

## US Watch

## Soft inflation, strong spending keep a March cut in balance

**PCE inflation continues to run at target**

Headline and core PCE inflation both increased by 0.17% m/m, in line with expectations. As a result, three-month (3m) annualized core PCE inflation fell from 2.2% to 1.5% and the six-month annualized rate held at 1.9%. Core services remained stickier than core goods in December, but we are seeing moderation in core services ex housing, as the 3m annualized rate slowed by seven tenths to 2.2% in December. Housing inflation remains stubbornly high at 5.7% on a 3m annualized basis, but asking rent inflation suggests it's only a matter of time before that cools. December PCE inflation was also boosted by financial services, which rose by 0.5% m/m. Financial services could raise the core PCE again in January, but one offset might be a decline in used car prices.

**Spending surged in December, as expected**

Personal spending rose by a robust 0.7% in December, beating our above-consensus forecast (0.6%). Strong spending gains were largely expected after the large beat in December retail sales. Goods spending was up 0.9%, while services increased by 0.6%. Meanwhile, real spending was up 0.5%, its second-largest monthly gain of 2023. Services spending growth was modest, but relatively broad based. Core goods spending surged by 1.3%, thanks to ongoing core goods deflation (Exhibit 9). However, we think the strength in goods spending was exaggerated by favorable seasonal factors, which should get paid back in January. Since there have also been weather disruptions across the country, risks are heavily skewed towards weak January spending growth.

**Income growth slowed & the saving rate dropped sharply**

Personal income rose by a soft 0.3% m/m in December, with wages and salaries rising by 0.4%. With nominal spending significantly outpacing income gains, the saving rate plunged by 0.4pp to 3.7% (Exhibit 1). However, given the expected weakness in spending in January, the saving rate should move back to around 4%. Stronger disposable income growth might also help, given that the social security cost of living adjustment (COLA) and the shift in tax brackets, which are both functions of past inflation, were larger than in pre-Covid years. Meanwhile, our estimate of excess savings dropped to \$800bn (Exhibit 2). At the current monthly rundown pace, excess savings should continue to support consumer spending at least through the rest of 2024.

**Fed implications: March is still on the table**

The December PCE data keep a March rate cut in play. Core PCE inflation has been close to or below 2% annualized in six of the last seven months (Exhibit 8). By the March meeting, the Fed could be looking at 10 months of essentially 2% core PCE inflation. We think this makes a strong case to start cutting rates, albeit only once per quarter, in March. Markets are pricing about a 40% probability of a March cut. We think this is reasonable given that we will get a lot more inflation and labor market data before the March Fed meeting. Resilient spending could also test the Fed's resolve to cut rates, although the expected slowdown in January would help on this front.

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Timestamp: 29 January 2024 04:30AM EST

29 January 2024

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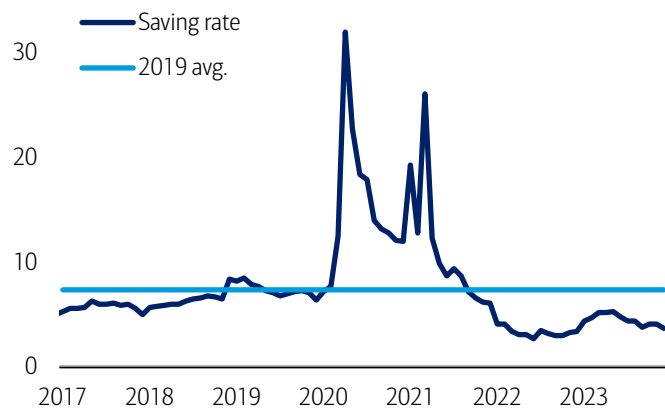
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PCE = Personal Consumption  
Expenditure

