Datanote: US Personal Incomes & Spending, June

In one line: Core inflation on track to hit the target in mid-2025

- The core PCE deflator rose 0.2%, in line with the consensus forecast.
- Real consumption rose by 0.2%, slightly weaker than the consensus, 0.3%. Net revisions were +0.2%.
- Personal incomes also rose by 0.2%, below the consensus, 0.4%. Net revisions were -0.1%.

These data are exactly consistent with the national accounts published yesterday, showing a 2.9% annualized increase in the core PCE deflator in Q2. To reach that, the April and May month-to-month readings have been revised up by 0.002% and 0.044% respectively.

June's three-decimal increase is 0.182%, slightly bigger than our forecast, 0.149%, hence the rounding to 0.2%. Behind the headline, prices for core services ex-housing rose 0.195%, trivially faster than in May but just under half the average

0.419% increase across the first half of the year. Prices rose at a 3.4% rate in Q2, much less than the disconcerting 5.2% jump in Q2. If the May/June average pace persists, Q3 will see a mere 2.3% increase in core services prices ex-housing, the smallest gain since Q4 2019, excluding the initial Covid hit. Elsewhere, core goods prices rose 0.1% in June, but this reversed only half the May drop and the trend in the y/y rate is heading towards -1%.

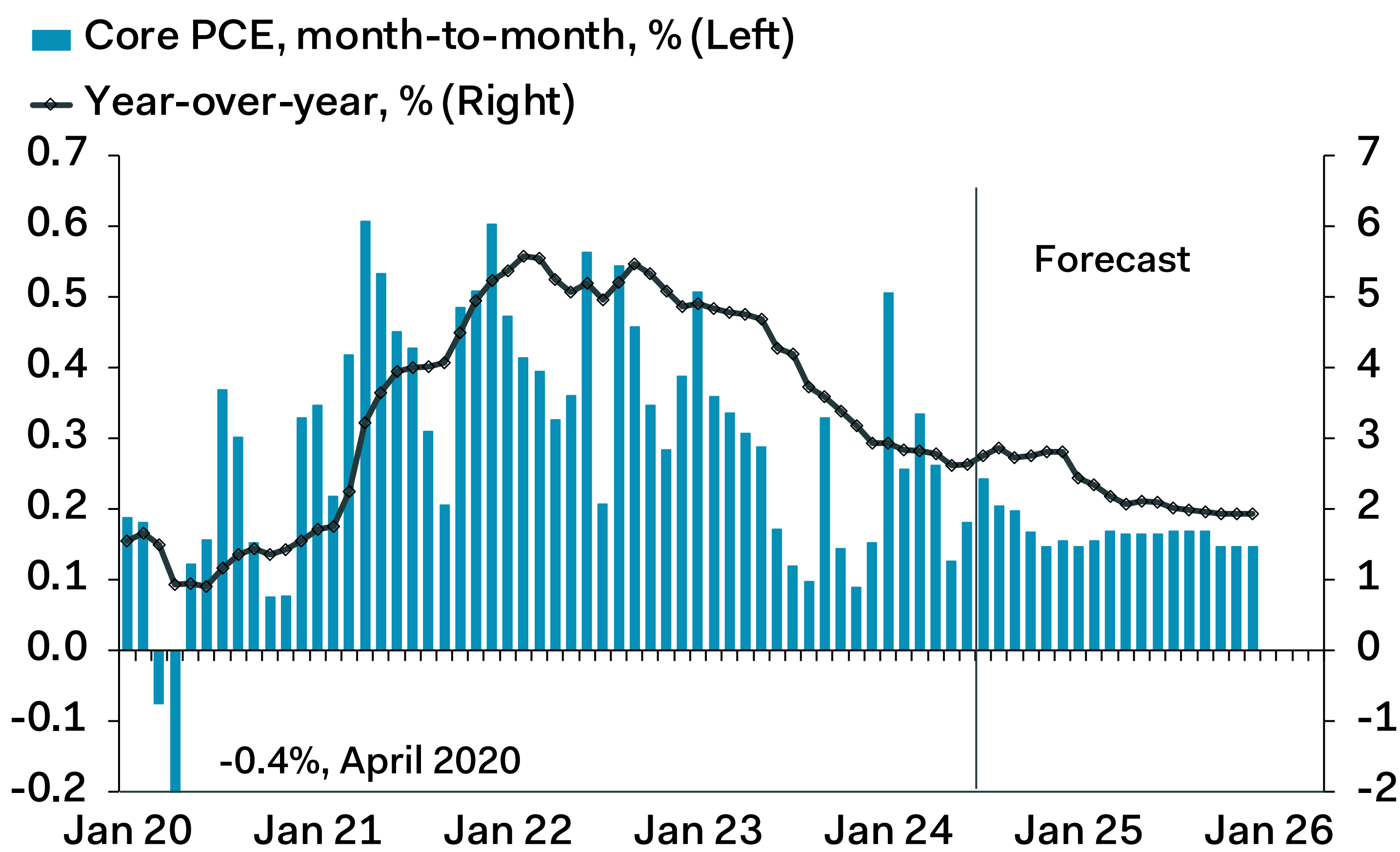
We see nothing in these data to change our view that the Q1 spike in the core PCE deflator was noise rather than signal, propelled mostly by seasonal adjustment problems. The underlying drivers of core inflation - wage growth, margins, supply chains, rents, oil prices and food prices - are all now under control, and will continue to feed into lower core inflation across the remainder of this year and into 2025. We see a decent chance that core PCE hits 2% in the middle of next year, much sooner than the Fed's forecast; the June SEP shows the target being reached at some point in 2026. If we're right, the clear and obvious progress towards the target across H2, coupled with a loosening of the labor market, will push the Fed into easing much more quickly than their current forecasts. We look for 25bp in Sep, then 50bp each in Nov/Dec.

