SCOTIA FLASH

January 25, 2024

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The US Economy Blew Away Forecasts Again

- **US GDP growth vastly exceeded everyone's forecasts...**
- **...extending the outperformance to six consecutive quarters**
- **The Fed is likely to celebrate strong growth...**
- **...with dampened confidence it can durably hit its dual mandate**
- **Rates dubiously rallied post-data perhaps because of other data**
- **The BoC is underestimating how the US economy has Canada's back...**
- **...while Canadian rates rallied post-data without understanding strike effects**

US Q4 GDP, q/q SAAR, %:
Actual: 3.3
Scotia: 2.2
Consensus: 2.0
Prior: 4.9

The US economy shamed the bears yet again. It grew by 3.3% q/q at a seasonally adjusted and annualized rate (SAAR) which was above all estimates in consensus that were between about 1½% and 2½%.

The outperformance is especially large in relation to the expectations coming into the quarter. For the sixth consecutive quarter, consensus came in expecting dire conditions and got blown away by remarkable growth (chart 1).

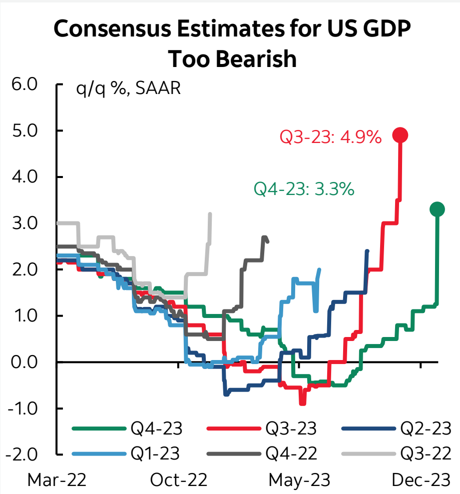
Chart 2 shows this is not a slowing economy by any means. Trend growth has remained very hot throughout the past six quarters.

SOLID DETAILS

The details were generally solid in terms of weighted contributions to growth (chart 3). Consumption added 1.9 ppts to the 3.3 GDP growth headline. That was roughly evenly split between services and goods spending.

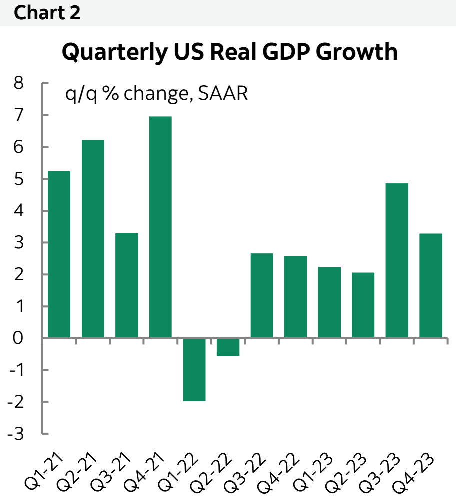
Investment added 0.4 ppts. Nonresidential investment added 0.3 ppts. Inventories only added 0.1 ppts and were not a factor. Residential investment contributed nothing. Exports add 0.7 ppts, but imports subtracted 0.25 ppts through a bigger leakage effect out of GDP in an accounting sense (higher imports). Higher imports are not necessarily a

Chart 1



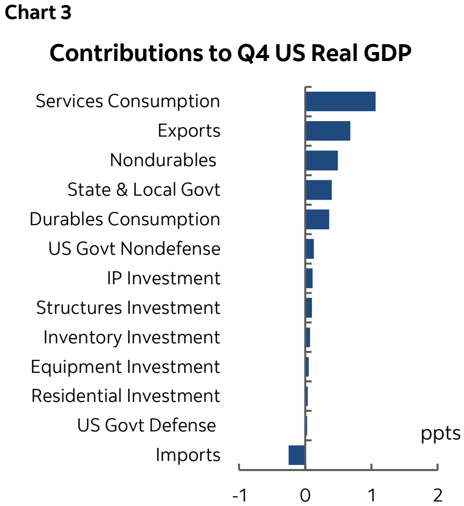
Sources: Scotiabank Economics, Bloomberg.

Chart 2



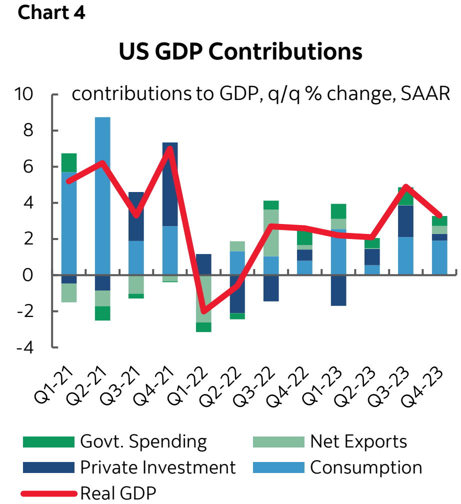
Sources: Scotiabank Economics, BEA.

Chart 3



Sources: Scotiabank Economics, BEA.

Chart 4



Sources: Scotiabank Economics, BEA.

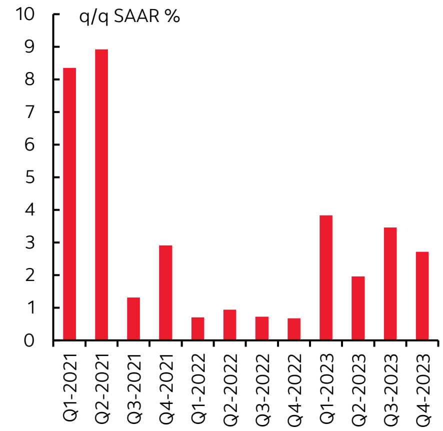
bad thing but they leak out of GDP. Government spending added another 0.56 ppts led by state and local governments.

