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Spending outpacing income

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- Core PCE inflation was flat in July, maintaining a monthly growth rate consistent with the Fed's 2% target. Much like the July CPI, core services prices accelerated, though mostly in housing components, and core goods prices remain comfortably in deflation territory. The distribution of price increases has become more favorable, with fewer spending components exhibiting price increases of 5% or greater.
- The personal savings rate has fallen to its lowest level since June 2022, with consumer spending continuing to outpace income growth. A recovery in real consumption of new and used autos helped to push up spending in July, but growth was also strong in discretionary services such as recreation. The appetite for consumption highlights the resilience of the US economy, and with a relatively low ratio of revolving credit to disposable personal income, households continue to have capacity to spend.

Inflation holds steady near 2%

Core inflation remained unchanged in July, with growth in the core PCE Price Index, the Fed's preferred inflation measure, holding steady at 2.6% on an annual basis and at 2% on an annualized monthly basis. Much like July's CPI, price accelerations were mostly concentrated in housing components, reversing some of the progress made in June. Core services excluding housing exhibited a slight acceleration, but much of it was offset by disinflation in core goods prices (Chart 1).

Overall, July's PCE inflation report offers little new information that wasn't already evident in the July CPI report from earlier this month. Volatility seems to be less of an issue with the PCE Price Index, especially in medical services where the methodology and scope differs most evidently from the CPI, but the general story remains the same.

Chart 1: Growth in core PCE inflation remains around 2% on an annualized monthly basis

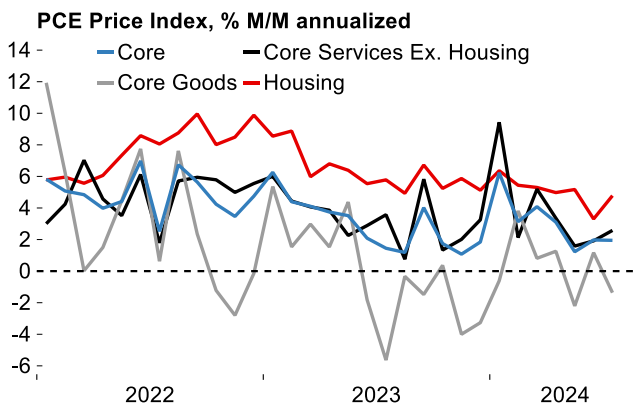
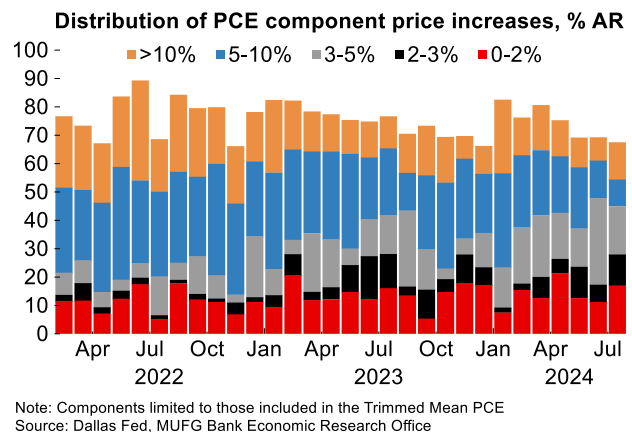


Chart 2: When excluding extreme outliers, fewer spending components are exhibiting price increases of 5% or greater



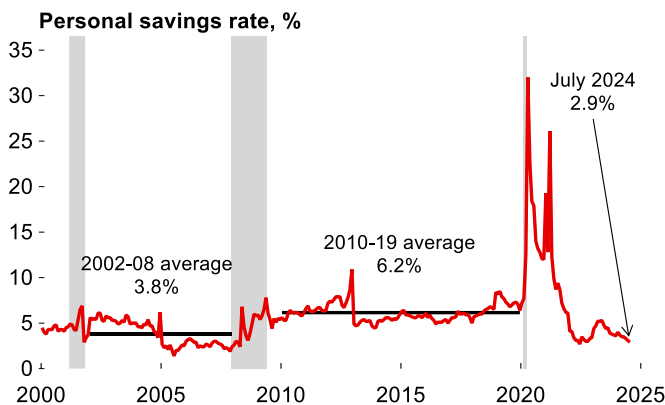
Inflation continues to move along the Fed's 2% target, and the risk of a broad-based reacceleration appears low. Shown in Chart 2, when observing the distribution of price increases of the trimmed-mean PCE, where both positive and negative outliers are excluded, a much smaller percentage of components are exhibiting price increases of 5% or greater on an annualized monthly basis. In comparison to the second half of 2023, when 1- and 3-month core inflation also trended along 2%, greater than 20% of PCE components had price increases ranging from 5-10%. In July, only 10% of components had price increases of 5-10%. The distribution is now much more centered around 2-5% growth.

Continued spending capacity

Though July's PCE report will likely not change most views about the trajectory of inflation, it should temper expectations of a significant downturn or a recession. Real personal consumption accelerated for goods, especially in durable goods with growth in spending on new and used autos. Services spending remained robust, with growth continuing in discretionary spending categories such as recreational services.

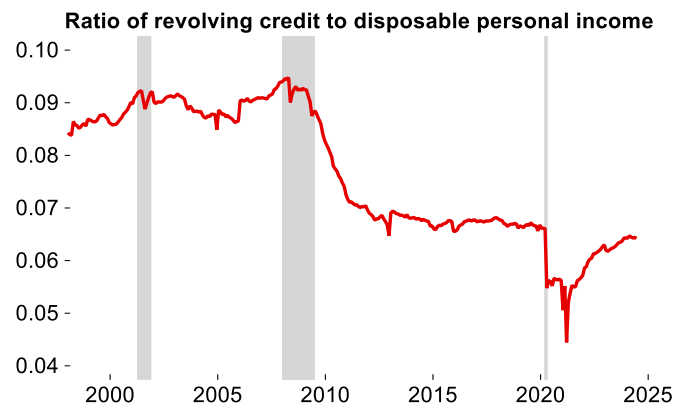
The pace of spending growth has accelerated relative to income growth, with the personal savings rate falling to 2.9%, the lowest level since June 2022 (Chart 3). Increasing levels of household net worth from booming asset values and investment and retirement accounts is supporting continued consumption growth. Historically, there is an inverse relationship between household net worth as a share of disposable income and the personal savings rate. When wealth rises, spending growth continues.

Chart 3: The personal savings rate has fallen to its lowest level in two years, indicating that spending is outpacing income



Source: BEA, MUFG Bank Economic Research Office

Chart 4: Growth in revolving credit as a share of disposable income remains below the pre-pandemic level



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

In terms of capacity to spend, households may not have significant, or any, reserves of excess savings remaining, but they are not in a position where they are forced to curb their use of credit just yet. While yes, delinquency rates are rising for credit cards and other consumer credit, but revolving debt in relation to income remains relatively low. Shown in Chart 4, the ratio of revolving consumer credit to disposable personal income remains slightly below the pre-pandemic level. Income growth has kept up with the rapid growth in credit card usage and other revolving consumer credit.

This isn't to say that strong spending growth will continue forever. There is an expectation that spending will slow by the end of this year, due in part to rising delinquency rates mentioned earlier, but households still have a capacity to spend given the growth in incomes. This should dispel expectations of a looming recession, and the idea that the Fed is far behind the curve when it comes to rate cuts.

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