US Macroeconomics

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A Clearer Disinflationary Trend Taking Shape

The personal income and consumption report for June is released this Friday. The data is of significance because it will provide us with important information on the state of consumer spending and underlying inflation. The Fed does not know this data at present, so any surprises will impact monetary policymakers as well as financial markets.

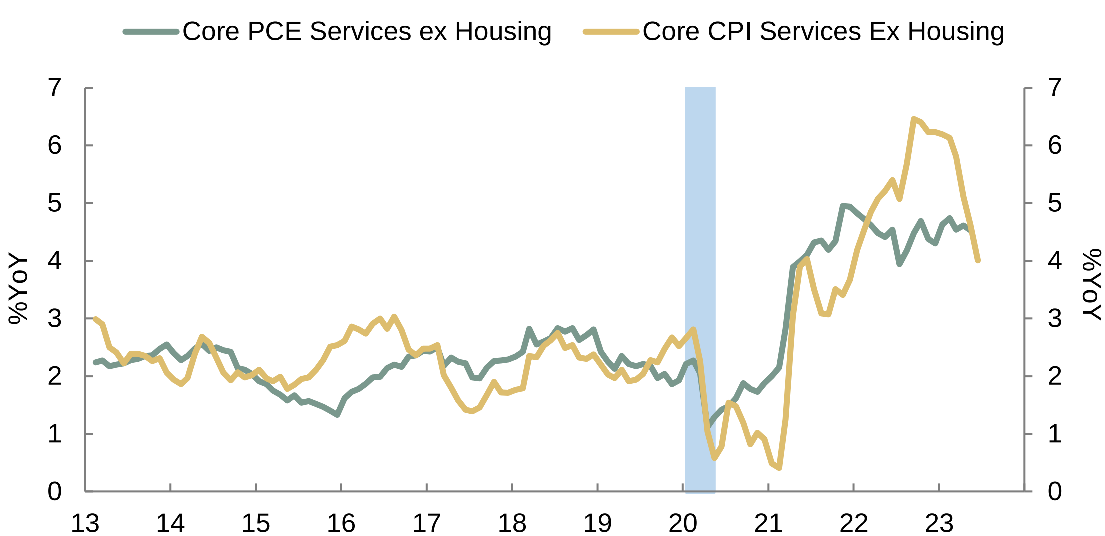
Regarding inflation-adjusted consumer spending, it can be broken down into two parts, goods and services. The former accounts for 40% of consumption and 28% of real GDP while the latter is 60% of consumption and 44% of GDP. Since total consumption accounts for 70% of the economy's output, the behavior of households is central to the outlook.

According to our calculations, real goods spendings is about 7% above its pre-covid trend as measured from 2015 to 2019. Goods purchases are expected to trend-revert and possibly fall well below trend given the fulfillment of pent-up demand. Inflation-adjusted goods outlays fell 0.4% in May and are down in three out of the last four months. In our view, this downturn has a long way to go.

Real services spending has recovered nearly in line with its pre-covid trend but is still roughly 1% below. If there is meaningful weakness in consumer spending, it is unlikely to happen here. Inflation-adjusted services spending rose 0.2% in May and is up six months in a row.

The core PCE deflator is the Fed's preferred inflation metric, but Chair Powell has highlighted a subset of this figure, core services excluding housing. This "super core" as it is colloquially known, rose 0.2% in May and is up 4.5% over the past 12 months. But **June inflation data from the consumer price index, which was reported earlier this month, suggests the super PCE core should trend lower**. See chart below.

Consequently, our best guess is that Friday's personal income and consumption report will solidify in analysts' minds a broader disinflationary trend in the most consequential subcomponents. From there the bond market will become more confident the Fed is finally done tightening. The next big question is exactly 'why' inflation has come down as forcefully as it has.



Sources: BEA, BLS, NBER, Bloomberg, Haver, SMBC Nikko

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