Datanote: US Personal Incomes & Spending, May

In one line: The economy's main engine of growth is looking a lot weaker.

- Real consumption rose by 0.3% in May, in line with the consensus. Net revisions were -0.2%.
- Personal incomes increased by 0.5%, a bit above the consensus, 0.4%. Net revisions were negligible.
- The core PCE deflator rose 0.1%, in

line with consensus. The net revision was 0.03%.

The 0.6% increase in goods consumption was slightly stronger than we had expected based on the May retail sales report, with a solid increase in core goods spending boosted by a 1.3% jump in real spending on gasoline, which offset a small dip in spending on autos. Services spending, however, looks much weaker than a couple months ago, growing by just 0.1% for the second month in a row. And that tepid headline services number was also boosted by a near-4% jump in spending on air transportation, flagged by TSA data on passenger numbers. That said, the May leap in the air transportation category was roughly offset by a drop in spending on utilities. Growth in services consumption slipped to 2.5% in the three months to May compared to the previous three months, slowing from nearly 4% on this basis at the start of the year, and a further dip below 2% in June is a decent bet. Sluggish growth in spending on food services suggests to us that consumers are cutting back on discretionary spending.

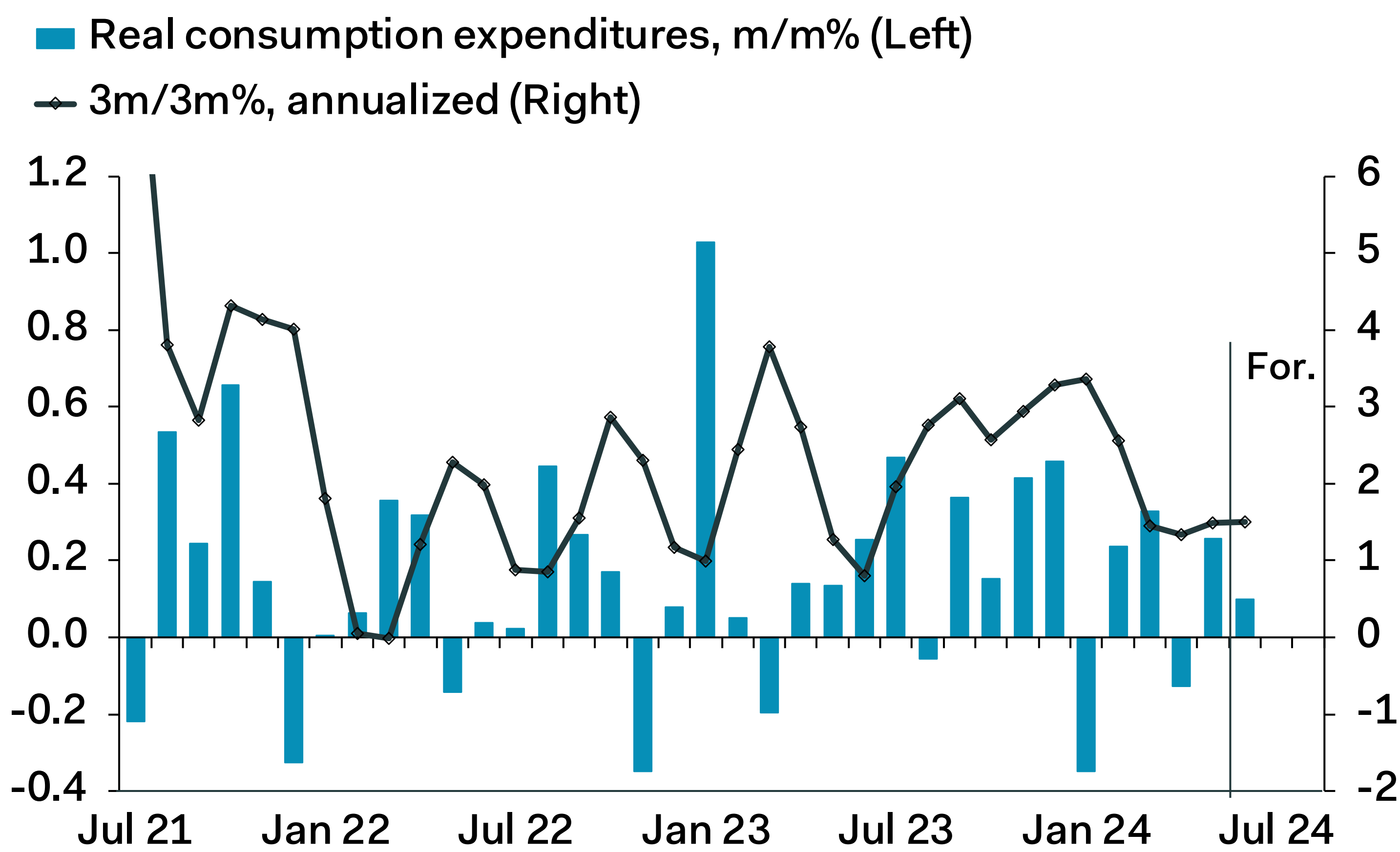
The substantial downward revision to consumption in Q1, to 1.55 from 2.0%, was revealed in yesterday's GDP revisions. But the combination of the revised monthly data released today, and the new information for May, suggest that Q2 spending is likely to rise at a similarly modest pace, assuming a 0.1% real increase in June. This is a far cry from the 3.2% average pace in the second half of last year.