Chart 4 shows that the evolution of the contributions to growth has been generally robust over time.

Chart 5 shows that final domestic demand also continues to grow at a hefty pace. This is arguably the better measure of underlying momentum in the domestic economy that excludes inventory and net trade swings. It's a purer consumption plus investment plus government spending measure. FDD grew solidly in every quarter of 2023.

Chart 5

Strong US Final Domestic Demand



Sources: Scotiabank Economics, BLS.

MARKET REACTION

US Treasuries rallied and markets added a few basis points to rate cut pricing through nearer term contracts. Why? And does it make sense?

One narrative is that it adds to evidence of a soft landing as recent inflation has been softer and growth is strong and the Fed will celebrate. I think that's misplaced.

I don't think that's how the Fed will view it next week. I wouldn't be surprised if former St. Louis Fed President Bullard choked on his cheerios when he saw this morning's GDP numbers after saying the other day he thought a cut in March was feasible.

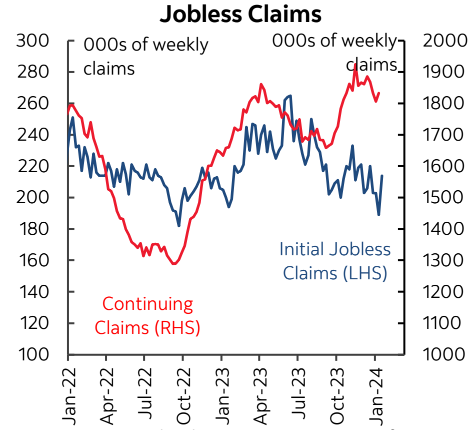
Inflation has many complicated drivers especially in the pandemic era, but one of the ones central banks speak to is the output gap framework. The US economy is growing by almost double the Fed's estimates of potential GDP. There is no evidence of slack emerging. In fact, the US economy is pushing further into excess aggregate demand.

This harkens back to Chair Powell's earlier press conference in which he said that while they have their dual mandate, if GDP keeps surprising it would frustrate hopes to durably bring down inflation. In next week's press conference, Powell will likely flag inflation progress, but sound careful and circumspect toward whether this progress is durable as growth continues to be strong while warning signs emerge on wage gains and shipping costs due to geopolitical turmoil.

I think the market reaction was more about other data recapped below.

Chart 6

US Initial & Continuing Jobless Claims



Sources: Scotiabank Economics, US Dept of Labor.

OTHER DATA

Markets might have also put more stock in other data even if I disagree with doing so.

Core PCE landed on the screws at 2% q/q SAAR ahead of tomorrow's December data and so there was no surprise there.

The GDP price deflator softened to 1.5% q/q SAAR. That's the economy-wide measure of overall prices, but it's not the PCE measure the Fed follows.

Jobless claims increased (chart 6). Initial filings moved up to 214k from the 189k drop the week before with no states estimated which validates data reliability. That's still low, but it indicates the prior drop was temporary. Continuing claims also increased to 1.833 million from 1.806 million.

Durable goods orders disappointed at 0% m/m in December (consensus 1.5%), but core capital goods orders that exclude defence and aircraft which serves as a better gauge of underlying investment were up 0.3% m/m (0.1% consensus).

The Chicago Fed's national activity index fell to –0.15 in December and has been weakening since August.

US new home sales beat expectations. They were up 8% m/m in December (10% consensus) but the level was higher than expected because the prior month was revised up to post a smaller drop of 9% instead of the –12.2% original estimate.

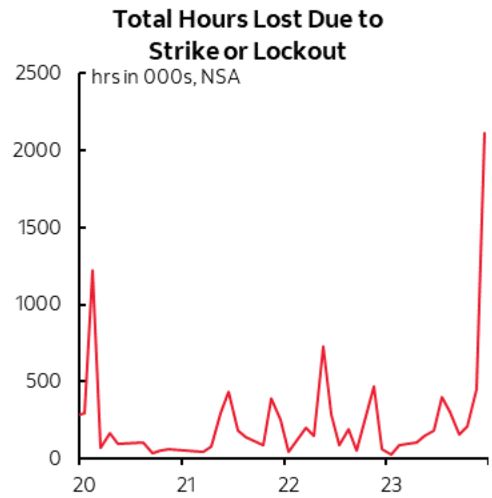
CANADIAN IMPLICATIONS

I think Governor Macklem blew it when asked during yesterday's press conference about whether US economic strength matters to Canada. His answer was that Canadian GDP is what matters and Canadian consumers.

Both would be correct. As long as the US economy keeps vastly outpacing everyone's expectations including the BoC's, it will support Canada's economy through trade linkages and by extension it will support Canadian jobs, investment and spending. If the Fed pushes back against nearer term rate cuts because of this strength, then there are limits to the ability of the BoC to ignore that especially given my ongoing narrative that Canada faces greater inflation risk going forward than the United States.

Now if markets this morning are driving the rally at the Canadian front-end because SEPH payrolls posted a drop of 88k in November then I give up hope for markets to apply any effort toward understanding data. SEPH fell because of 66k striking education workers in Quebec and other striking public sector workers in that province. SEPH treats striking workers as lost jobs off payroll if they are on strike for the entire reference week as they were. But they are not lost jobs and the Labour Force Survey does not treat striking workers the same way. In other words, SEPH was data noise.

Chart 7



Sources: Scotiabank Economics, Statistics Canada.

What's not data noise, however, is that Canada is losing more hours due to striking workers than it was losing to pandemic lockdowns (chart 7). That's just stunning. Striking workers are denting GDP growth on tap of the other serial shocks to growth since last Spring that go well beyond the effects of tighter monetary policy that Governor Macklem overemphasizes.