Scotiabank

GLOBAL ECONOMICS

SCOTIA FLASH

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Contributors

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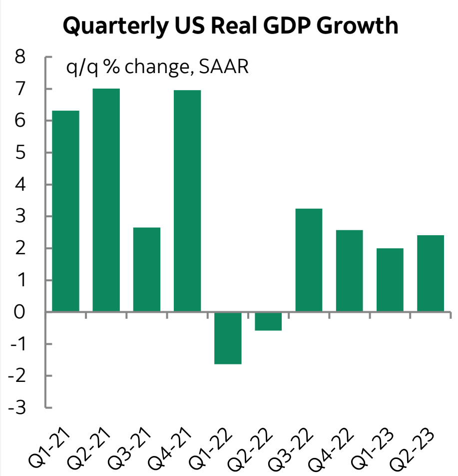
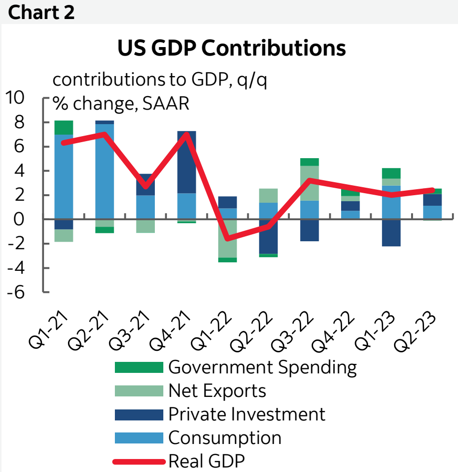
Chart 1



Sources: Scotiabank Economics, BEA.

Chart 2



Sources: Scotiabank Economics, BEA.

Data is More Decisive Than Central Bankers

- **Central banks may be mealy-mouthed of late...**
- **...but data is decisively strong...**
- **...across US GDP, jobless claims, durable goods orders...**
- **...but core PCE indicates a soft June reading tomorrow**

US Q2 GDP growth q/q SAAR:
Actual: 2.4
Scotia: 2.0
Consensus: 1.8
Prior: 2.0

It seems that data is more decisive than central banks.

A broad suite of strong readings on the US economy is driving higher short-term Treasury yields. This contrasts to the mealy-mouthed could, might, maybe, should we, maybe not brand of guidance from Fed Chair Powell yesterday and ECB President Lagarde today. In my opinion, central bank communications are displaying little to no market savviness with respect to the need to sound forceful in such fashion as to avoid feeding the equity beast. It doesn't need to be fed and yet an easing of financial conditions could inflame future challenges to monetary policy. In my opinion, the Fed and ECB should have sounded much more determined to hike in September than they did.

We'll park that issue for now and focus upon the data at hand in this note. Fears of the demise of the US economy continue to be misplaced.

US GDP BEATS ESTIMATES

GDP growth solidly beat expectations at 2.4% (1.8% consensus, 2% Scotia). This extends the streak of ongoing strength in the US economy in defiance of persistent pessimism (chart 1). Tail talk of how the US is already in recession is clearly absurdly mischievous. A point I've been repeatedly emphasizing is that it's not just the magnitude of growth that is relevant; it's the magnitude relative to forecast contractions in the US economy during Q1 and Q2 that have proven to be disastrously wrong by multiple percentage points. That means the US economy is not opening up disinflationary slack to this point in the cycle; in fact, it continues to go in the other direction.

Chart 2 shows the weighted contributions to Q2 GDP growth over time and chart 3 provides a finer breakdown. Quality was ok.

The consumer had a better pulse than expected with growth at 1.6% q/q SAAR versus a 1.2% consensus. Consumption added 1.1 percentage points to overall GDP growth in weighted terms. This was almost all due to services consumption.

Inventories were not a factor with just a 0.1% contribution to q/q SAAR GDP growth.

There was less of an import leakage effect on growth (ie: lower imports) as imports added 1.2 ppts to GDP growth.

A way of looking beyond inventory and import effects is to focus upon the final sales estimates. Final sales to domestic purchasers were up by +2.3% q/q SAAR which indicates solid growth under the hood (chart 4).

Across other components, housing has become less of a drag on growth. After averaging around 1% drags on growth for 3 quarters, housing investment is now just a 0.2% annualized drag on both Q2 and Q1 GDP growth and maybe turning positive going forward.

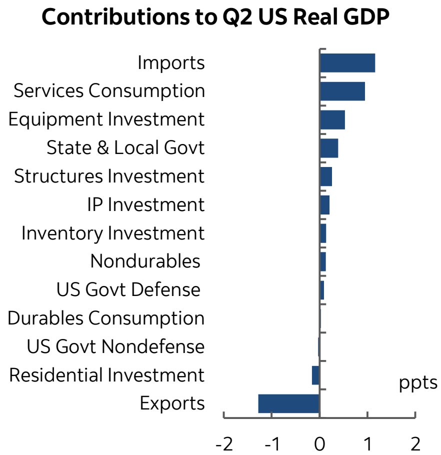
Equipment investment added ½% to GDP growth q/q SAAR, led by transport equipment.

Nonresidential structures investment added ¼% to q/q annualized GDP growth for a third consecutive gain. This plays to the point that the office market is just a part of the picture versus resilient commercial/industrial sectors.