The 0.2% increase in real consumption was marginally softer than we expected based on yesterday's GDP release and the June retail sales report, but both April and May's numbers were revised higher. Goods consumption saw a meager 0.2% increase, depressed by a 3.4% fall in spending on autos after many dealers were hit by a ransomware attack. July likely will bring a hefty rebound. Spending on core goods exautos rose by 0.6%. June's 0.2% pick-up in services consumption was relatively broad-based, although the modest 0.1% increase in recreational services and a 0.1% fall in spending on food services and accommodation provides further signs that the consumer is starting to cut back on discretionary spending.

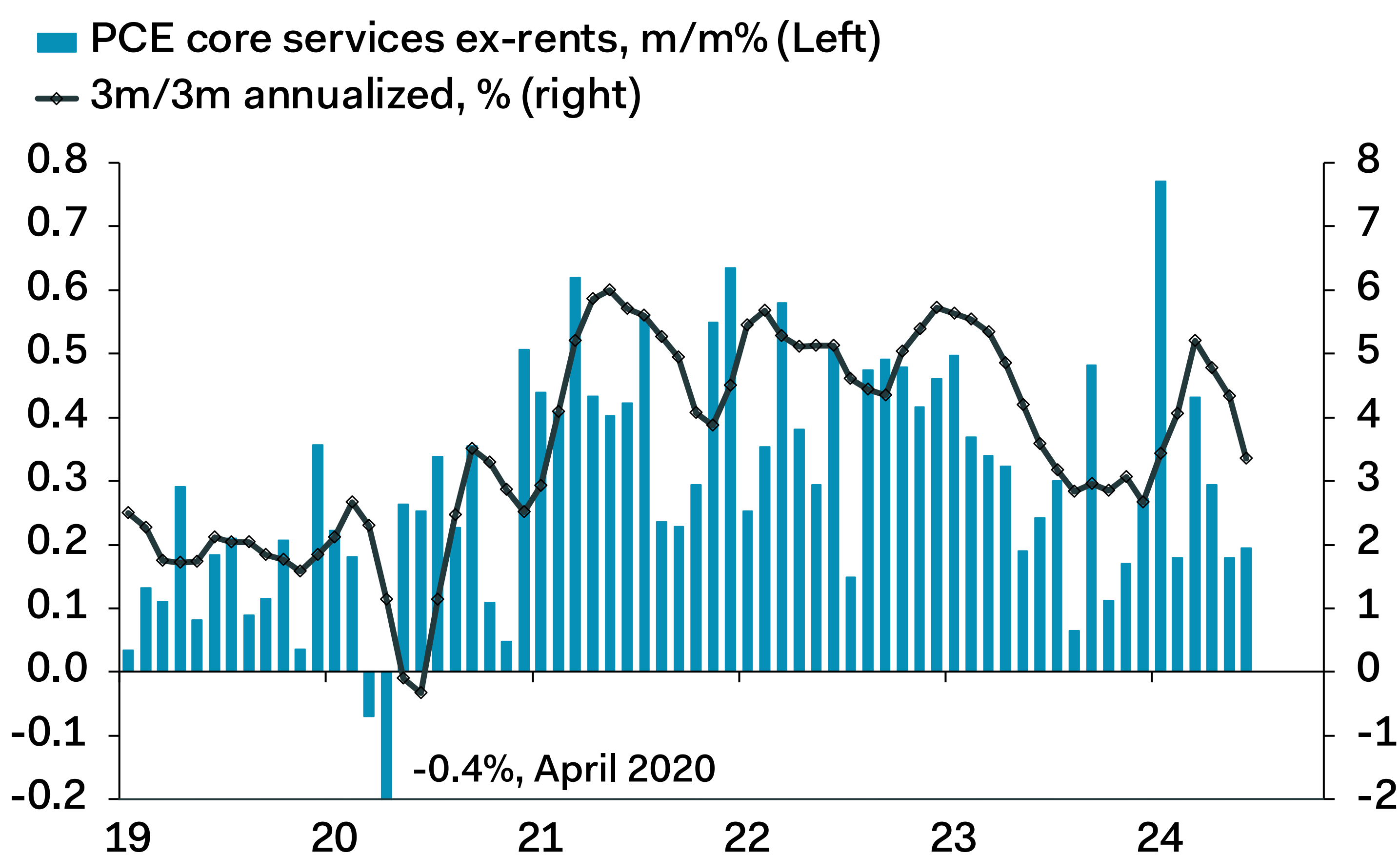
The momentum in overall services spending is clearly slowing, with a 2.2% annualized gain in the three months to June, compared to the previous three months; that's the worst performance on this basis in eight months, and down from 2.5% in the three months to May.

Consumers' spending rose by 2.3% in Q2 overall, a reacceleration from the 1.5% pace recorded in Q1, but still well below the 3.2% average in the second half of last year. We expect a renewed slowdown over the next couple of quarters, due mostly to weaker income growth and a gradual climb in the savings rate.

