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GLOBAL ECONOMICS

SCOTIA FLASH

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Contributors

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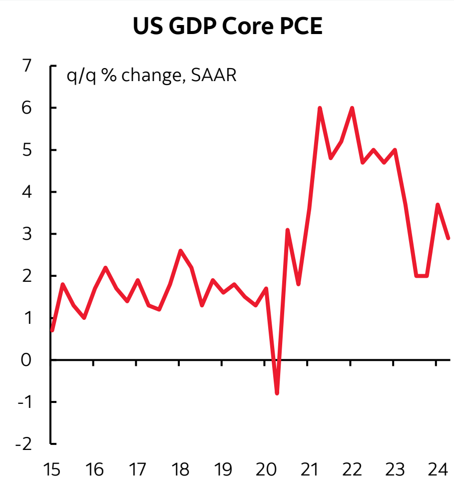
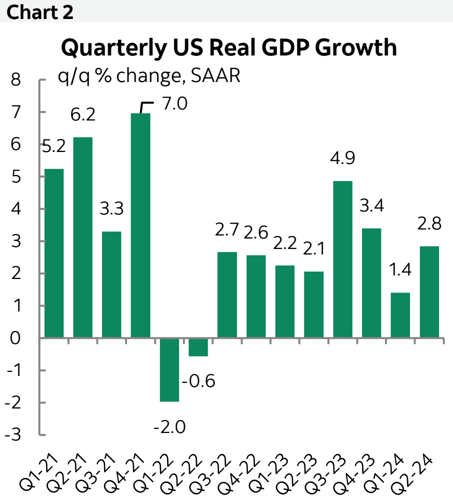
Chart 1



Sources: Scotiabank Economics, BEA.

Chart 2



Sources: Scotiabank Economics, BEA.

Higher US GDP & Core PCE Change Nothing for the Fed

- **US Q2 GDP grew faster than expected…**
- **…but details were mixed…**
- **The US economy is still slowing as potential growth picks up**
- **Q2 Core PCE surprised higher…**
- **…but probably due to early Q2 monthly revisions that may not alter the soft patch**
- **Other US data was generally constructive**

US Q2 GDP / core PCE, q/q SAAR %, SA:
Actual: 2.8 /2.9
Scotia: 2.0/ 2.7
Consensus: 2.0 / 2.7
Prior:1.4 / 3.7 unchanged

Stronger than expected US GDP growth is welcome, but not narrative busting for the Fed's path to easing. Nor is an upside surprise on Q2 core PCE. I'll explain why along with the details.

Core PCE Surprises Higher

Q2 core PCE inflation was hotter than expected at 2.9% q/q SAAR (2.7% consensus and Scotia). This must be due to monthly revisions, but we'll find out for sure tomorrow. If there were no revisions to available data up to May, then June core PCE would have to be up by about 0.35% m/m SA which seems implausible given what we know about core CPI that was only 0.06% m/m SA higher. Q1 core PCE was not revised at 3.7% and so it must be that we'll find out that April and/or May were both firmer than the 0.26% m/m and 0.08% m/m reported readings respectively.

Depending upon the revisions and the exact June print, the soft patch for US core PCE inflation on a monthly basis may very well lie intact. Also, core PCE is well off the peak rates of increase (chart 1). Further, as excess demand conditions in the economy and labour market ebb, there is likely to be less core inflation pressure on a go-forward trend basis. That turns the focus to GDP as an input to assessing the evolution of excess demand conditions in the US economy.

US Q2 GDP Beats

US Q2 GDP was stronger than expected at 2.8% q/q SAAR (consensus and Scotia 2.0%). That's welcome from a growth standpoint (chart 2).

Final domestic demand also grew at a decent clip (chart 3).

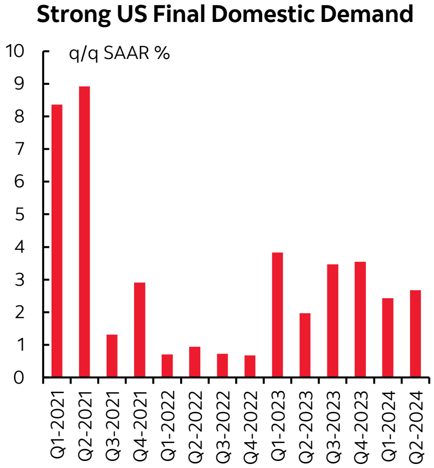
Weighted contributions to growth are shown in chart 4. The details were not all rosy. Consumption added 1.6 percentage points to growth mostly due to services (1%) as goods spending added 0.55 ppts to GDP growth.

