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Datanote: US Personal Incomes & Spending, July

In one line: Undershooting the Fed's June core PCE forecast for the third straight month.

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

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Net revisions were negligible.

July's two-decimal increase in the core PCE deflator is 0.16%, only slightly above our forecast, 0.13%, and in line with the average 0.16% forecast among analysts who supply forecasts to that level of precision to the WSJ. In June, the median FOMC participant forecast that core PCE inflation would average 2.6% in Q4 2024, implying average month-to-month increases of 0.19% from May onwards. July is the third straight month that the m/m deflator has undershot that expected run rate, after increases of 0.10% in

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May and 0.16% in June. As a result, the Committee next month will have to revise down their Q4 2024 inflation forecast by at least 0.2pp, and possibly by more, if the recent slowing has increased their confidence in the outlook for the next few months.

Admittedly, the sluggish increase in the core deflator was enabled by an unsustainably small 0.22% rise in prices for core services ex-rent. Notably, the risk of a rebound in the healthcare services deflator—almost one-third of core services ex-rent—looks high after

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July’s no-change print, given the ongoing momentum in labor compensation in the sector. In addition, the July NFIB survey showed that the net balance of businesses planning to raise prices is still slightly above its 2015-to-19 average, despite falling steadily over the last six months. Nevertheless, we expect weakening growth in consumer demand to squeeze retailers’ margins, enabling the current flat trend in core goods prices to be maintained. At the same time, increases in the primary rents and OER likely will continue to slow, in lagged response to the moderation in new rent increases

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signalled by Zillow's data. Accordingly, core PCE prints over the coming months will not prevent the FOMC easing policy quickly to try to shore up the labor market. We continue to look for 125bp over the next three meetings, with a further 150bp next year.

We see very few signs, meanwhile, of a significant slowdown in consumption growth in this report. The 0.7% jump in July goods consumption was partly due to a rebound in spending on autos following a one-time drop in June, but spending on core goods ex-autos rose by 0.4%,

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following solid 0.7% increases in both May and June. The annualized growth rate of goods consumption in the three month to July, compared to the prior three months, rose to 5.7% last month, the strongest pace since mid-2021. The broad-based 0.2% increase in services consumption, meanwhile, was less impressive, but still leaves the underlying trend looking robust following a slowdown earlier this year.

The significant upward revisions to real consumption in May and June in this report are not new information; the monthly data have been brought into

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line with yesterday's second estimate of Q2 GDP. After rising at an annualized rate of 2.9% in Q2, consumption now seems to have accelerated to 3.8% in the three months to July, compared to the previous three months. A strong base for comparison means that even unchanged consumption in August and September would still see consumers' spending growth by 3% in Q3 overall. This pace of growth in consumers' spending looks unsustainable, however, and we expect a sharp slowdown later this year.

Income growth has been weak for some

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time. Personal incomes increased by 0.3% in July, a bit stronger than the recent trend, partly due to an unexpectedly strong month for small business and rental incomes, both of which seem unlikely to reaccelerate. More importantly, real after-tax incomes rose by just 0.1%, leaving the year-over-year growth rate only marginally above 1%. Consumers' spending growth has been running well ahead of real income growth for some time, which has only been possible due to a drop in the personal saving rate to a very low level. The saving rate dropped to just 2.9% in July, from 3.1%. That is

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the second-lowest since 2008, and well below its pre-Covid average, just above 6%. This looks unsustainably low now that pandemic-era excess savings have diminished significantly, and the ongoing softening in the labor market ought to lead to more precautionary saving. We expect a climb in the saving rate to dampen consumption growth significantly over the next few quarters.

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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

-0.4%, April 2020

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

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PCE core goods, m/m% (Left)
3m/3m annualized, % (right)

