US Core PCE Holds Firm As Consumers Spend … For Now!

United States, Personal Income / Consumption, % m/m, August:
Actual: 0.3 / 0.3
Consensus: 0.4 / 0.3
Scotia: 0.3 / 0.3
Prior: Unrevised from 0.3 / 0.4

United States, PCE / core PCE deflators, y/y % change, August:
Actual: 2.2 / 2.0
Consensus: 2.2 / 2.0
Scotia: 2.2 / 2.0
Prior: Unrevised from 2.3 / 2.0

- The US consumer continues to perform well during the third quarter and that's helping to keep the Fed's preferred inflation measure elevated. Indeed, core PCE inflation did not follow core CPI lower, at least when rounded up (see chart). The far more important issue here lies in terms of whether the spending burst in Q2 and Q3 is sustainable. Arguments are provided below that lean toward looking through all of this to the hangover that may lie ahead into the key holiday shopping season.
- Core PCE inflation was 1.9586% y/y in August. I quote to the fourth decimal place to point to the role of rounding upward to yield the unchanged 2% print when in fact there was very marginally cooler pressure from 2.0245% core PCE inflation the prior month.
- After rising by a revised 3.8% q/q in Q2, US real consumption growth is tracking another gain of 3.2% in Q3 assuming September comes in flat. A tiny Sept gain would get the quarter up to about 3 1/2% SAAR consumption growth.
- **Growth in real consumption is outpacing incomes.** Real personal disposable income growth was only 2.5% q/q at a seasonally adjusted and annualized rate in each of Q2 and with Q3 tracking.
- **So where is the money coming from?** Getting this right may serve as a warning sign on the durability of the spurt in US consumer spending. The saving rate jumped by about a full percentage point to 7.2% in Q1 from Q4 and is pushing lower through Q2 into Q3. It stood at 6.6% in August. Why did the saving rate soar in Q1 and then begin to unwind? One reason is that a harsher and colder than seasonally usual winter depressed consumption somewhat in Q1 and this spending got deferred into Q2. The other reason is that consumers got an unanticipated positive income shock at the start of the year and they initially responded by squirrelling it away. Nuts from heaven. Real personal disposable income growth soared to 4.5% in Q1 over Q4 at a seasonally adjusted pace and then corrected to about two full points lower than that in each of Q2 and Q3. The hoarded income boost in Q1 was then spent in classic lagged fashion into Q2 and Q3. This spending gain is an overshoot on trend income growth. It is only occurring because of the transitory boost to incomes at the start of the year as companies disbursed some of the benefits of the tax changes in the TCJA and consumers got a

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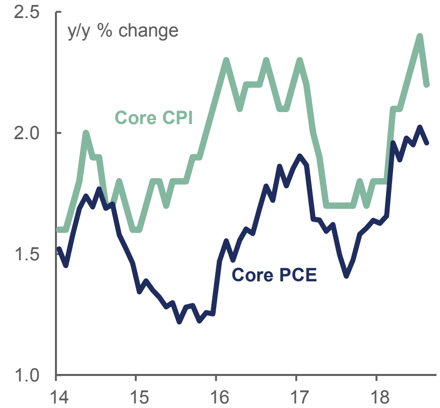
Fed's Preferred Core Inflation Will Likely Follow Core CPI Higher



Sources: Scotiabank Economics, Bloomberg.

modest tax cut that was mostly skewed toward upper income earners. This won't make America great again or drive sustained strong growth. It is classic fiscal pump priming ahead of the midterm elections on November 6th and it will likely take until after that point for reality to set in. Consumption growth may well revert to being considerably softer into year-end and beyond as demand was brought forward.