monetary and Budgetary Policy Should Be the Same**

One major difference between 1979 and now is that while governments today recognize that inflation is a problem, they're not doing much to rein it in. In Canada, governments seem to be trying to soften the blow of inflation rather than addressing its root causes. From the time he was nominated in July 1979, Volcker had the backing of President Jimmy Carter and then Carter's successor, Ronald Reagan. Both presidents were also concerned with setting fiscal or regulatory policy that didn't add fuel to the inflationary fire. Today, the Fed and other central banks would probably have an easier time if governments opted for more austerity. The rift could grow even bigger if the economy tips into a recession, especially if inflation is still high.

### **Act before It's Too Late**

In his autobiography,<sup>1</sup> Paul Volcker insisted that monetary policy should be counter-cyclical and contain inflationary pressures as swiftly as possible. He quoted William Martin, who was Fed Chair from 1951 to 1970. Martin said that a central bank's job was to "take away the punch bowl just when the party gets going." Since that didn't really happen prior to 1979, lowering inflation and inflation expectations was harder and took longer. But according to Volcker, "Maintaining the expectation, that confidence, is a fundamental responsibility of monetary policy. Once lost, the consequences can be severe and stability hard to restore." He also said we shouldn't get our hopes up too soon. This can lead to complacency that could push up prices even higher.

So have central banks started to normalize monetary policy too late this time around? It seems so, but with the pandemic and successive waves of COVID-19, it's unclear. What is clear is that the Fed is playing catch-up and may wish it had started a bit sooner.

### **Similar but Different**

We need to remember the lessons of the last high inflation episode and the monetary policy instituted in 1979. But even those lessons aren't a perfect roadmap. Mistakes were made, and the situation today is very different. Confidence in the US dollar remains high, as evidenced by the strength of the greenback. Yes, inflation is still elevated, but not as elevated as it was in 1980. And it's still unclear whether the long-term expectations of consumers and businesses are anchored at

notably higher levels than they were before the pandemic. Fortunately, restoring the Fed's credibility and bringing inflation back to target should be less painful today than it was in the early 1980s.

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<sup>1</sup> Paul A. Volcker with Christine Harper, *Keeping At It: The Quest for Sound Money and Good Government*, New York, Hachette, 2018.

# What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, and Francis Généreux, Principal Economist

## THURSDAY October 13 - 8:30

<b>September</b>	<b>m/m</b>
Consensus	0.2%
Desjardins	0.2%
<b>August</b>	<b>0.1%</b>

## FRIDAY October 14 - 8:30

<b>September</b>	<b>m/m</b>
Consensus	0.2%
Desjardins	-1.1%
<b>August</b>	<b>0.3%</b>

## FRIDAY October 14 - 10:00

<b>October</b>	<b>Index</b>
Consensus	58.8
Desjardins	56.5
<b>September</b>	<b>58.6</b>

## FRIDAY October 14 - 8:30

<b>August</b>	<b>m/m</b>
Consensus	0.1%
Desjardins	0.0%
<b>July</b>	<b>-0.6%</b>

## FRIDAY October 14 - 8:30

<b>August</b>	<b>m/m</b>
Consensus	-1.2%
Desjardins	-1.6%
<b>July</b>	<b>-0.9%</b>

## UNITED STATES

**Consumer price index (September)** – Headline inflation eased for the second month in a row in August, retreating further from June's peak of 9.1%. We expect another dip in the year-over-year change in the consumer price index (CPI) in September. Falling energy prices—especially gasoline, which was 6.8% cheaper than the preceding month—will again be the main factor behind this decline. However, we expect food prices to have surged once more. Food and gas excluded, core CPI should be up 0.4% for September, slightly lower than August's 0.6% increase. Price pressures on goods seem to be slowly easing. We could see a drop in the cost of some goods this month, including used cars and trucks. However, price pressures on services are likely to remain acute in the very short term. Overall, the month-over-month change in the all-items index is expected to come in at 0.2%, just above August's 0.1% rise. The year-over-year change should fall from 8.3% to 8.0%, with core inflation expected to edge up from 6.3% to 6.5%.