Inventories added 0.8 ppts to growth for the biggest addition since 2023Q3.

Government spending added 0.5 ppts split equally between federal versus state and local governments.

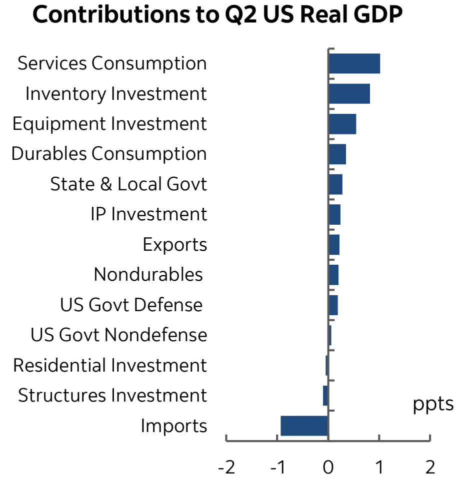
Net trade was a 0.7 ppts drag on GDP growth as exports only added 0.2 ppts and imports dragged 0.9 ppts off of GDP growth through more of an import leakage effect (higher imports, more of a pull effect from domestic demand partly dollar driven).

Chart 3



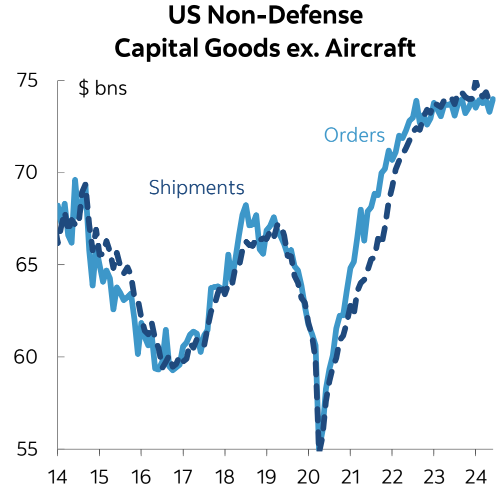
Sources: Scotiabank Economics, BLS.

Chart 4



Sources: Scotiabank Economics, BEA.

Chart 5



Sources: Scotiabank Economics, US Census Bureau.

Investment added 1.5 ppts to growth entirely on the business side as residential investment was flat. Business investment came through a 0.55 ppt contribution to GDP growth due to higher equipment spending as spending on structures was a small drag that knocked 0.1 ppt off of GDP growth.

Other Data Was Constructive

Durable goods orders fell –6.6% m/m SA but entirely due to transportation. Ex-transportation orders were up 0.5% m/m. Core capital goods orders excluding aircraft and defence—a proxy for underlying equipment investment—were up 1% m/m in June from a downwardly revised –0.9% dip in May (previously –0.6%). That leaves the trend in core capital goods orders still looking toppish at high levels (chart 5).

Weekly initial jobless claims pulled back a bit from the prior week's jump. They were at 235k last week, down from 245k the prior week which was upu from 223k for the week including July 4th. The pattern marginally supports the notion that claims ebbed during the holiday week, then pent-up filings increased, and now we're pulling back. The data is seasonally adjusted, but doesn't necessarily compensate for the shifting timing of the July 4th holiday and its proximity to weekends from year to year.

All of Which May Change Nothing for the Fed

I don't think the GDP figures change anything for the Fed. It's still a marked slowdown from 4.9% in Q3 last year and 3.4% in Q4 to go to 1.4% in Q1 and 2.8% in Q2. Further, Chair Powell will repeat that the supply side has picked up with population growth of about 3.5 million in each of the past two years including undocumented workers and trend productivity.

At 1.6% q/q SAAR on average in H1, the US economy is probably growing below potential this year which is how Powell is likely to play it.

We're therefore left no further ahead or behind on the path to the September meeting in my opinion. We need to see further reports on inflation and jobs in particular in order to more fully evaluate risks to the Fed's dual mandate and hence the potential to deliver upon our September rate cut call.