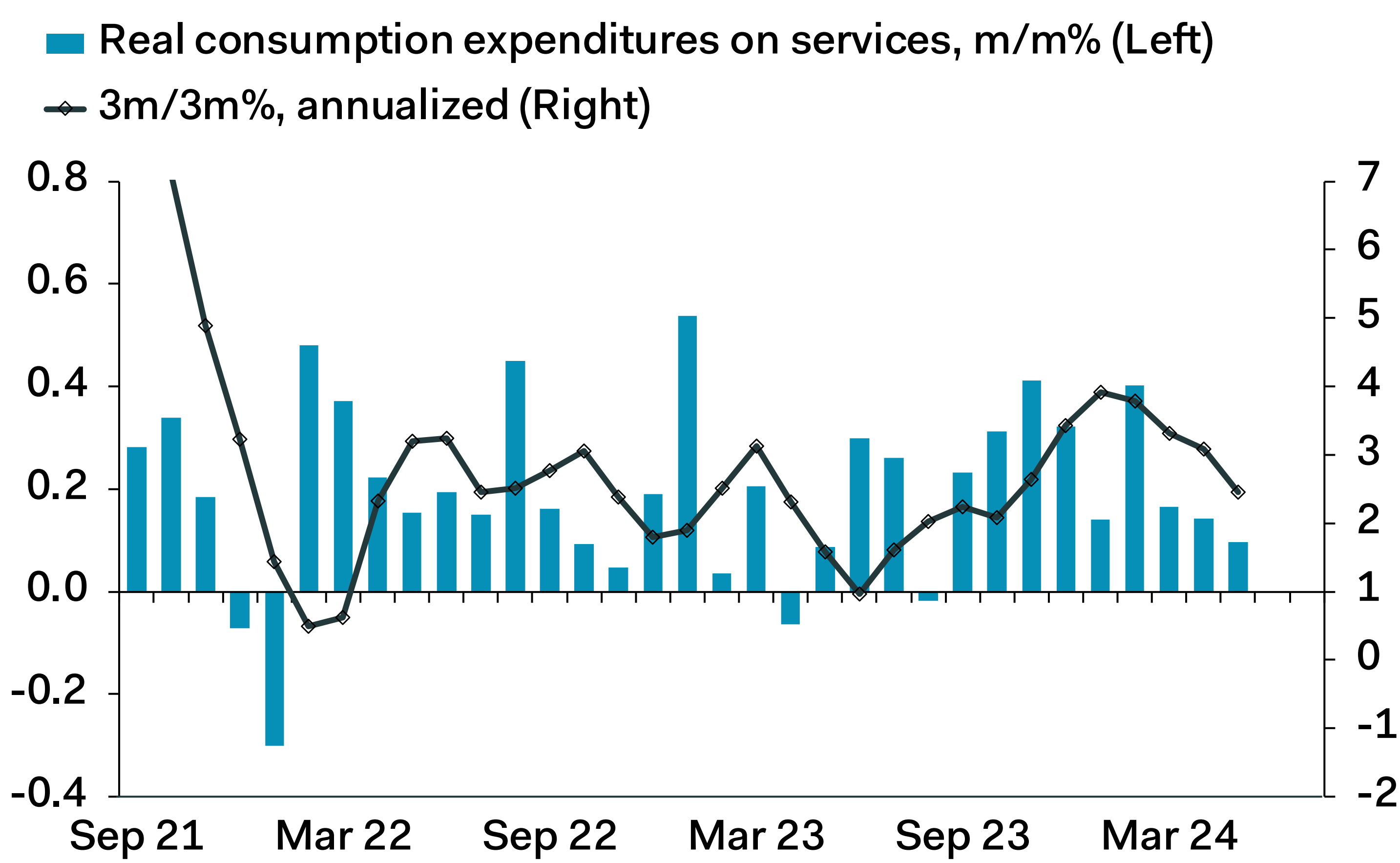
The 0.5% increase in personal incomes was driven mostly by the salaries and wages component and was a bit quicker than the recent trend. Even so, we doubt that this marks the start of a renewed period of stronger income growth, given the raft of indicators pointing to a looser labor market and lower wage growth. The 0.5% rise in real after-tax personal incomes in May was the biggest monthly increase since January 2023, but also seems unlikely to be repeated, and only leaves the three-month-on-three-month annualized growth rate only just above 1%. With pandemic-era excess savings now significantly depleted, interest rates still very high, and real income growth subdued, consumption growth faces some significant headwinds.