**Retail sales (September)** – Retail sales rose 0.3% in August after falling 0.4% in July, mainly on the back of solid gains in the automotive and food services sectors. However, preliminary data from card transactions points to another decline in total retail sales in September. Despite an increase in the number of new vehicles sold, we anticipate a slight drop in automotive sector sales. We're also forecasting a further decline in gas station receipts. All in all, retail sales should fall 1.1%, while sales excluding food and gas are projected to drop 1.0%. That said, a larger than expected change in goods prices could impact the month-to-month retail sales figure.

**University of Michigan consumer sentiment index (October – preliminary)** – Consumer sentiment as measured by the University of Michigan index continued to improve in September. This is the first time in two years that the index has risen in three successive months. However, we expect this streak to end in October. The recent increase in gas prices—although minor compared to the decline we've witnessed since June—and the fall in the major stock indexes since mid-September suggest that consumer sentiment is eroding a bit. However, the strength of the labour market—and the drop in unemployment claims—continues to underpin sentiment. We should see the University of Michigan index dip slightly to 56.5.

## CANADA

**Wholesale trade (August)** – We expect wholesale trade to be flat in August, trailing the 0.8% early estimate from Statistics Canada. The weaker projection is based on growth in employment, real imports and auto sales data for the month, as well as goods prices and the Canadian dollar.

**Manufacturing sales (August)** – Manufacturing sales are expected to have continued their descent in August, likely falling by 1.6% for the fourth consecutive monthly decline. This is slightly more optimistic than Statistics Canada's flash estimate of -1.8%. Plummeting September sales should be primarily driven by lower volumes in the month—the first decrease since May 2022—on declining employment and hours, a drop in real imports of manufacturing inputs and a retreat in seasonally-adjusted auto production. Manufacturing prices are also expected to fall for the third consecutive month, albeit more modestly than the projected downward trend in real manufacturing.

FRIDAY October 14 - 9:00

<b>September</b>	<b>m/m</b>
Consensus	n/a
Desjardins	-4.9%
<b>August</b>	<b>-1.0%</b>

TUESDAY October 11 - 2:00

<b>August</b>	<b>m/m</b>
Consensus	0.0%
<b>July</b>	<b>0.2%</b>


**Existing home sales (September)** – After taking a bit of a breather in August, existing home sales are expected to have resumed their inexorable decline in September, likely falling by around 4.9%. Local data so far is sparse for the month but the direction is clear. The Toronto Regional Real Estate Board (TRREB) puts the seasonally-adjusted monthly drop in Hogtown's home sales at 10.8%, after increasing by 11.1% in August. Sales in other communities have been more mixed, but Toronto's weight in total sales (roughly 40–45% of Ontario sales and 15–20% of national sales) makes its impact inescapable.


## OVERSEAS

**United Kingdom: Monthly GDP (August)** – After falling 0.6% in June, UK real GDP rose 0.2% in July. This is a good start but is unlikely to be enough to keep growth positive over the entire third quarter, and carry-over growth is slightly negative. The UK economy is grappling with a number of challenges, particularly surging energy prices. This is already impacting households. Retail sales plummeted 1.6% in August, which doesn't bode well for the month's GDP print.