1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8

9
6
3
0
-3
-6

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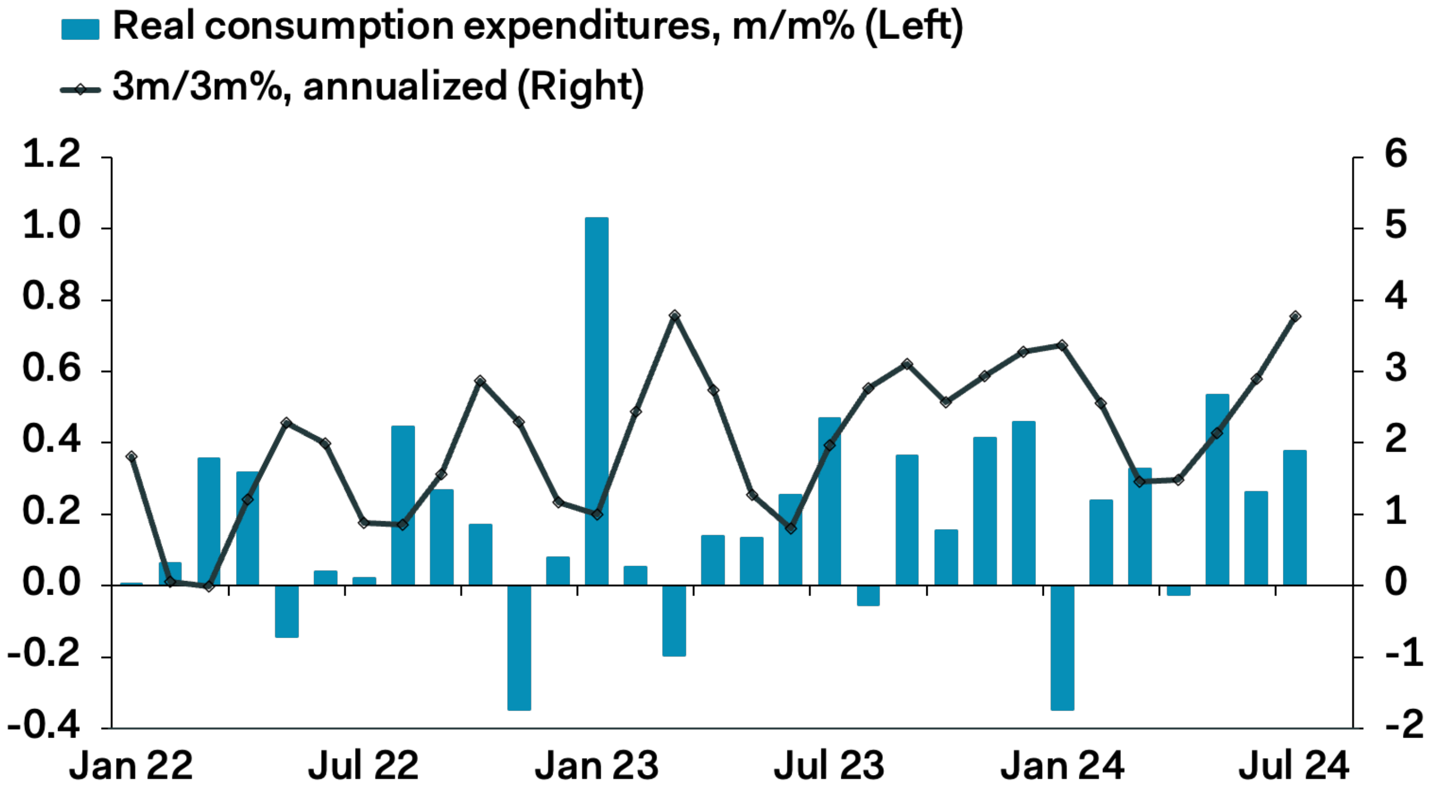

Real after-tax income, 2019 average = 100

Real consumption, 2019 average = 100

130.8, March 2021

120
115
110
105
100
95
90
85

15 16 17 18 19 20 21 22 23 24

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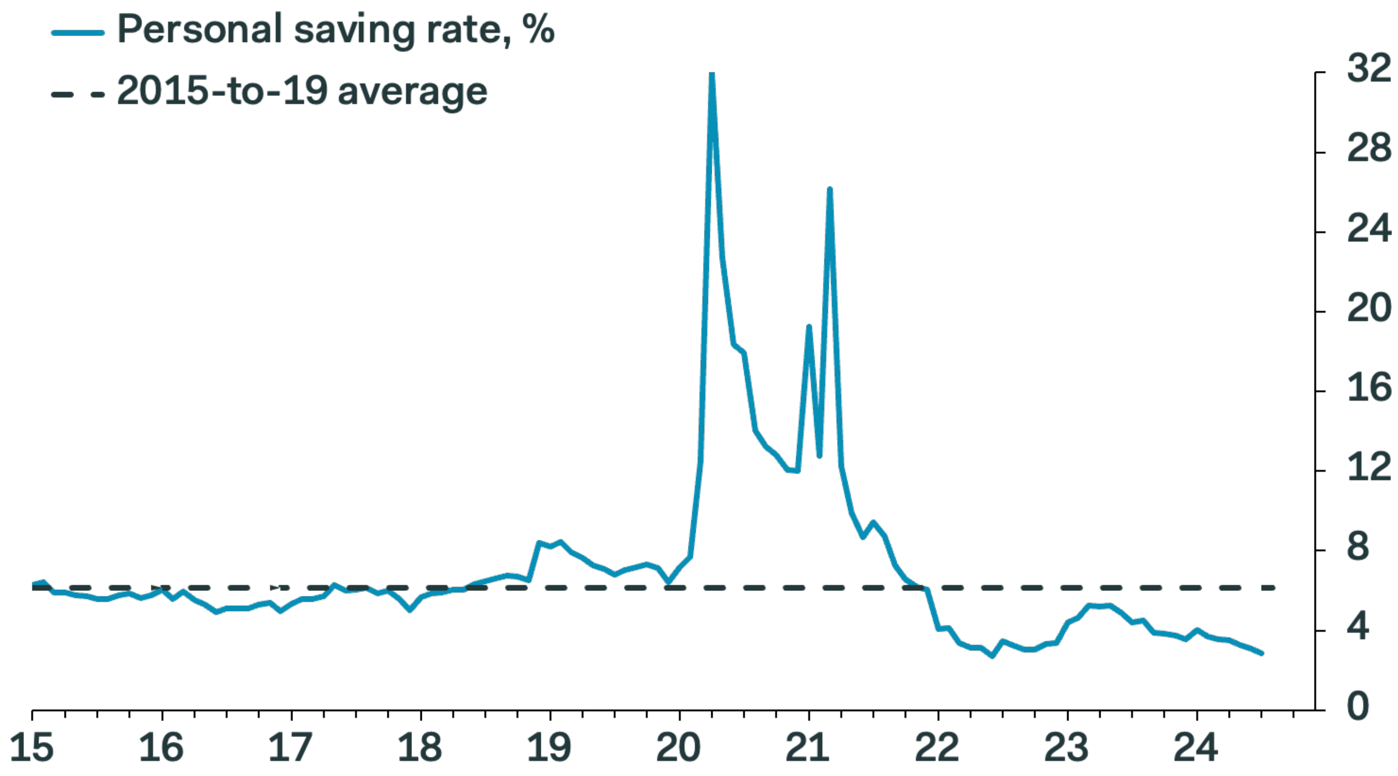

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