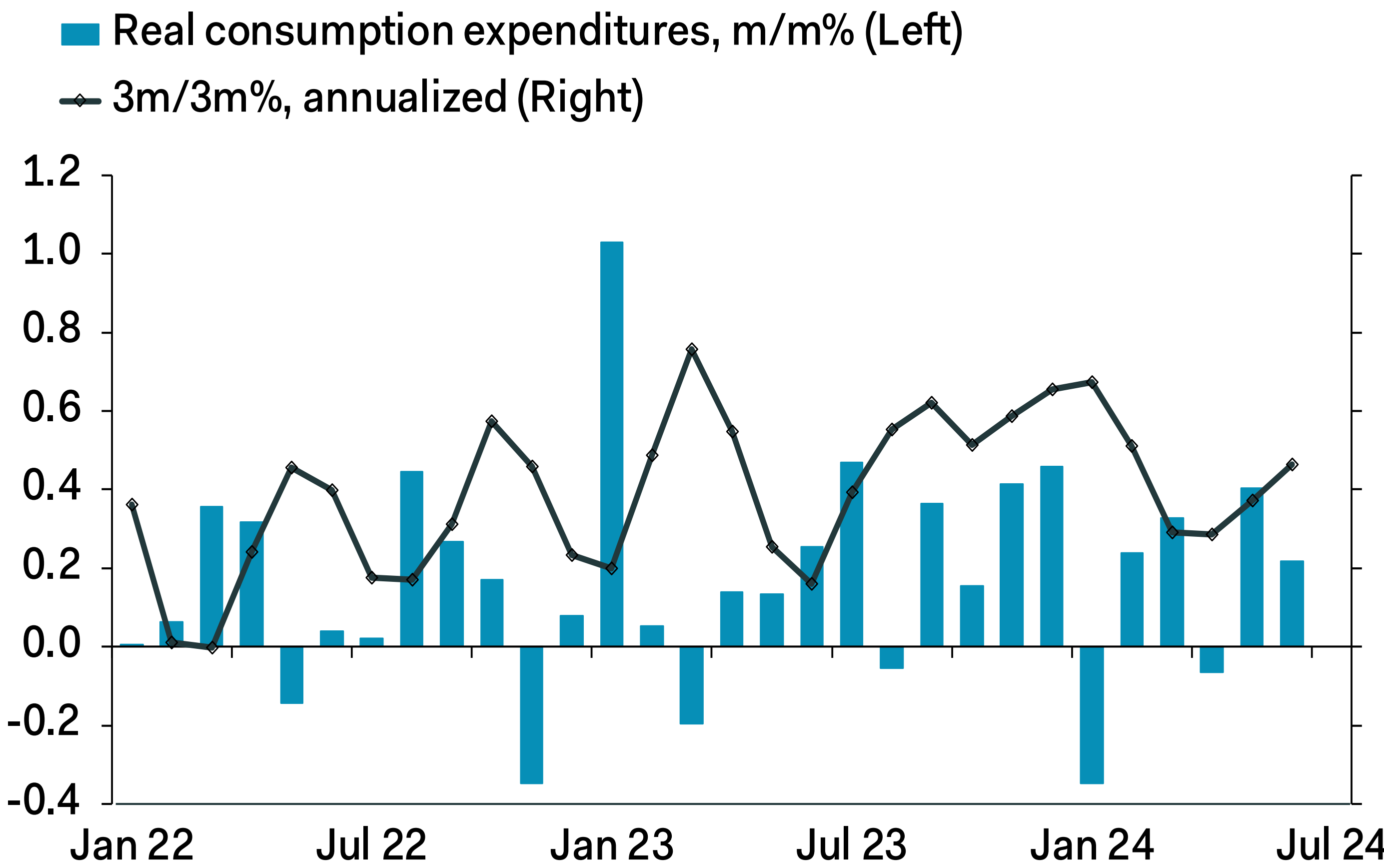
The downside surprise on personal incomes in June seems mostly to be due to a step-down in growth in the wages and salaries component, which rose by 0.3% last month, compared to 0.6% in May and an average of around 0.5% over the previous six months. Notably, real-after tax disposible incomes increase by just 0.1% in June, growing at an annualized rate of only 1.0% in Q2 overall. With pandemic-era excess savings now mostly exhausted, and the savings rate looking unsustainibly low, growth in real consumption will probably drop back to around that level, if not a bit below, quite soon. Indeed, the personal savings rate dipped to just 3.4% in June, leaving it well below its 2015-to-19 average, 6.2%.

