PNC ECONOMICS RESEARCH

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Solid Gains in Personal Income and Consumer Spending in August, With Inflation Benign

Headlines

- **Personal income and after-tax income both rose 0.4% in August.**
- **Consumer spending rose 0.6%.**
- **The PCE price index was up 0.3% in August, with core PCE inflation of 0.2%. Both measures are above the Fed's 2% objective on a year-ago basis and have moved higher in recent months.**
- **Consumer spending growth is set to slow in the near term, with inflation expected to pick up due to tariffs.**

Personal income increased 0.4% in August from July, before adjustment for inflation, according to the Bureau of Economic Analysis. After-tax personal income was also up 0.4% for the month. However, wages and salaries rose a smaller 0.3% for the month; these are more important for consumer spending. There was a large 0.9% increase in profits for business owners.

Nominal consumer spending rose 0.6% in August, the largest increase in spending since December 2024. Spending on both durable and durable goods rose 0.8% over the month, with spending on services up 0.5%.

With spending up more than saving, the personal saving rate fell to 4.6% in August from 4.8% in June and is down from 5.7% in April. Spending has been increasing more quickly than incomes over the past few months.

The personal consumption expenditures price index increased 0.3% in August from July; the PCE price index has increased 0.2% to 0.3% in each of the past five months. Durable goods prices actually fell 0.1% in August, with nondurable goods prices up 0.2%, showing limited impact on goods prices from higher tariffs. The core PCE price index, excluding volatile food and energy prices, rose 0.2% in August, consistent with readings in recent months.

On a year-ago basis overall PCE inflation was 2.7% in August, up from 2.5% in July. Core inflation was 2.9% in August, the same pace as in July but up from 2.6% in April. Both of these measures are above the Federal Reserve's 2% objective and are moving higher. Inflation soared during the recovery from the pandemic to the highest levels in more than 40 years, slowed in 2023 and the first half of 2024, and then stabilized in late 2024 and early 2025, albeit at

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above 2%. But inflation has started to tick up in recent months, and tariffs are likely to push inflation still higher later this year and into 2026.

Real (inflation-adjusted) after-tax income increased 0.1% in August, with real consumer spending up 0.4%. On a year-over-year basis real after-tax income was up 1.9% in August, with real consumer spending up 2.7%.

The personal income and outlays report for August was mixed. Income growth was solid, but is slowing as the labor market softens. Consumer spending growth is running ahead of income growth and the saving rate is falling. While this is good for near-term economic growth—consumer spending makes up about two-thirds of GDP—spending growth cannot continue to indefinitely outpace income growth.

The inflation readings were largely benign. Monthly inflation was modest, and the flow-through from tariffs to goods prices has been limited so far this year. But neither core nor overall PCE inflation has been at the Federal Reserve's 2% objective since early 2021, and both are creeping higher on a year-over-year basis. Firms are likely to push more of their tariff costs onto consumers in the months ahead, and the Trump administration just announced new tariffs on drugs and some furnishings. With inflation still too high for the Fed and moving higher, but job growth slowing simultaneously, the Federal Open Market Committee may have to decide which of its two priorities is more important: keeping inflation low or supporting the labor market.

After the FOMC cut the federal funds rate by 25 basis points at their meeting last week, PNC's baseline forecast is for three additional 25 basis point rate cuts, at each of the next three FOMC meetings. This would take the fed funds rate to a range of 3.25% to 3.50% by late January 2026.

Consumer spending growth is set to slow in the near term but should not experience an outright decline. Job and income growth are slowing, and higher prices from tariffs will also be a drag on household purchases. Offsetting this somewhat are the strong stock market and big gains in house prices in recent years, which have boosted household wealth, particularly for upper-income earners. Interest rates remain elevated, but expected Fed rate cuts should provide a modest boost to consumer spending in 2026.

Risks to the consumer spending outlook are the downside. In particular the soft labor market could deteriorate with job losses and a rising unemployment rate, leading households to cut back on their purchases. High inflation could deter the Fed from cutting rates, keeping interest costs high and weighing on spending on big-ticket items.

Please reach out with any questions,

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