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GLOBAL ECONOMICS

SCOTIA FLASH

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U.S. Economy Beats, Core PCE Misses — Which One To Emphasize?

- **US GDP growth beats again…**
- **…and other readings were simultaneously strong…**
- **…but yields rallied…**
- **…perhaps by placing more attention upon core PCE**
- **We need tomorrow's September PCE to assess pressures at the margin**
- **The FOMC might not see it the same way as markets did**

US Q3 GDP, q/q SAAR, %:
Actual: 4.9%
Scotia: 3.8
Consensus: 4.5
Prior: 2.1

A lot of information hit markets all at about the same time this morning (ECB, US indicators, etc) and this makes it difficult to draw overly strong conclusions about what markets reacted to. Nevertheless, it seems probable that US Treasury yields fell after 8:30amET US data because markets placed greater emphasis upon a small miss by core PCE inflation and ignored a beat by Q3 GDP alongside impressive details. I'm skeptical toward whether this was the correct reading from a Fed narrative standpoint.

First the data. Q3 GDP grew by 4.9% q/q SAAR and hence slightly in excess of consensus and well above the bottom end of consensus that had also included Scotiabank Economics' estimate. Growth sharply accelerated to the strongest since 2021Q4 (chart 1).

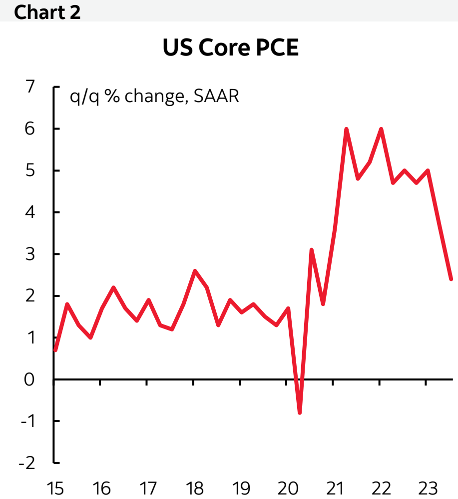
Core PCE, however, missed consensus expectations by a tick and landed at 2.4% q/q SAAR. We can't tell if that was due to revisions to prior months or a signal that tomorrow's reading for core PCE in the month of September will land weaker than expected. We need to see tomorrow's data in order to evaluate inflationary pressures at the margin using the Fed's preferred gauge. For now, chart 2 largely just tells us what we know about the soft patch in monthly core PCE readings mapped onto the Q3 tally.

Chart 3 breaks down what drove Q3 GDP growth of 4.9% by individual expenditure driver. Consumption added 2.7ppts on a weighted contribution to GDP growth basis. That was split between services that added 1.6ppts and goods that added 1.1 ppts.

Chart 1

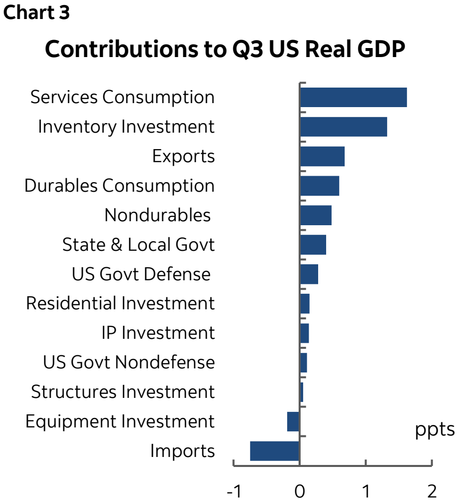
Sources: Scotiabank Economics, BEA.

Chart 2



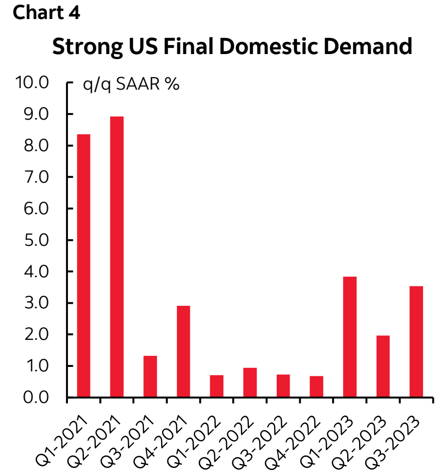
Sources: Scotiabank Economics, BEA.

Chart 3



Sources: Scotiabank Economics, BEA.

Chart 4



Sources: Scotiabank Economics, BLS.

Investment added just 0.2 ppts to GDP growth. Nonresidential investment was flat as structures investment made no contribution to growth and equipment investment knocked off 0.2 ppts from GDP growth. Residential investment added 0.2 ppts.