Exports were a large drag on GDP growth that knocked about -1.3 ppts off headline growth.

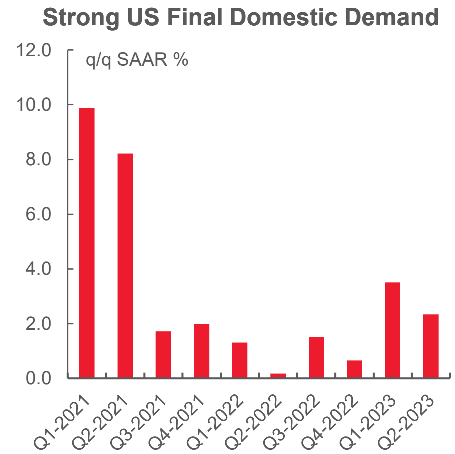
Government spending added ½% to q/q SAAR GDP growth due to state and local government spending.

Chart 3



Sources: Scotiabank Economics, BEA.

Chart 4



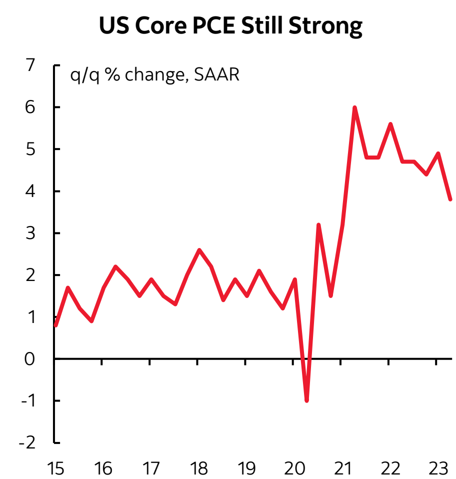
Sources: Scotiabank Economics, BLS.

Q2 CORE PCE INFLATION LEANS TOWARD A SOFT JUNE PRINT TOMORROW

The rub lies in the fact that core PCE inflation was a bit softer than consensus expectations. Core PCE inflation was up by 3.8% q/q SAAR (4% consensus). See chart 5. What we can't tell until tomorrow's figures for June is whether Q2 landed weaker than expected because June core PCE was weak or due to downward revisions to prior months. I had already gone below-consensus at 0.1% m/m for core PCE in June that is due out tomorrow versus most estimates at 0.2%+. That's because of PCE's lower weight on shelter than core CPI, but again, I'm not sure if that will be the outcome or if Q2 overall was softer than expected due to revisions to prior months.

Having said that, a 0.1% m/m increase in June would yield 3.87% q/q SAAR for Q2 core PCE which comes close to the 3.8% Q2 estimate. That could mean very little by way of revisions to prior months and mostly just a soft reading for June. Softer than core CPI.

Chart 5



Sources: Scotiabank Economics, BEA.

STRONG INVESTMENT IS DRIVING A MASSIVE ORDER BOOK

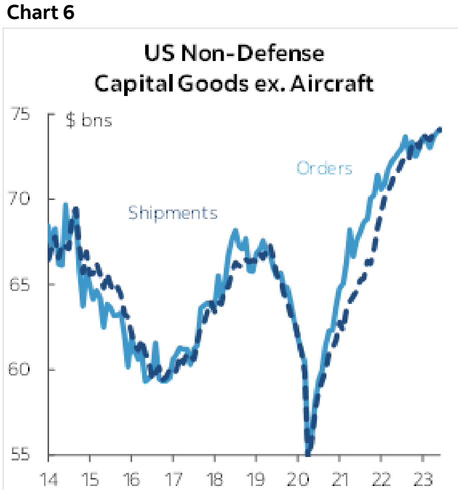
Durable goods orders crushed expectations with a 4.7% m/m gain (1.3% consensus). Core durable goods orders ex-defence and air were up 0.2% m/m which extends the streak of monthly gains and maintains a strong overall order book (chart 6).

JOBLESS CLAIMS FELL

Initial jobless claims fell to 221k last week and continuing claims also fell to 1.69 million (1.749 prior) which itself indicates a steadily declining number of people on extended jobless benefits. Chart 7 shows the declining trends in both series.

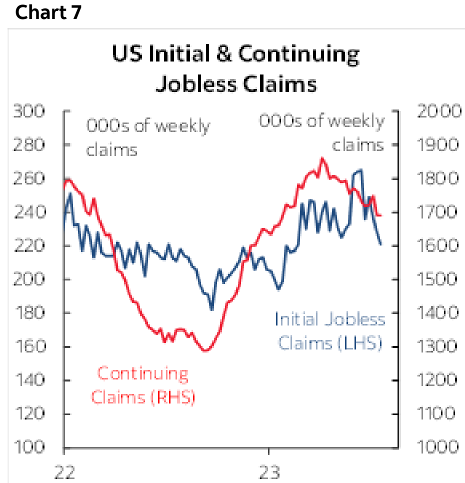
What this plays to is my longstanding rotation argument. Layoffs are running at modest levels and there is enough strength elsewhere in the job market to create ongoing momentum.

Chart 6



Sources: Scotiabank Economics, US Census Bureau.

Chart 7



Sources: Scotiabank Economics, US Dept of Labor.