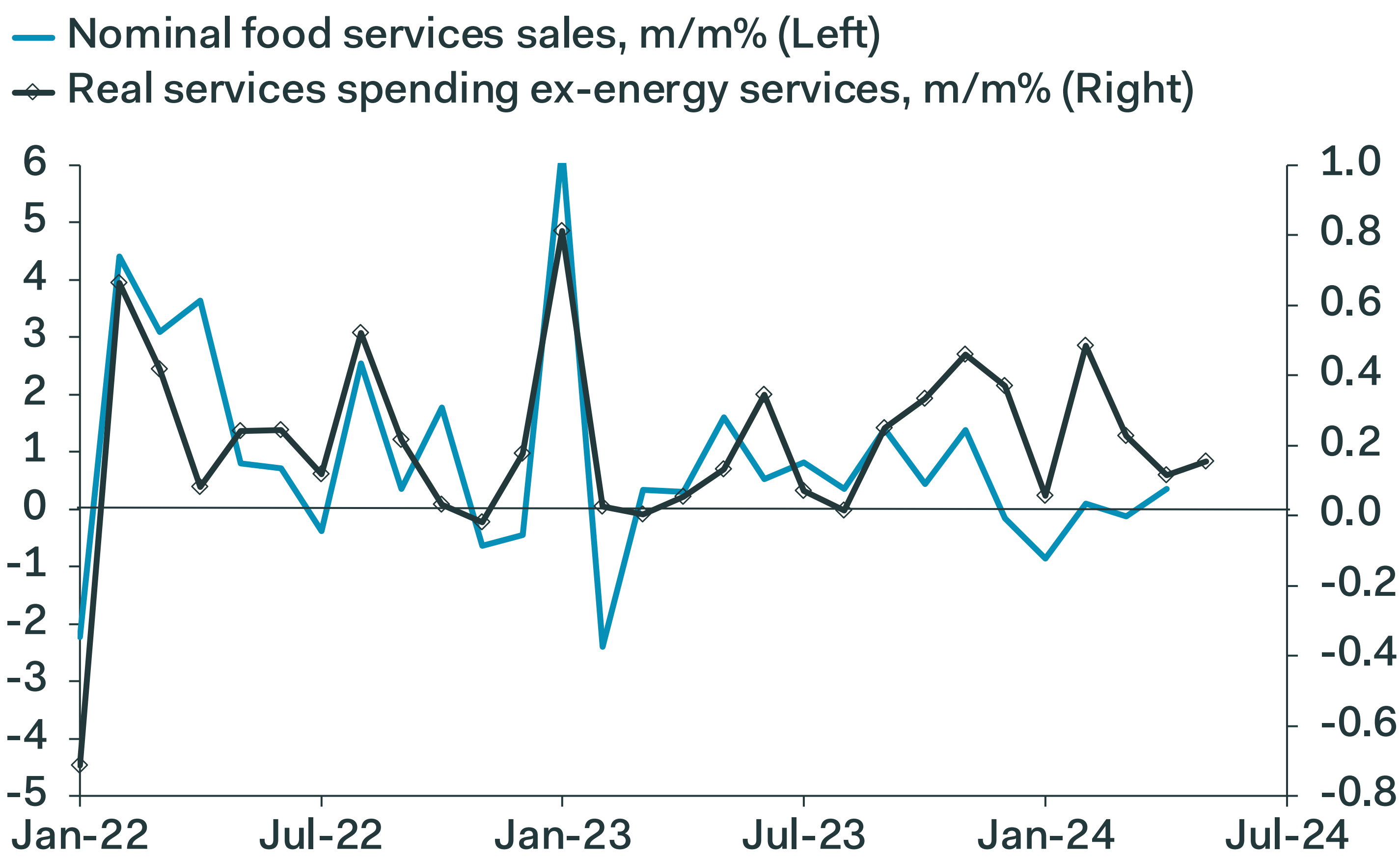
The 0.08% increase in the core PCE deflator in May was close to our 0.11% forecast and below the 0.13% consensus. The modest increase—the smallest since November 2020—partly was due to a hefty 0.04pp drag from the PCE portfolio management component, which lags changes in the stock market and so will be fleeting. The rebound in stock prices means that portfolio management costs likely will boost the month-to-month change in the core PCE deflator by about 0.05pp in June. In addition, rising passenger numbers are consistent with the PCE airline fares component recovering in June, after falls in April and May depressed the core PCE by 0.03pp and 0.02pp respectively.

