

Solid Increase in Consumer Spending in July, But Real Income Was Down; Inflation Picked Up

- **Nominal consumer spending rose 0.6% in July, with nominal personal income up 0.2%.**
- **Real spending rose 0.4%, with real after-tax income down 0.2%.**
- **Both overall and core PCE inflation were 0.2% in July.**
- **Overall and core PCE inflation both picked up somewhat on a year-ago basis in July from June, and both remain well above the Fed's 2% objective.**
- **Growth in personal income and consumer spending will slow through the rest of this year.**

Consumer spending rose a very solid 0.6% in July, before adjusting for inflation, with big increases in spending on durable goods (up 0.7%), nondurable goods (0.7%) and services (0.8%). Nominal consumer spending has increased for nine straight months.

Personal income rose 0.2% in July. There was a 0.4% increase in wages and salaries, but a big drop in transfer payments (down 0.6% over the month) somewhat offset this. With a big increase in tax payments (up 1.3% in July) nominal after-tax personal income was flat over the month.

The personal consumption expenditures price index rose 0.2% in July. A 0.4% increase in services prices more than offset price declines for goods. PCE inflation was also 0.2% in June. On a year-ago basis PCE inflation was 3.3%, up from 3.0% in June.

Core PCE inflation, which excludes food and energy prices and is the Federal Reserve's preferred inflation measure, was 0.2% in July, the same pace as in June. Year-ago core PCE inflation was 4.2% in July, up from 4.1% in June. Both core and overall PCE inflation remain well above the Fed's 2% objective on a year-ago basis.

After adjusting for inflation consumer spending rose 0.6%, while after-tax personal income was down 0.2%.

With spending up more than income, the personal saving rate fell to 3.5% in July, from 4.2% in June. This is the first time the personal saving rate has been below 4% since December 2022.

On a year-ago basis real after-tax personal income was up 3.8% in July, while real consumer spending was up 3.0%.

The outlook for consumers is mixed as the summer months of 2023 progress. Consumer spending rose sharply in July. Some of the increase came from higher prices, but more of it was from higher volumes, with big gains for both goods and services. But at the same time nominal after-tax income was flat, and declined after accounting for inflation. Some of this came from lower transfer payments, but income growth is softening as job growth slows. As a result the saving rate fell sharply in July.

At the same time inflation picked back up on a year-over-year basis. Some of this was from higher energy prices, but core PCE inflation also accelerated slightly in July. Not only does this hit consumers' pocketbooks, but it also may spur the Federal Open Market Committee to further tighten monetary policy.

Both household income growth and consumer spending growth are set to slow through the rest of this year. Job gains are slowing, which will weigh on income growth; this will also weigh on spending growth. Additional drags on consumer spending growth in the remainder of 2023 include higher interest rates, a slowing housing market, the need to increase saving, and pent-up demand for many types of durable goods.

Although the inflation news was somewhat negative, PNC expects the FOMC to hold the fed funds rate steady in its current range of 5.25% to 5.50% when it meets in a few weeks. At this level the fed funds rate is contractionary, weighing on economic growth. And with inflation down from 2022 and job growth slowing, the FOMC has a bit of breathing room to keep the rate unchanged for now, knowing that it can increase the funds rate later this year if inflation or job growth reaccelerate.

PNC expects a mild recession starting in early 2024, as the cumulative impact of higher interest rates weighs on the economy, particularly on consumer spending on durable goods, housing, and business investment.

There was a downward revision to after-tax real income in June (no change, compared to a 0.2% increase). Real consumer spending growth was unrevised in June.

Please reach out with any questions.

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