Inventories added 1.3 ppts, all in nonfarm inventories. Even excluding this amount, growth would have been robust and I'll come back to this in a moment.

Net trade was a small drag of -0.1 ppts as exports added 0.7 ppts and imports subtracted 0.75 ppts. In other words, imports increased in a reversal of the prior quarter's decline and that meant that in Q3 higher imports served as a bigger leakage effect on GDP growth (negative contribution) which is perhaps consistent with higher inventories. Companies are importing more and restocking perhaps in preparation for the holiday shopping season.

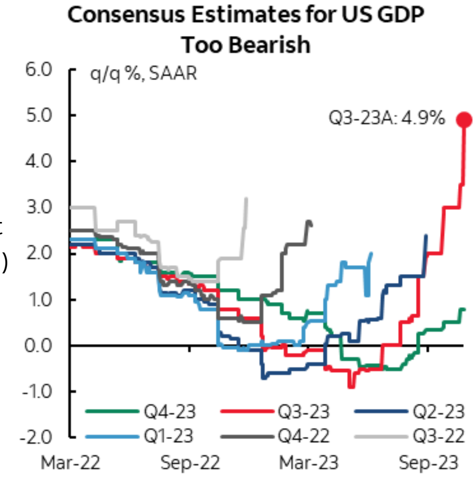
Government spending added 0.8 ppts and this was evenly split between Federal and state/local governments.

Final domestic demand few strongly in Q3 and posted a gain of 3.5% q/q SAAR (chart 4). Recall that FDD is consumption plus government spending plus investment and hence excludes inventories and net trade. This measure is clean of inventory and import effects that shouldn't necessarily be stripped out but the strength in FDD serves as a cross check on how strong the domestic economy was last quarter.

What today's numbers achieved was to extend for yet another quarter the five-quarter streak of how consensus has come into each quarter thinking this is the one when the shoe will drop, only to spend the rest of the quarter revising up growth estimates and still being beaten in the end. There is nascent evidence that this is starting to happen again in Q4 (chart 5).

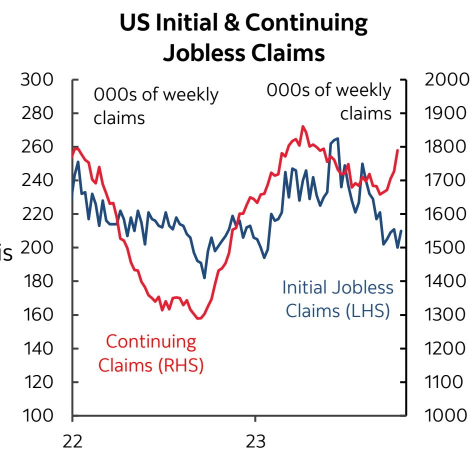
At the same time, weekly claims remained low at 210k last week (200k prior week) and US capital goods orders ripped (charts 6, 7). Core orders ex-defence and aircraft were up 0.6% m/m in September and revised up to 1.1% m/m in August (from 0.9%). Total durable goods orders were up 4.7% m/m SA (1.9% consensus). Business investment was very much alive in September.

Chart 5



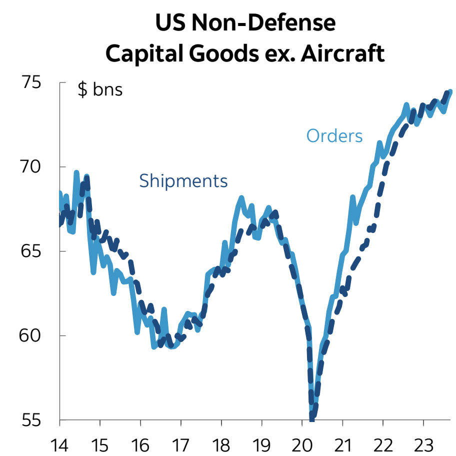
Sources: Scotiabank Economics, Bloomberg.

Chart 6



Sources: Scotiabank Economics, US Dept of Labor.

Chart 7



Sources: Scotiabank Economics, US Census Bureau.

WILL THE FED SEE IT THE SAME WAY AS MARKETS?

So did markets react the way they should have? I'm uncertain, but think that Chair Powell's argument is that persistent strength in GDP growth amplifies future inflation risk even if that output gap and augmented Phillips Curve approach to gauging future inflation has frankly been a dud to date. The US economy is showing few signs of slowing down and is therefore driving persistent capacity pressures that could be keeping inflation risk very much alive regardless of the summer/Q3 soft patch.