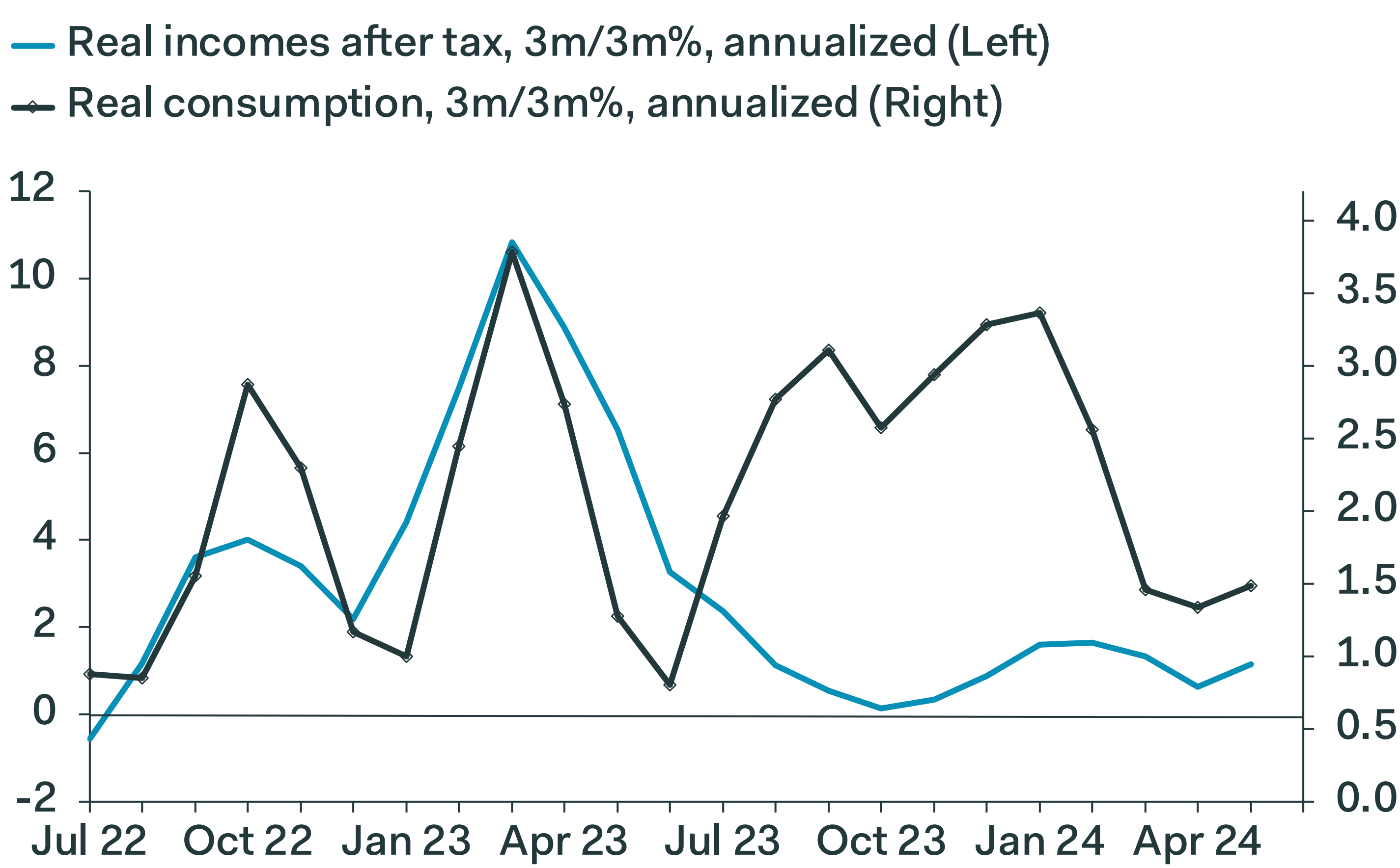
Nonetheless, the rate of increase in prices across a broad range of other components slowed in May. Core PCE services ec-housing, the key measure for the Fed, rose only 0.17%, well below the alarming 0.45% average in Q1 and slightly below April's 0.31%. Stripping out financial services and transport services too, core-core services rose 0.29%, below the 0.40% average in Q1 and slightly below April's 0.31% increase, demonstrating that the slowdown was deep-rooted. Meanwhile, the core goods PCE fell by 0.2%, ensuring that three-month-on-three-month annualized growth was unchanged at 1.1%.

