

Decent Numbers for Income and Spending in February, But in a Surprise Inflation Reaccelerated

- **After-tax personal income rose a strong 0.8% in February. Some of this was due to a one-time factor, but wages and salaries rose a solid 0.4%.**
- **Consumer spending rose 0.4%, with strong growth in goods spending.**
- **Inflation was stronger than expected, with PCE inflation of 0.3%, and core PCE inflation of 0.4%.**
- **Progress on slowing inflation has stalled since mid-2024, making the Fed's job more difficult.**
- **Consumer spending should continue to increase at a modest pace going forward.**

Nominal personal income, not adjusted for inflation, rose a strong 0.8% in February from January, according to the Bureau of Economic Analysis. Wages and salaries rose a solid 0.4%. There was a large 2.2% increase in transfer payments, in large part because of tax credits for health insurance under the Affordable Care Act. This followed a large 0.7% increase in personal income in January, supported by the annual cost-of-living adjustment for Social Security. After-tax personal income also rose 0.8% in February.

Nominal consumer spending rose 0.4% in February. Spending on durable goods rose 1.4% over the month, with spending up 0.9% on nondurable goods and up 0.2% on services. Some of the gain in goods spending likely came from households trying to make purchases ahead of potential tariff-caused price increases.

With income up more than spending the saving rate rose to 4.6% in February from 4.3% in January; the saving rate was at or below 4% in the last four months of 2024.

The personal consumption expenditures price index increased 0.3% in February from January; it has increased 0.3% in four of the last five months, including in January. The core PCE price index, excluding volatile food and energy prices and the Federal Reserve's preferred inflation measure, rose 0.4% in February. Core PCE inflation has accelerated over the last four months; it was 0.1% in November, 0.2% in December, and 0.3% in January.

On a year-ago basis overall PCE inflation was 2.5% in February; it has been 2.5% or 2.6% for the last four months, up from 2.1% in September. Core PCE inflation was 2.8% year-over-year in February; it has been between 2.6% and 2.9% since April 2024.

After adjusting for inflation after-tax income rose 0.5% in February from January, while real consumer spending increased 0.1% on the month. On a year-ago basis real after-tax income increased 1.8% in February, with real consumer spending up 2.7%.

Both overall and core PCE inflation accelerated in February, creating a headache for the Federal Reserve. This acceleration came as a surprise, as inflation measured using the consumer price index slowed over the month. Both PCE inflation measures remain above the Fed's 2% objective on a year-ago basis, and overall PCE inflation has reaccelerated since the fall, while there has been no progress in slowing core inflation for almost a year. Inflation is down significantly from a few years ago: overall PCE inflation peaked at above 7% in mid-2022, and core PCE inflation at close to 6%. But wringing that last bit of excess inflation out of the economy has been more difficult. And the task will not get any easier. Tariffs are likely to drive a reacceleration in inflation, at least temporarily, and there is the potential for reduced immigration to drive stronger wage growth that would also cause higher inflation.

In their latest "dot plot," from last week, the Federal Open Market Committee indicated that it wanted to cut the fed funds rate twice (25 basis points each time) in 2025. But until inflation readings start turning down, those rate cuts will remain on hold.

The good news from the report is that consumers are holding up. Income has jumped in the last two months because of one-time factors, but more fundamental income growth coming from the labor market remains solid. Households are gradually increasing their spending. The savings rate has moved higher in recent months, providing consumers with a bit more of a cushion. Some of the drivers for consumer spending growth are negative: high interest rates, potential tariffs that would raise prices, and a stock market correction that may constrain high-income households. But overall the solid labor market should support sustainable consumer spending growth through the rest of 2025, although at a slower pace than in 2024.

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