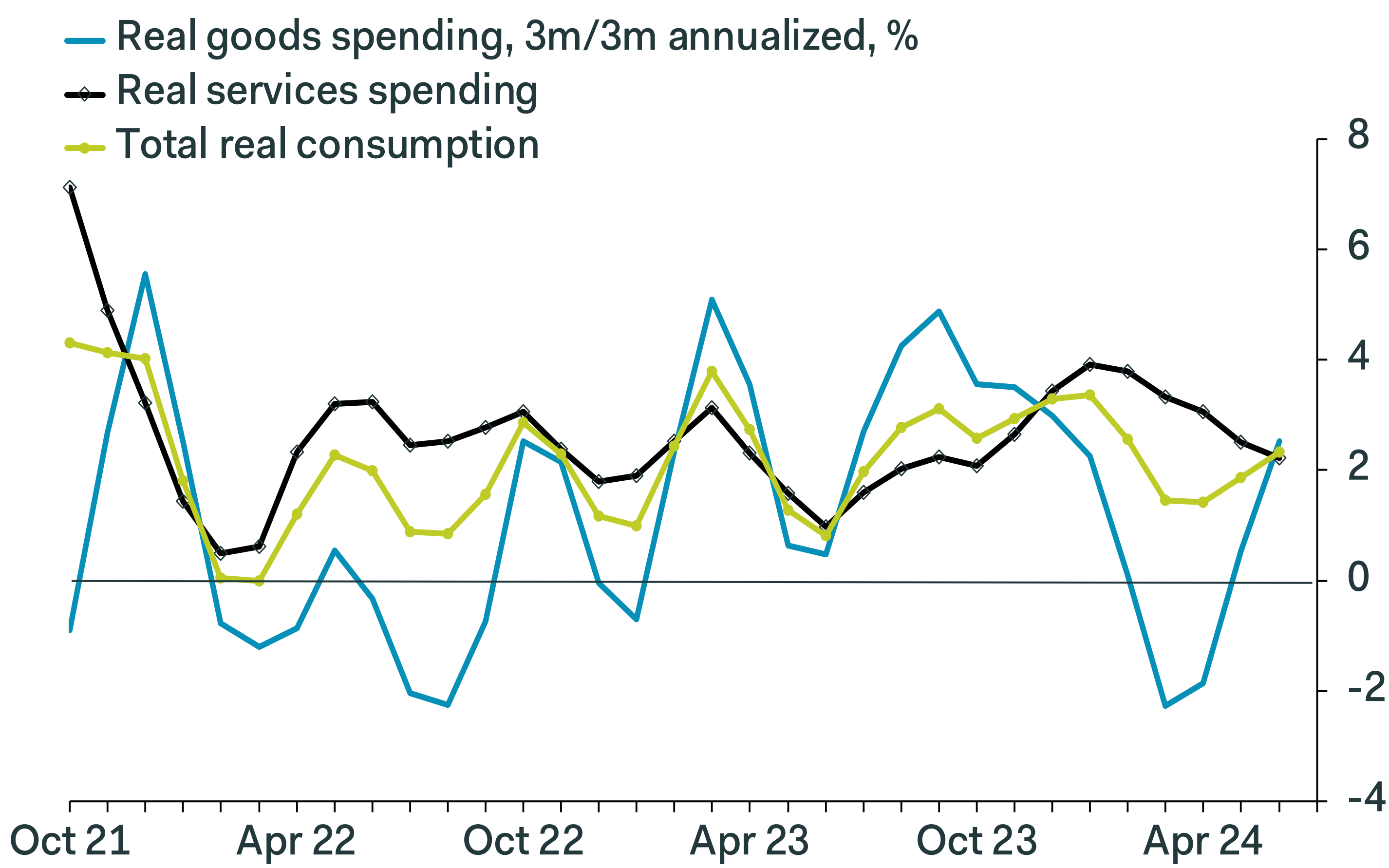


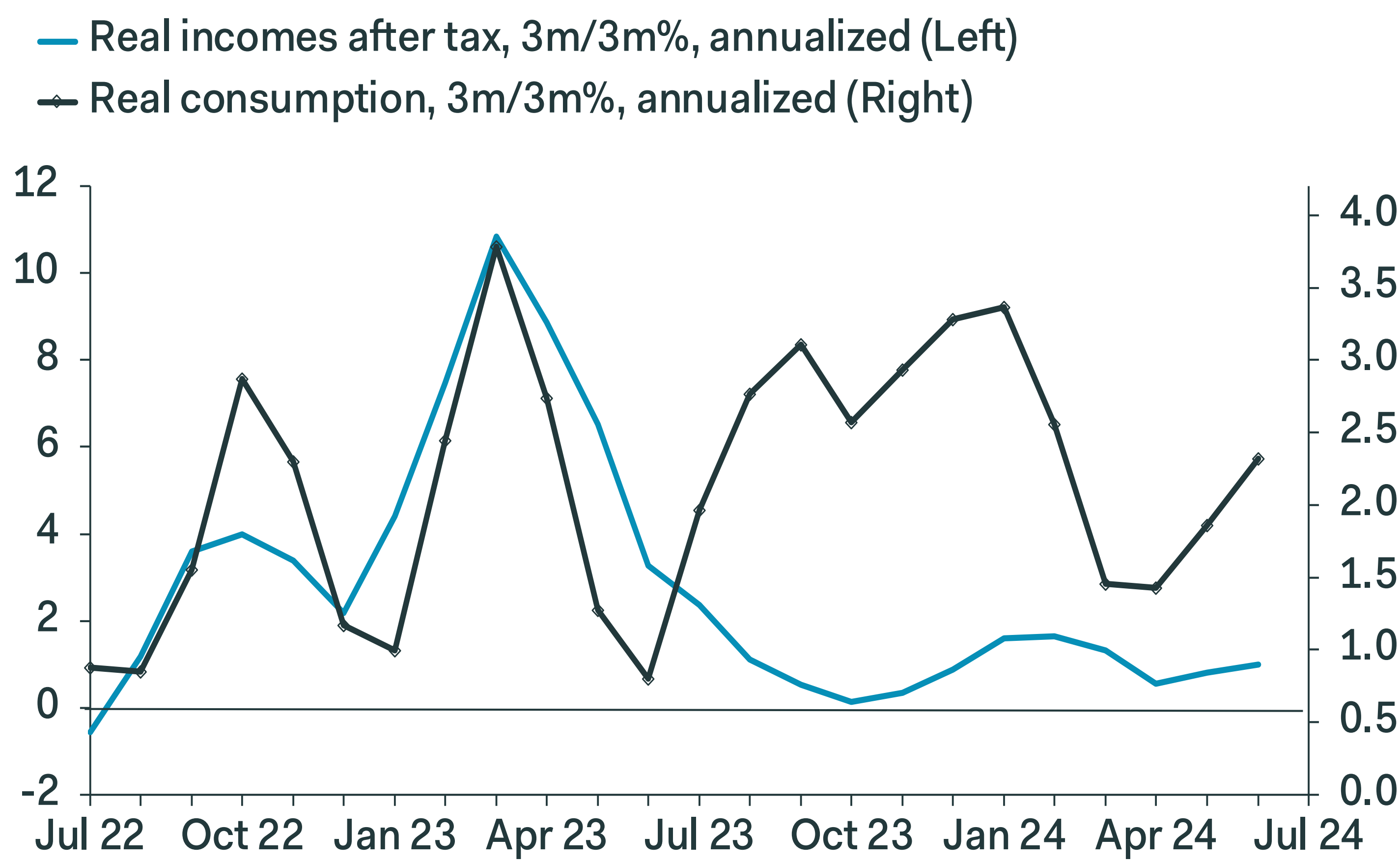
Core PCE, month-to-month, % (Left)
Year-over-year, % (Right)
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
-0.1
-0.2
7
6
5
4
3
2
1
0
-1
-2
Forecast
-0.4%, April 2020
Jan 20
Jan 21
Jan 22
Jan 23
Jan 24
Jan 25
Jan 26