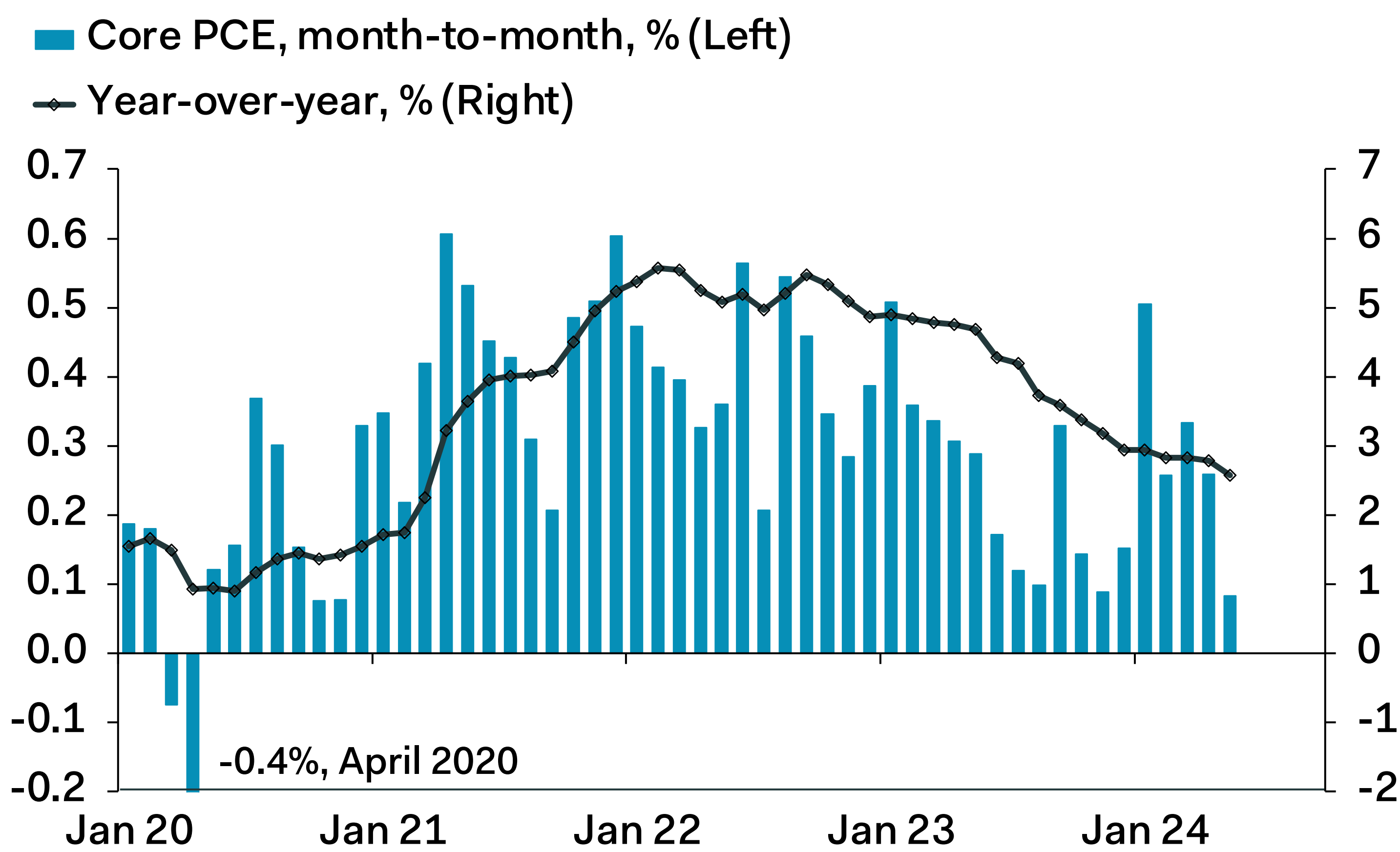
Looking ahead, we see little chance of a lasting and broad-based re-acceleration in the core PCE deflator after the slowing in April and May. Accumulating labor market slack is increasingly weighing on wage growth, commodity prices are broadly flat, supply chains remain fluid, margins are under increasing pressure, and newly-agreed rents are rising slowly. So after a pick-up in June—we're pencilling-in a 0.25% print for now—we look for a multi-month run of increases in the core PCE deflator within a 0.15-to-0.20% range. If we're right, the Fed should be confident enough by its meeting in September that core PCE inflation is heading sustainably back to 2% that it can start to ease.

