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GLOBAL ECONOMICS

SCOTIA FLASH

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US Markets Shake Off Strong Data

- **Warm inflation and a hotter than previously understood Q3 economy…**
- **…were accompanied by ongoing investment strengths…**
- **…a 3½ year low for continuing claims that supports low unemployment…**
- **…but Q4 consumption is tentatively tracking softly…**
- **…as one-offs drove income gains**
- **Markets ignored it because a Fed hike was priced and equity worries dominate**
- **Our 4.5% and 3.25% Fed and BoC terminal rates may be too light**

Markets largely shook off a round of US data releases that on balance came in strong. One reason for this is that the Federal Reserve was already fully priced for a December 9th hike. Another is that the bond rally is being driven by concern over market risk appetite as tech and broader stocks continue to fall. I'll keep the round-up brief because of this.

CORE INFLATION REMAINS TOO HOT FOR THE FOMC

The Fed's preferred measure of inflation—the PCE deflator—was up by 0.32% m/m SA and so was core PCE ex-food and energy (0.29%) as both measures round to 0.3%. Both were on consensus and matched Scotia's estimates. That makes it three in a row for core PCE readings of 0.3% for a three-month moving average at 3.6% m/m SAAR (chart 1).

Also key to the Fed is ongoing strength in core services inflation (chart 2).

Warm inflation readings like this will keep the Committee in hike mode and could drive them to anticipate more hikes in the 2027 dot plot than were shown in the September dot plot that had hikes ending this year.

GDP—NO SLOWING DOWN YET!

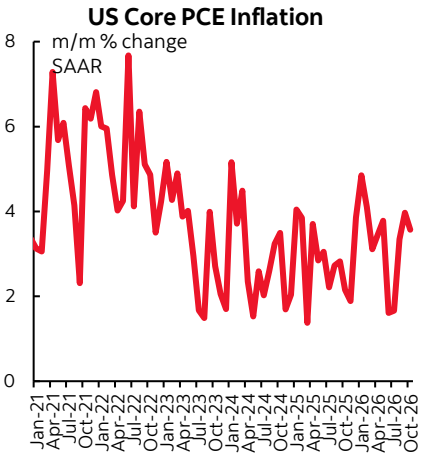
Wow. That sums up the US economy. Q3 GDP was revised up to 4.3% q/q SAAR from 3.4% in the first estimate. The main revision drivers were consumption and investment (chart 3). Consumption grew by 4.2% q/q SAAR from 3.8% originally. Investment was revised up but primarily through intellectual property, not equipment and structures.

Final domestic demand adds government spending, consumption and investment and is a better gauge of underlying momentum in the domestic economy. It excludes inventories and net trade. This measure grew by 5.8% q/q SAAR which is the fastest since 2021Q2 when volatile pandemic data was surging (chart 4).

CONSUMER SPENDING AND INCOMES—STRONG Q3 BROUGHT FORWARD?

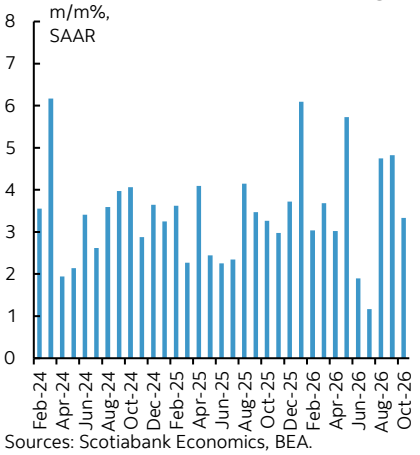
Spending was flat in inflation-adjusted terms during October (-0.03% m/m SA) after only a 0.1% m/m SA gain in September (chart 5). As a consequence, only 1% q/q SAAR consumption growth is baked into Q4 based on the way Q3 ended and October data and with a lot of further data still ahead. We'll need to monitor holiday sales

Chart 1



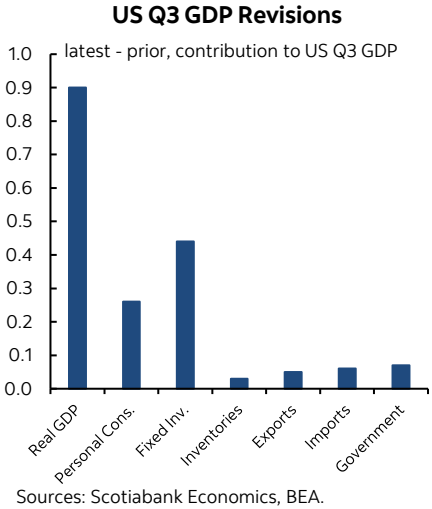
Sources: Scotiabank Economics, BLS.

Chart 2



Sources: Scotiabank Economics, BEA.

Chart 3



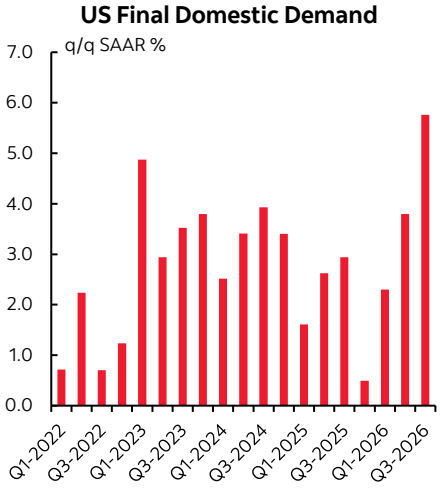
Sources: Scotiabank Economics, BEA.

this week into next week to get a better feel for whether consumption growth was merely brought forward and perhaps in anticipation of higher holiday-season prices and tariff effects.

