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US GDP Beats, But Raises Durability Risks

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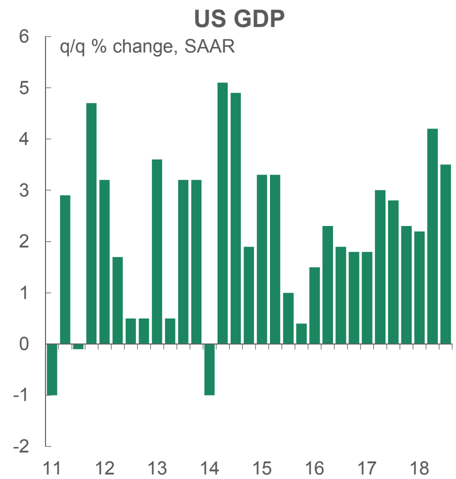
2018Q3 GDP growth, q/q % change SAAR:
Actual: 3.5
Scotia: 3.2
Consensus: 3.3
Prior: 4.2

- While US GDP growth slightly exceeded expectations in Q3, the composition may be setting up bigger question marks on the fourth quarter's growth rate. Stocks, Treasuries and the USD were little affected in the aftermath.
- Consumption was up 4% q/q SAAR in Q3 and that contributed 2.7 points to the 3.5% GDP growth headline in weighted terms. 1.2 of those points came from spending on goods including a ½% from durables, 1 ½% from services and ¾% from nondurables. Quarterly consumption growth is running toward the post-crisis highs.
- Consumption growth was a half point faster than we had anticipated and seven-tenths faster than consensus estimated. The inference is that the combination of what happened to spending in September (that arrives on Monday) and any revisions resulted in a better than anticipated outcome possibly due to the quarter ending on a high note.
- Assuming no revisions to prior months, the consumption math backs out to a rise in inflation-adjusted spending of 0.6% m/m in September. That was a powerful ending to Q3. There have only been four stronger months since the GFC and three ties. The early consensus estimate for Monday's figures was for a consumption rise of half that, so fresher estimates will move higher. Because of the way the quarter may have ended (again, assuming away revisions), that bakes in 2% consumption growth in Q4 before we get any monthly Q4 spending figures. The holiday season's start around T-giving is going to be key to the durability of consumption growth (and earnings guidance on a day when that's key to equity markets).
- From there, the details and risks deteriorate.
- Inventories added 2.1 points to GDP growth in weighted terms. That makes for the fourth highest contribution to growth from inventories over the post-crisis period. Some of this may have been tariff front-running. If so, then the effects are probably transitory.
- Government spending added 0.56 percentage points to top line GDP growth in weighted terms. Of that, 0.35% came from state and local governments. ¼% came from Federal spending and mostly through defense spending for the second straight quarter. Recall the US$300 billion spending bill and that about half of it was focused upon defense spending. What's the best way to fool US voters on the path to midterms? Classic pro-cyclical pump priming timed to the electoral cycle and particularly by making more bullets as the easiest way to provide immediate stimulus even if it essentially goes nowhere useful. This is a transitory addition to growth.
- Net exports subtracted 1.8 percentage points from GDP growth. A ½% drag came from gross exports while higher import leakages knocked 1.3% off topline growth. I think the trend continues to point to a challenging US net



Sources: Scotiabank Economics, BEA.

trade picture given that the USD's rise has taken it to being roughly tied with the highest levels of the past three decades. A strong USD challenges export competitiveness and cheapens the cost of imports all else equal.

- Investment outside of inventories didn't do much for the economy. Nonresidential structures investment dragged ¼% off GDP growth. Equipment spending made no contribution to GDP growth as a small contribution from industrial equipment was offset by a drag from transportation equipment. Housing investment knocked about 0.2% off GDP as higher mortgage rates and reduced mortgage interest write-offs in the TCJA lead to a curtailment of housing demand.