July 31, 2025

Slower Growth in Personal Income and Consumer Spending in June; Tariffs May Be Pushing Higher Inflation

- **After-tax personal income and consumer spending both rose 0.3% in June before adjustment for inflation.**
- **The PCE price index rose 0.3% in June, up from April and May.**
- **On a year-over-year basis PCE inflation remains above the Fed's 2% objective and is moving higher.**
- **Consumer spending continues to increase, but growth is slowing.**
- **PNC expects the next fed funds rate cut to come at the end of 2025.**

Personal income increased 0.3% in June from May before adjustment for inflation, with after-tax income also up 0.3%, according to the Personal Income and Outlays release from the Bureau of Economic Analysis. Disposable (after-tax) personal income fell 0.4% in May after rising 0.8% in April due to changes in Social Security benefits.

Consumer spending increased 0.3% in June as well.

The personal consumption expenditures price index, the Federal Reserve's preferred inflation measure, rose 0.3% on the month, after increasing 0.2% in April and May. Higher energy prices (up 0.9% in June) accounted for part of the acceleration in inflation. But core PCE inflation, excluding food and energy prices, also rose 0.3% for the month, after 0.2% increases in April and May. Goods PCE inflation was 0.4% in June, the largest goods price increases since January, with durable goods inflation of 0.5%; it could be that tariffs are starting to push goods prices higher, contributing to the pickup in inflation.

On year-ago basis overall PCE inflation was 2.6% in June, up from 2.4% in May and 2.2% in April. Core PCE inflation was 2.8% in June, unchanged from May but up from 2.6% in April. Inflation has slowed dramatically from 2022, when overall inflation peaked at above 7% and core inflation at close to 6%, but has been hovering at around 2.4% (overall) and 2.7% (core) for a year, stubbornly above the Fed's 2% objective. And inflation is set to move higher in the near term as importers pass along tariff increases to consumers.

With moderate inflation on the month, real (adjusted for inflation) after-tax income was flat in June from May, while real consumer spending was up 0.1% for the month.

Gus Faucher
Chief Economist

Jay Hawkins
Senior Economist

Stuart Hoffman
Senior Economic Advisor

Kurt Rankin
Senior Economist

Ershang Liang
Economist

With 0.3% increases in both after-tax income and consumer spending in June, the savings rate held steady at 4.5% from May, and up from below 4% at the end of 2024.

Real after-tax income was up 1.7% in June from a year earlier, close to the pace throughout 2025. Real consumer spending rose 2.1% year-over-year in June, a slowing from around 3% real growth in late 2024 and early 2025.

The June Personal Income and Outlays report is consistent with slowing growth in the U.S. economy in mid-2025, but continued expansion. Inflation-adjusted incomes are increasing, but at a slower pace than in 2024, due to a softening labor market. Consumer spending growth is also softening, to a pace more consistent with income growth. With consumer spending making up about two-thirds of GDP, this means weaker overall economic growth.

The drivers for consumer spending are mixed heading into the second half of the year. Job growth continues to soften, and higher prices from tariffs will be a drag on spending, as will cuts to federal government employment. High interest rates are also a drag, particularly for purchase of big-ticket items. But job growth, although slower, is still positive, and wages are rising more quickly than prices. Record-high stock prices are a positive for spending by higher-income households. PNC expects modest growth in consumer spending in the near term, at somewhat above 1%, over the next year.

Inflation remains too high for the Fed's liking, and is set to move higher from tariffs in the near term. Yesterday the Federal Open Market Committee kept the federal funds rate, the committee's key short-term policy interest rate, unchanged in a range between 4.25% and 4.50%. After cutting the rate by a cumulative one percentage point in the last four months of 2024, the FOMC has kept the rate unchanged this year, concerned about inflation that is still above the committee's 2% objective and set to move higher. President Trump is pushing hard for rate cuts, but Fed Chair Powell in his press conference yesterday indicated that rate cuts are not necessarily imminent. Today's report, showing an acceleration in monthly inflation, is consistent with Powell's caution about near-term rate cuts.

Right now the fed funds futures market is pricing in a 39% probability of a 25 basis point fed funds rate cut at the FOMC's next meeting, on September 17. This is down from above 50% before yesterday's FOMC statement and Powell press conference. PNC's baseline forecast is for the next fed funds rate cut to come at the last FOMC meeting of the year, in mid-December, of 25 basis points, with additional 25 basis point rate cuts at the first two FOMC meetings of 2026. This would take the fed funds rate to a range of 3.50% to 3.75% by next spring.

Wages and salaries rose a soft 0.1% in June before adjustment for inflation, below overall income growth. This was the slowest growth in almost a year, and is another sign of the ongoing labor market weakening.

In consumer spending, durable goods purchases rose 0.5% in June before adjustment for inflation, but just 0.1% real. There was a 1.6% surge in real durable goods spending in March as households rushed to make purchases ahead of tariffs, but it is down since then as consumers pulled forward some of their buying. Real spending on nondurable goods rose 0.4% in June, with real services spending up 0.1%.

PNC Economics
Gus Faucher, Chief Economist
economics@pnc.com

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