Real disposable incomes were up by 0.5% m/m for the strongest gain since January (chart 6).

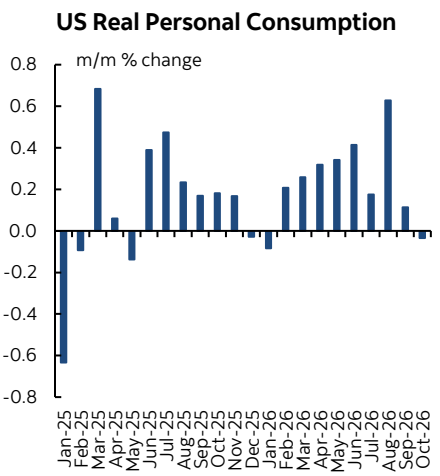
Nominal personal income was up by 0.7% m/m SA. That wasn't because of compensation that grew by 0.4% m/m SA. Dividend income grew strongly (1.8% m/m SA) as did transfers from government (1.1% m/m SA) partly because of some one-off effects like a one-time Medicare premium rebate of $90 to about 21 million Americans and because of a calendar effect as November 1st was on a Sunday this year which meant some payments were brought forward to October. Fade the income gain. Overall, compensation of employees contributed 0.3 of the 0.7% m/m SA income gain, personal income receipts on assets including dividends contributed 0.2, and higher transfers from governments contributed 0.2.

Chart 4



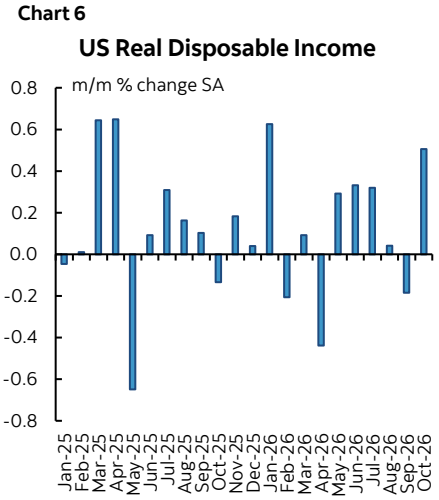
Sources: Scotiabank Economics, BLS.

Chart 5



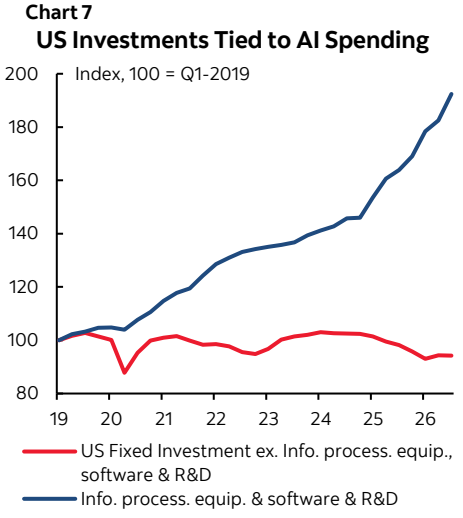
Sources: Scotiabank Economics, US BEA.

Chart 6



Sources: Scotiabank Economics, US BEA.

Chart 7



Sources: Scotiabank Economics, BEA.

CORE DURABLE GOODS ORDERS REMAIN HOT

Core durable goods orders (ex-defence and air) were up by 1.2% m/m SA and revised up to 0.8% m/m in September from 0.6%. Core orders remain very strong and not least of which driven by trend spending on tech (chart 7).

Total durable goods orders, disappointed at +0.2% m/m SA (0.7% consensus) after a large 2% prior gain.

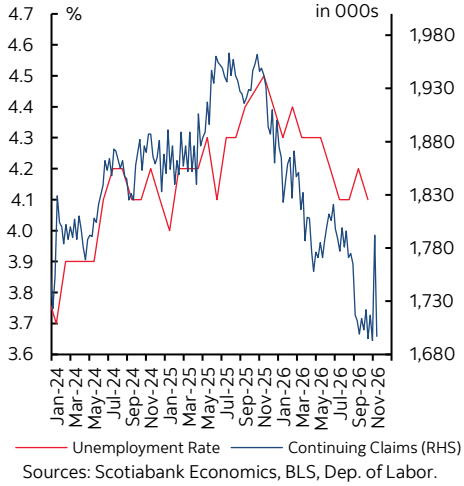
CONTINUING JOBLESS CLAIMS FALL BACK TO 3½ YEAR LOW

Initial claims fell back to 189k from 202k. Continuing claims fell to just under 1.7 million from 1.792 which if it persists would be correlated with a lower unemployment rate (chart 8).

CONCLUSION—THE FED AND THE BOC

This kind of overall strength makes our call for two more hikes from the FOMC look a little light. We had one more than the FOMC's September dot plot and I'd lean toward a little more at this point. The December dot plot is likely to see the Committee add more hikes in 2027 whereas the median forecast had previously signalled no further hikes after this year. What happens in the US, doesn't stay in the US given the strong, inextricable linkages between the US and Canadian economies and between US and Canadian inflation rates that are highly correlated. For as long as the US has an inflation problem, Canada will too as supply chains import price pressures along with a weak C$ and other domestic inflation drivers. I don't find our 3.25% BoC terminal rate to be too high; I'm more worried it's too low.

Chart 8



Sources: Scotiabank Economics, BLS, Dep. of Labor.

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