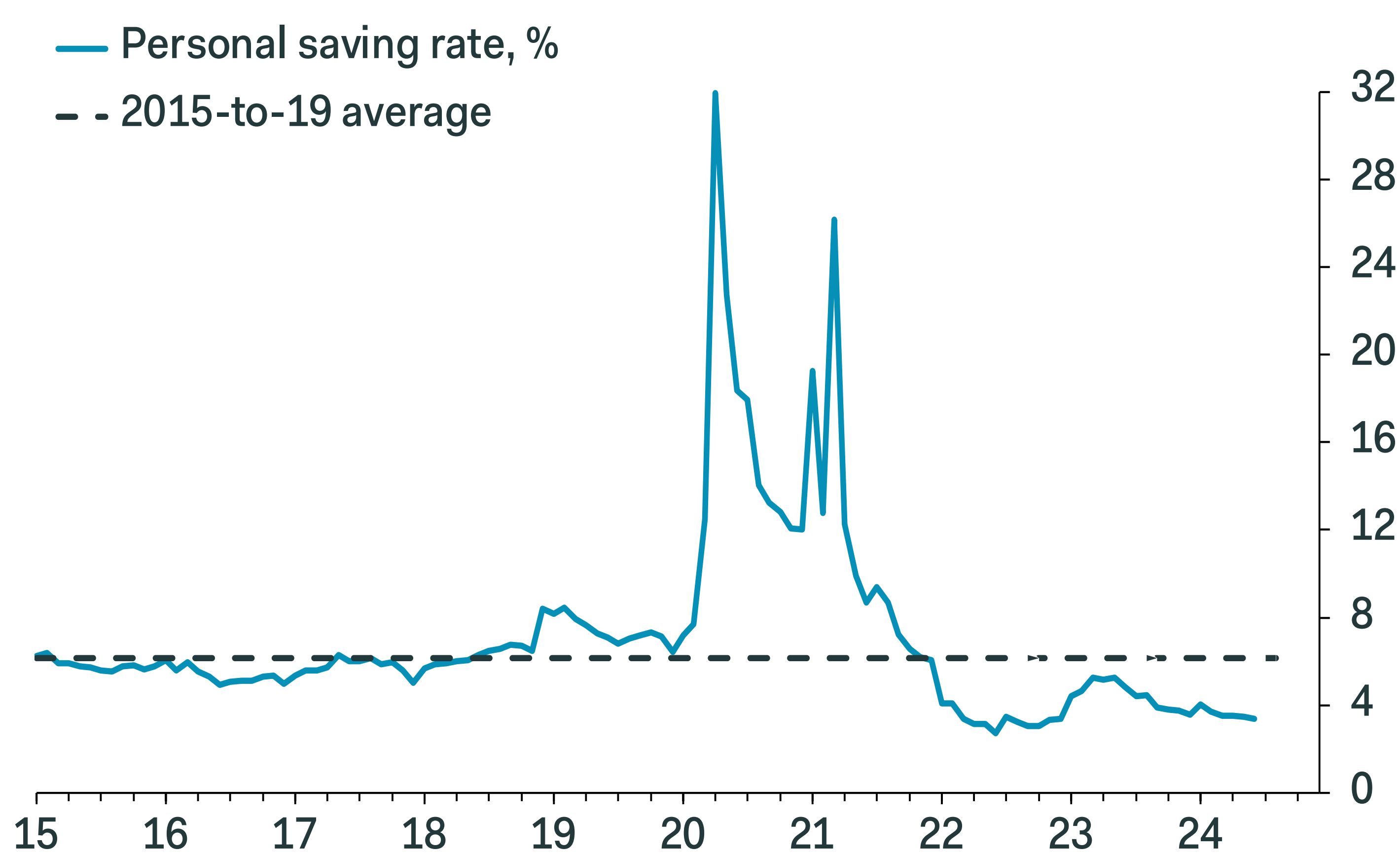
PCE core services ex-rents, m/m% (Left)
3m/3m annualized, % (right)
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
-0.1
-0.2
8
7
6
5
4
3
2
1
0
-1
-2
-0.4%, April 2020
19
20
21
22
23
24


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
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24


Real goods spending, 3m/3m annualized, %
Real services spending
Total real consumption
8
6
4
2
0
-2
-4
Oct 21
Apr 22
Oct 22
Apr 23
Oct 23
Apr 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
Jul 24



Personal saving rate, %
2015-to-19 average
32
28
24
20
16
12
8
4
0
15
16
17
18
19
20
21
22
23
24