AGRON NICAJ
US Economist

Economic Research Office

T: +1 (646) 357 6180
E: anicaj@us.mufg.jp

MUFG Bank, Ltd.
A member of MUFG, a global financial group

Goods inflation has temporarily returned

March 29, 2024

- Monthly growth in core PCE services inflation has fallen back close to target, around 2% at an annual rate, but growth in core goods has entered positive territory after being deflationary since June of last year. Geopolitical risks stemming from the Red Sea have likely contributed to this growth, helping to raise import prices, but the effects are fading.
- Real income growth was comparatively weak in February, and spending remained relatively strong. Easing of labor market and wage pressures are helping to bring core services inflation back into balance, but the effect on real incomes in negative. Despite this, growth in household net worth may help sustain spending growth and keep savings rates relatively low.

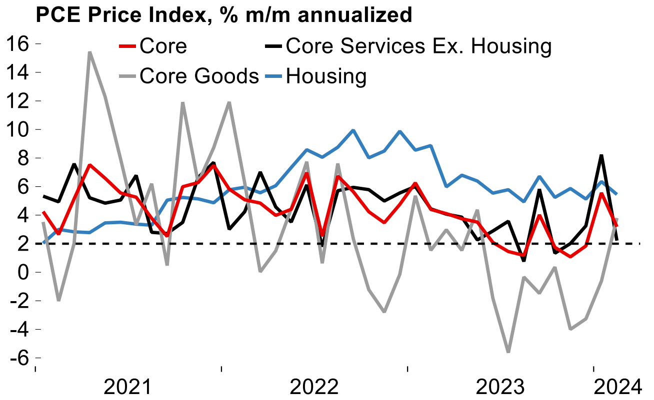
Core goods inflation re-entered positive territory

February's PCE Price Index may be better news for the Fed than the top line figure suggests. Core inflation eased to 3.2% at an annualized monthly rate, down from 5.6% in January, but it is the second highest monthly growth rate since September of last year (Chart 1). This isn't particularly worrisome because growth in February was driven by core goods, which in this case, very well may be transitory.

Geopolitical risks stemming from the Red Sea likely contributed February's price growth. Around 30% of global container shipments transit through the Red Sea, and the average Drewry World Container Index level more than doubled from December 2023 to February 2024. The good news is that pressures have since subsided, evidenced by slower growth in container shipping indexes from Drewry and the Shanghai Shipping Exchange. The impact on prices will likely fade by March or April.

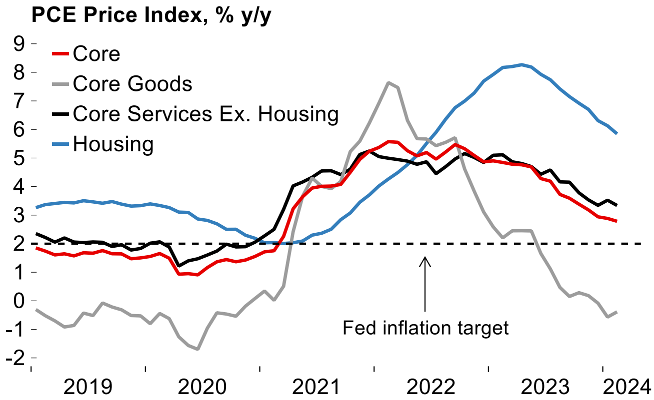
Month growth in core services excluding housing has fallen to 2.2% at an annual rate, the slowest growth since November 2023 (Chart 1), and annual growth eased to 3.3%, down from 3.5% in January (Chart 2).

Chart 1: Core goods have re-entered positive growth territory, but the effect will likely be transitory



Source: BEA, MUFG Bank Economic Research Office

Chart 2: Inflation is generally headed toward the Fed's 2% target, though bumps are expected along the way



Source: BEA, MUFG Bank Economic Research Office

Rising household net worth may sustain spending

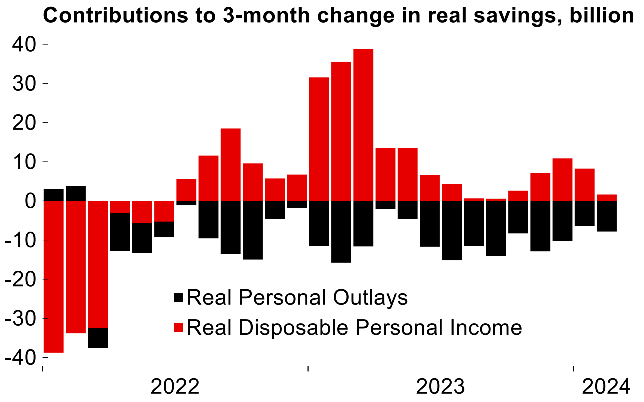
Real disposable personal income fell in February for the first time since September 2023. This is seemingly at odds with growth in personal spending, which entered positive territory this month after contracting in January. The general trend over the last few months can be characterized with dwindling household savings. Real income growth is fast approaching zero, while personal outlays have eased but remain comparatively strong (Chart 3).

