Moderate Growth in Consumer Spending, Personal Income in July; Core Inflation Picked Up

Headlines

- **Personal income and after-tax income both rose 0.4% in July.**
- **Consumer spending was up 0.5%.**
- **Overall PCE inflation was 0.2%, with core inflation 0.3%. Both overall and core PCE inflation are above the Federal Reserve's 2% objective on a year-ago basis, and moving higher.**
- **US economic growth should continue, but at a slower pace in recent years. Recession risks are elevated.**
- **PNC's forecast is for fed funds rate cuts starting next month.**

Details

Personal income increased 0.4% in July from June, before adjusting for inflation, according to the Bureau of Economic Analysis. After-tax (disposable) personal income also rose 0.4% over the month. The increase included a solid 0.6% increase in wages and salaries, which is important for consumer spending. Disposable personal income rose 0.3% in June and fell 0.5% in May.

Consumer spending rose 0.5% in July before adjusting for inflation, the largest increase since March. Spending jumped almost 2% on durable goods over the month as vehicle sales rose. Nondurable goods spending was up 0.1%, with spending on services up 0.4%. Spending rose 0.4% in June and was flat in May.

The personal saving rate held steady at 4.4% of after-tax income in July from June.

The personal consumption expenditures price index rose 0.2% in July on a monthly basis. PCE inflation was 0.3% in June and 0.2% in May. Core PCE inflation, excluding volatile food and energy prices, was 0.3% in July, the same pace as in June. On a year-ago basis overall PCE inflation was 2.6% in July, unchanged from June, but up from 2.2% in April. Core PCE inflation was 2.9% in July year-over-year, the fastest pace since February. Both overall and core PCE inflation are moving further away from the FOMC's 2% objective, and

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tariffs are likely to push inflation higher in the near term.

Adjusted for inflation after-tax personal income rose a moderate 0.2% in July, with real (inflation-adjusted) consumer spending up 0.3%. On a year-ago basis real disposable personal income was up 2.0%, with real consumer spending up 2.1%.

The personal income and outlays report is consistent with modest growth in the US economy in mid-2025, but accelerating inflation. Household income is rising, but the pace of gains is slowing with weaker job growth. Consumers are gradually increasing their spending, but remain concerned about tariffs and inflation. Given this the US economy should continue to expand through the rest of the year, but at a slower pace than in 2023 and 2024. The administration's immigration crackdown is also weighing on job growth, constraining gains in income and consumer spending. High interest rates remain a drag on consumer spending growth was well. Real income and consumer spending will increase at a pace of 1% or slightly higher in the near term, and the US should avoid a recession. But recession risks are elevated given slow job growth, the drag from tariffs, and tariff-induced higher inflation.

The Federal Reserve faces a dilemma. PCE inflation remains well above the central bank's 2% objective, is picking up, and will accelerate further through the rest of the year as importers pass higher costs from tariffs along to their customers. The increase in inflation is likely to be short term, with price growth settling back down in early 2026. But the Fed is concerned that tariff-induced price increases could cause permanently higher inflation. At the same time the labor market is softening; average monthly job growth of just 35,000 in the three months through July was the slowest pace since the economy was losing millions of jobs during the pandemic. Federal funds interest rate cuts could support job growth, but at the risk of pushing inflation higher. PNC's baseline forecast is for the Federal Open Market Committee to cut the federal funds rate by 25 basis points at its next meeting in mid-September, and then again at its subsequent three meeting, through late January 2026. This would push the fed funds rate down to a range of 3.25% to 3.50% by mid-winter.

Please reach out with any questions.

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