

Mixed News on Personal Income and Consumer Spending in August; Big Slowing in Core Inflation Is Encouraging

- **Personal income rose 0.4% in August, with strong gains from the labor market. But after accounting for inflation and taxes, real disposable personal income was down 0.2% over the month.**
- **Nominal consumer spending rose 0.4% in August, with real spending up 0.2%.**
- **Overall consumer inflation accelerated in August from July with a big increase in energy prices.**
- **Core inflation slowed in August, both month-to-month and year-over-year. It still remains well above the Fed's 2% objective.**

The August report on personal income, consumer spending and inflation from the Bureau of Economic Analysis was a mixed bag. Headline inflation was the strongest it has been in months. And although core inflation is slowing, it is still much higher than the Fed would like. Consumer spending continues to rise as households spend down more and more of the savings they accumulated during the early stages of the pandemic. Growth in nominal personal income was solid, but real after-tax income fell after including higher tax payments and high inflation.

Although consumer spending growth remains solid, it will slow in the months ahead as job and wage gains slow and high interest rates and inflation remain drags. Falling stock prices are a headwind on spending for higher-income households. The end of a deferment on student loan payments will also be a drag, and an extended auto strike is a downside risk to consumer spending. Consumers will also need to eventually increase their saving, weighing on demand. Spending gains over the next couple of years will be concentrated in services, rather than goods. Goods spending surged in 2020 and early 2021 with restrictions on purchases of services but has leveled off over the past couple of years as consumers have already purchased a lot of goods.

The open question is whether consumer spending outright declines, signaling a recession, or settles in a long-run sustainable pace, leading to slower overall growth but not an outright economic contraction. PNC's baseline forecast is for a mild recession starting in late winter/early spring of 2024, but there is still about a 40% chance that the economy can avoid a downturn. The UAW strike and a potential government shutdown are downside risks to the outlook.

If the economy does experience a recession next year, core inflation would move quickly to the Fed's 2% objective.

Personal income increased 0.4% in August from July, including a solid increase in wages and salaries of 0.5% thanks to job growth and wage gains. After-tax income was up a more moderate 0.2%, as there was a large 1.5% increase in tax payments over the month.

Consumer spending rose 0.4% in August. Services spending rose 0.4% over the month. Nondurable goods spending rose 1.3% with higher energy prices. Durable goods spending fell 0.6% as higher interest rates, including a big increase in mortgage rates, weighed on purchases of big-ticket items like cars and housing-related goods like appliances.

With spending up more than after-tax income the personal saving rate fell to 3.9% in August from 4.1% in July. Households continue to spend down the saving they accumulated in 2020 and 2021, when they received stimulus income from the government and had limited opportunities to spend with the pandemic.

The personal consumption expenditures price index rose 0.4% in August from July, driven by a big 6.1% in energy prices over the month. This was the largest one-month increase in the PCE price index since January 2023. But the core index, which excludes volatile food and energy prices, rose a scant 0.1%, the smallest increase since July 2022.

On a year-over-year basis overall PCE, inflation accelerated slightly to 3.5% in August, from 3.4% in July. Still, total PCE inflation is much slower than the almost 7% inflation in the summer of 2022. Core PCE inflation, excluding volatile food and energy prices, slowed on a year-ago basis to 3.1% in August from 3.2% in July, and a peak of 5.4% in early 2022. The Federal Reserve is closely focused on core PCE inflation, and this slowing is encouraging, but inflation still remains well above the central bank's 2% objective.

With the acceleration in inflation in August real after-tax income, adjusted for inflation, fell 0.2% in August, after a decline of the same size in July. Real consumer spending increased 0.1% in August from July.

Please reach out with any questions.

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