

US Core PCE Holds Firm As Consumers Spend ... For Now!

United States, Personal Income / Consumption, % m/m, August:

Actual: 0.3 / 0.3

Consensus: 0.4 / 0.3

Scotia: 0.3 / 0.3

Prior: Unrevised from 0.3 / 0.4

United States, PCE / core PCE deflators, y/y % change, August:

Actual: 2.2 / 2.0

Consensus: 2.2 / 2.0

Scotia: 2.2 / 2.0

Prior: Unrevised from 2.3 / 2.0

- The US consumer continues to perform well during the third quarter and that's helping to keep the Fed's preferred inflation measure elevated. Indeed, core PCE inflation did not follow core CPI lower, at least when rounded up (see chart). The far more important issue here lies in terms of whether the spending burst in Q2 and Q3 is sustainable. Arguments are provided below that lean toward looking through all of this to the hangover that may lie ahead into the key holiday shopping season.
- Core PCE inflation was 1.9586% y/y in August. I quote to the fourth decimal place to point to the role of rounding upward to yield the unchanged 2% print when in fact there was very marginally cooler pressure from 2.0245% core PCE inflation the prior month.
- After rising by a revised 3.8% q/q in Q2, US real consumption growth is tracking another gain of 3.2% in Q3 assuming September comes in flat. A tiny Sept gain would get the quarter up to about 3 1/2% SAAR consumption growth.
- **Growth in real consumption is outpacing incomes.** Real personal disposable income growth was only 2.5% q/q at a seasonally adjusted and annualized rate in each of Q2 and with Q3 tracking.
- **So where is the money coming from?** Getting this right may serve as a warning sign on the durability of the spurt in US consumer spending. The saving rate jumped by about a full percentage point to 7.2% in Q1 from Q4 and is pushing lower through Q2 into Q3. It stood at 6.6% in August. Why did the saving rate soar in Q1 and then begin to unwind? One reason is that a harsher and colder than seasonally usual winter depressed consumption somewhat in Q1 and this spending got deferred into Q2. The other reason is that consumers got an unanticipated positive income shock at the start of the year and they initially responded by squirrelling it away. Nuts from heaven. Real personal disposable income growth soared to 4.5% in Q1 over Q4 at a seasonally adjusted pace and then corrected to about two full points lower than that in each of Q2 and Q3. The hoarded income boost in Q1 was then spent in classic lagged fashion into Q2 and Q3. This spending gain is an overshoot on trend income growth. It is only occurring because of the transitory boost to incomes at the start of the year as companies disbursed some of the benefits of the tax changes in the TCJA and consumers got a

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics

416.863.7707

Scotiabank Economics

derek.holt@scotiabank.com

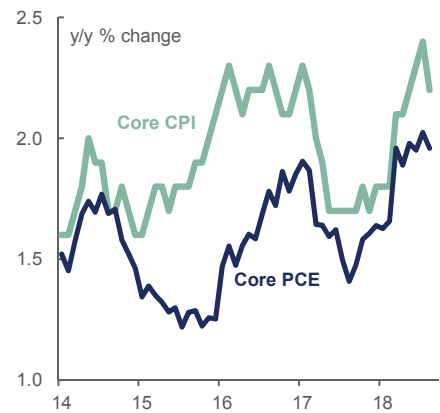
Sam Fraser, Research Analyst

416.866.4212

Scotiabank Economics

sam.fraser@scotiabank.com

Fed's Preferred Core Inflation Will Likely Follow Core CPI Higher



Sources: Scotiabank Economics, Bloomberg.

modest tax cut that was mostly skewed toward upper income earners. This won't make America great again or drive sustained strong growth. It is classic fiscal pump priming ahead of the midterm elections on November 6th and it will likely take until after that point for reality to set in. Consumption growth may well revert to being considerably softer into year-end and beyond as demand was brought forward.

This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia’s regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.