Easing of labor market and wage pressures are welcomed developments with respect to services inflation, but the effect is not a positive one for real incomes. Even though wage growth remains elevated above overall inflation, employment growth in high paying industries such as professional and business services has been relatively slow, affecting aggregate income growth.

With excess household savings having likely been fully depleted, as discussed in a previous brief, the current trend of real income growth is unlikely to fully sustain current spending rates. However, rising household net worth may be a factor in keeping spending high and savings rates low. Shown in Chart 4, the personal savings rate has an inverse relationship with household net worth as a share of disposable personal income (DPI).

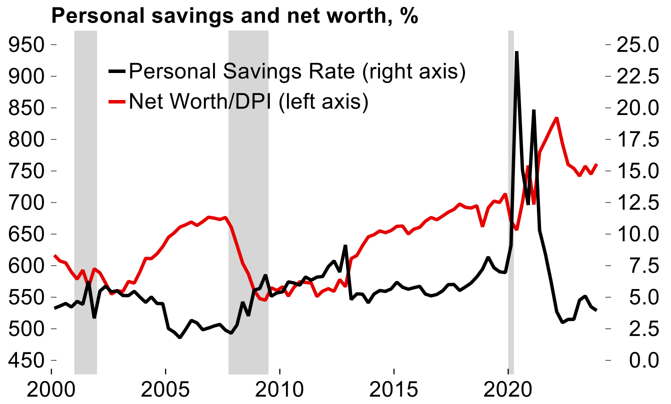
Expectations of future rate cuts and increased valuations of AI related companies has helped spur growth in household net worth, which can help keep spending growth in positive territory.

Chart 3: Real incomes are rising slower than expected, and spending momentum has only slightly eased



Source: BEA, MUFG Bank Economic Research Office

Chart 4: Net worth and personal savings as a share of disposable income have an inverse relationship



Source: BEA, Federal Reserve, MUFG Bank Economic Research Office

Analyst Certification

The views expressed in this report solely reflect the personal views of Agron Nicaj, the primary analyst responsible for this report, about the subject securities or issuers referred to herein, and such views may not necessarily reflect the thoughts and opinions of MUFG Bank, Ltd. and its affiliates or management team. No part of such analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed herein.

Disclaimers

The information and views contained herein are not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject MUFG Bank, Ltd. (collectively with its various offices and affiliates, "MUFG Bank") to any registration requirement within such jurisdiction or country. The information and views contained herein are provided for general informational purposes only, are subject to change, and are not intended to be, nor should be used, or considered, as an offer, or the solicitation of an offer, to sell or to buy or to subscribe to or for securities or any other financial instruments, and do not constitute specific investment, legal, tax or other advice or recommendations. The information contained herein reflects the thoughts and opinions of the noted authors only, and such information does not necessarily reflect the thoughts and opinions of MUFG or its management team. Neither this nor any other communication prepared by MUFG Bank should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective and it does not take into account the specific investment objectives, financial situation, or the particular needs of any specific person who may receive this information. Any information relating to performance contained herein is illustrative and no assurance is given that any indicative returns, performance or results, whether historical or hypothetical, will be achieved. Before entering into any particular transaction, you should consult an independent financial, legal, accounting, tax, or other advisor as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by MUFG Bank. MUFG Bank hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting, or other issues or risks that may arise in connection with any particular transaction or business strategy. While MUFG Bank believes that any relevant factual statements contained herein, and any assumptions on which such statements are based, are in each case accurate, neither the authors nor MUFG have independently verified its accuracy, and such information may be incomplete or condensed. The information is provided "AS IS". The authors and MUFG do not warrant the accuracy of the materials provided herein, either expressly or implied, for any particular purpose and expressly disclaims any warranties of merchantability or fitness for a particular purpose. The authors and MUFG cannot and do not guarantee the accuracy, validity, timeliness or completeness of any information or data made available to you for any particular purpose. MUFG Bank may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information and views contained herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the analysts who prepared them, and MUFG Bank is under no obligation to ensure that such other reports are brought to your attention.

About MUFG and MUFG Americas

Mitsubishi UFJ Financial Group, Inc. (MUFG) is one of the world's leading financial groups. Headquartered in Tokyo and with over 360 years of history, MUFG has a global network with approximately 2,000 locations in more than 40 countries. MUFG has nearly 120,000 employees and offers services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group aims to "be the world's most trusted financial group" through close collaboration among our operating companies and flexibly respond to all the financial needs of our customers, serving society, and fostering shared and sustainable growth for a better world. MUFG's shares trade on the Tokyo, Nagoya, and New York stock exchanges.

MUFG's Americas operations, including its offices in the U.S., Latin America, and Canada, are primarily organized under MUFG Bank, Ltd. and subsidiaries, and are focused on Global Corporate and Investment Banking, Japanese Corporate Banking, and Global Markets. MUFG is one of the largest foreign banking organizations in the Americas. For locations, banking capabilities and services, career opportunities, and more, visit www.mufgamericas.com.