July 29, 2021

Strong US GDP Growth Is Even Stronger Than It Appears

- **Although strong Q2 GDP growth missed expectations…**
- **…the miss was mainly due to an inventory drawdown and import leakage effects…**
- **…that reflect supply chains struggling to catch up to demand**
- **The broad tone of the report was strong on details**
- **Core inflation hit a 38 year high and year-ago base effects had nothing to do with it**

US Q2 GDP, q/q % SAAR:
Actual: 6.5
Scotia: 7.7
Consensus: 8.4
Prior: 6.3 (revised from 6.4%)

While Q2 US GDP growth missed expectations at 6.5% (consensus 8.4%), the underlying details (here) were better than the headline growth number. The overall tone of the report lends evidence to the narrative that there is a rotation of the sources of growth relatively away from goods consumption (though still strong) and housing, toward services, investment and exports. That is a constructive indication of resilient growth not only on levels (chart 1) but also its shifting composition.

The USD initially dipped on the headline miss but subsequently rallied after considering the drivers. The 10 year Treasury yield performed similarly in the report's aftermath.

The growth miss was primarily attributable to drags from inventory and import leakage effects. Chart 2 shows the weighted contributions to GDP growth that break out the accounting categories. Those two drivers reflect supply chain challenges in keeping up with demand. An import surge is attempting to address inventory shortfalls and replenish supply chains for rebounding demand.

Inventories subtracted 1.13 percentage points from GDP growth in terms of the weighted contribution. Imports were higher which in a GDP accounting sense gets recorded as a leakage of domestic economic activity abroad and so the import gain subtracted 1.1ppts from overall GDP growth.

Consumption added 7.8ppts to growth in Q2, again in weighted contribution terms. 5.1 ppts came from services consumption and 2.7 ppts came from goods consumption.

Housing investment dragged 0.5 ppts off Q2 growth which is the first drag on growth in four quarters. The US achieved strong GDP growth despite housing's waning influence and as supply chains struggle to keep up.

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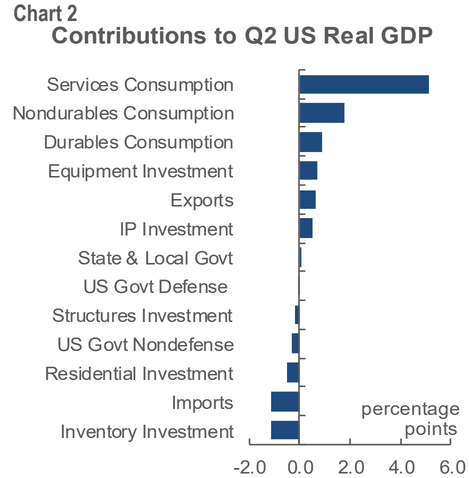
Chart 1

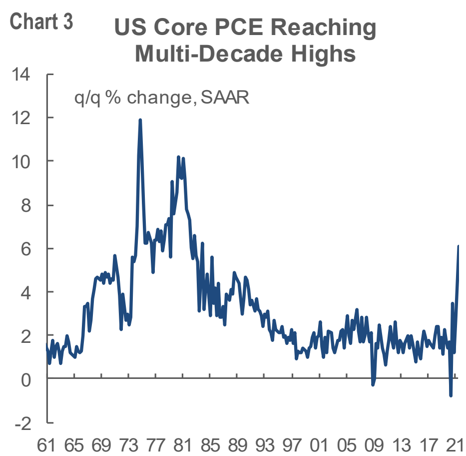
Sources: Scotiabank Economics, BEA.

Chart 2



Sources: Scotiabank Economics, BEA.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

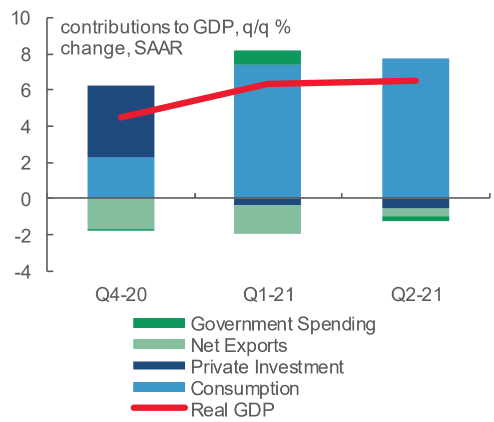
Nonresidential investment added 1.1 ppts mostly through equipment spending as structures spending was a mild drag on growth.

Gross exports added 0.6 ppts but because of the import leakage effect with higher imports the net exports contribution to growth was -0.44 ppts.

Government spending subtracted 0.3 ppts from annualized Q2 growth, all at the federal level as state/locals added a bit to growth.

Core PCE inflation was up 6.1% q/q and the prior quarter was revised up to 2.7% q/q from 2.5%. Chart 3 serves as a reminder that core PCE inflation is running at its hottest pace since 1983. Being a quarter-on-quarter gauge, this is not about base effects.

Chart 4 US GDP Contributions



Sources: Scotiabank Economics, BEA.