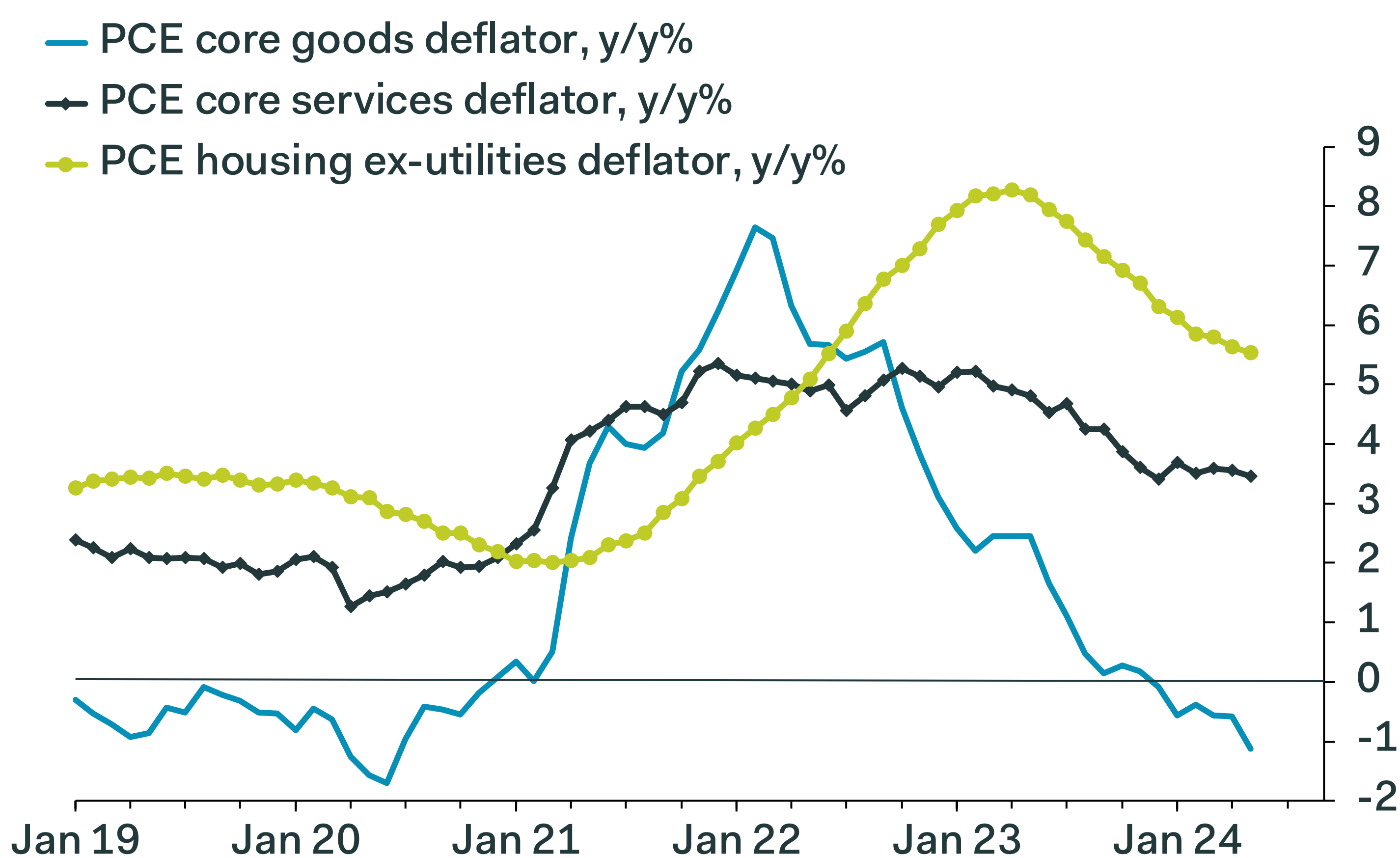

Real consumption expenditures, m/m% (Left)
3m/3m%, annualized (Right)
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
6
5
4
3
2
1
0
-1
-2
For.
Jul 21
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24


Real consumption expenditures on services, m/m% (Left)
3m/3m%, annualized (Right)
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
7
6
5
4
3
2
1
0
-1
-2
Sep 21
Mar 22
Sep 22
Mar 23
Sep 23
Mar 24


Nominal food services sales, m/m% (Left)
Real services spending ex-energy services, m/m% (Right)
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8
Jan-22
Jul-22
Jan-23
Jul-23
Jan-24
Jul-24


Real incomes after tax, 3m/3m%, annualized (Left)
Real consumption, 3m/3m%, annualized (Right)
12
10
8
6
4
2
0
-2
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Jul 22
Oct 22
Jan 23
Apr 23
Jul 23
Oct 23
Jan 24
Apr 24


Core PCE, month-to-month, % (Left)
Year-over-year, % (Right)
-0.4%, April 2020
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
-0.1
-0.2
7
6
5
4
3
2
1
0
-1
-2
Jan 20
Jan 21
Jan 22
Jan 23
Jan 24


PCE core goods deflator, y/y%
PCE core services deflator, y/y%
PCE housing ex-utilities deflator, y/y%
9
8
7
6
5
4
3
2
1
0
-1
-2
Jan 19
Jan 20
Jan 21
Jan 22
Jan 23
Jan 24