# Economic Indicators

Week of October 10 to 14, 2022

Date	Time	Indicator	Period	Consensus		Previous data
UNITED STATES						
MONDAY I0	---	Bond markets closed (Columbus Day)				
	9:00	Speech of the Federal Reserve Bank of Chicago President, C. Evans				
	13:00	Speech of a Federal Reserve Governor, L. Brainard				
TUESDAY I1	---	Federal budget (US\$B)	Sept.	n/a	n/a	-64.94
	12:00	Speech of the Federal Reserve Bank of Cleveland President, L. Mester				
WEDNESDAY I2	8:30	Producer price index				
		Total (m/m)	Sept.	0.2%	-0.1%	-0.1%
		Excluding food and energy (m/m)	Sept.	0.3%	0.3%	0.4%
	14:00	Minutes of the Federal Reserve meeting				
	18:30	Speech of a Federal Reserve Governor, M. Bowman				
THURSDAY I3	8:30	Initial unemployment claims	Oct. 3-7	n/a	225,000	219,000
	8:30	Consumer price index				
		Total (m/m)	Sept.	0.2%	0.2%	0.1%
		Excluding food and energy (m/m)	Sept.	0.4%	0.4%	0.6%
		Total (y/y)	Sept.	8.1%	8.0%	8.3%
		Excluding food and energy (y/y)	Sept.	6.5%	6.5%	6.3%
FRIDAY I4	8:30	Export prices (m/m)	Sept.	-1.2%	-1.0%	-1.6%
	8:30	Import prices (m/m)	Sept.	-1.1%	-0.8%	-1.0%
	8:30	Retail sales				
		Total (m/m)	Sept.	0.2%	-1.1%	0.3%
		Excluding automobiles (m/m)	Sept.	-0.1%	-1.3%	-0.3%
	10:00	Michigan's consumer sentiment index – preliminary	Oct.	58.8	56.5	58.6
	10:00	Business inventories (m/m)	Aug.	0.9%	0.9%	0.6%
	10:30	Speech of a Federal Reserve Governor, L. Cook				
CANADA						
MONDAY I0	---	Markets closed (Thanksgiving Day)				
TUESDAY I1	---					
WEDNESDAY I2	---					
THURSDAY I3	---					
FRIDAY I4	8:30	Wholesale sales (m/m)	Aug.	0.1%	0.0%	-0.6%
	8:30	Manufacturing sales (m/m)	Aug.	-1.2%	-1.6%	-0.9%
	9:00	Existing home sales (m/m)	Sept.	n/a	-4.9%	-1.0%

Note: Desjardins, Economic Studies are involved every week in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. The times shown are Eastern Standard Time (GMT - 4 hours).  Forecast of Desjardins, Economic Studies of the Desjardins Group.

# Economic Indicators

Week of October 10 to 14, 2022

Country	Time	Indicator	Period	Consensus		Previous data	
				m/m (q/q)	y/y	m/m (q/q)	y/y
<b>OVERSEAS</b>							
<b>DURING THE WEEK</b>							
China	---	Trade balance (US\$B)	Sept.	81.20		79.39	
<b>MONDAY 10</b>							
Japan	19:50	Current account (¥B)	Aug.	-472.2		-629.0	
<b>TUESDAY 11</b>							
United Kingdom	2:00	Trade balance (£M)	Aug.	-8,700		-7,793	
United Kingdom	2:00	Construction	Aug.	-0.1%	5.6%	-0.8%	4.3%
United Kingdom	2:00	Index of services	Aug.	0.1%		0.4%	
United Kingdom	2:00	Monthly GDP	Aug.	0.0%		0.2%	
United Kingdom	2:00	Industrial production	Aug.	-0.1%	0.6%	-0.3%	1.1%
United Kingdom	2:00	ILO unemployment rate	Aug.	3.6%		3.6%	
Italy	4:00	Industrial production	Aug.	0.0%	n/a	0.4%	-1.4%
<b>WEDNESDAY 12</b>							
South Korea	---	Bank of Korea meeting	Oct.	3.00%		2.50%	
Euro zone	5:00	Industrial production	Aug.	0.7%	1.2%	-2.3%	-2.4%
Japan	19:50	Producer price index	Sept.	0.3%	8.8%	0.2%	9.0%
<b>THURSDAY 13</b>							
Germany	---	Current account (€B)	Aug.	n/a		5.0	
Germany	2:00	Consumer price index – final	Sept.	1.9%	10.0%	1.9%	10.0%
China	21:30	Consumer price index	Sept.		2.8%		2.5%
China	21:30	Producer price index	Sept.		1.0%		2.3%
<b>FRIDAY 14</b>							
France	2:45	Consumer price index – final	Sept.	-0.5%	5.6%	-0.5%	5.6%
Euro zone	5:00	Trade balance (€B)	Aug.	-45.0		-40.3	

Note: In contrast to the situation in Canada and the United States, disclosure of overseas economic figures is much more approximate. The day of publication is therefore shown for information purposes only. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. The times shown are Eastern Standard Time (GMT - 4 hours).