**Exhibit 1: Personal saving rate (% of disposable income)**

The saving rate was 3.7% in December

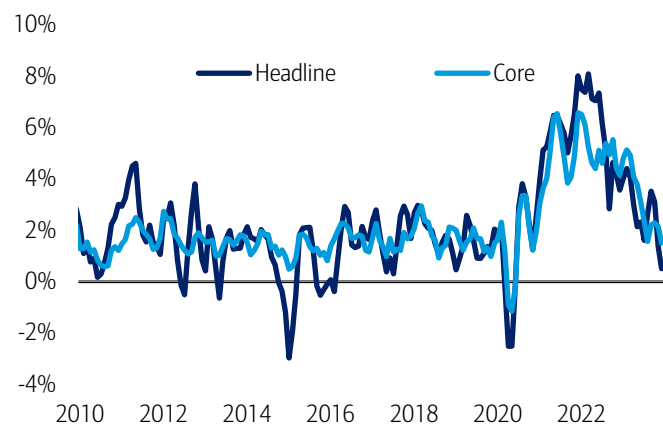


Source: Bureau of Economic Analysis (BEA)

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**Exhibit 3: Headline and core PCE inflation (3m % ch. annualized)**

Headline and core PCE inflation are both well below 2% on a 3m annualized basis

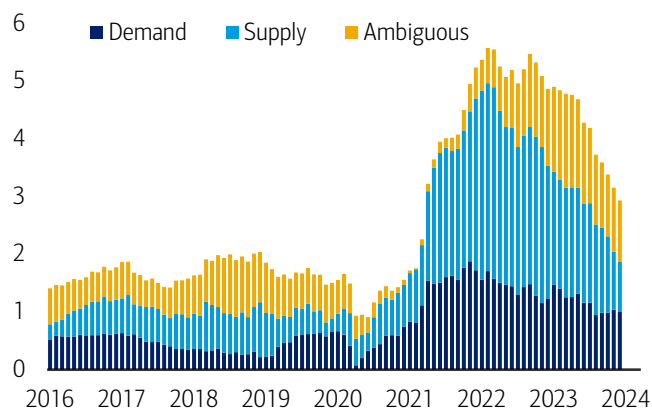


Source: BEA, Haver Analytics

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**Exhibit 5: Contributions of supply and demand to y/y core PCE inflation (percentage points (pp))**

Supply improvements have been the biggest driver of ongoing disinflation

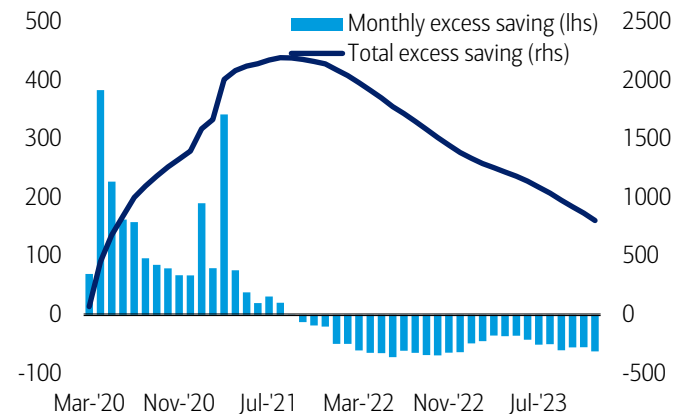


Source: BofA Global Research, Federal Reserve Bank of San Francisco, BEA

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**Exhibit 2: Excess saving (\$bn)**

We estimate that excess savings were around \$800bn in December

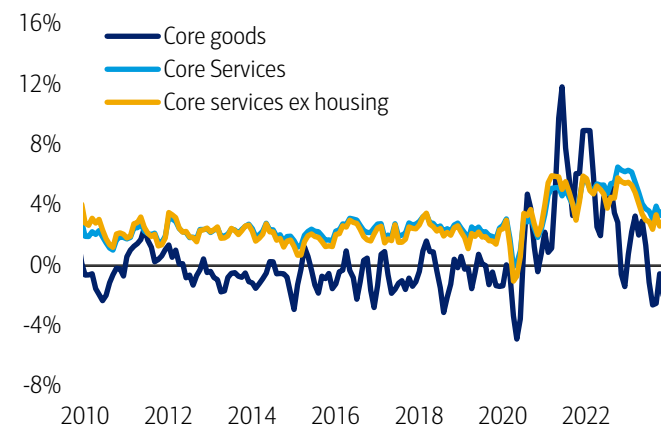


Source: BEA, Haver Analytics, BofA Global Research. Excess savings calculated by comparing actual savings to what savings would have been if the saving rate held at the 2019 average rate.

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**Exhibit 4: Core goods, services, and services ex housing inflation (3m % ch. annualized)**

Core goods inflation is deeply negative on a three-month basis

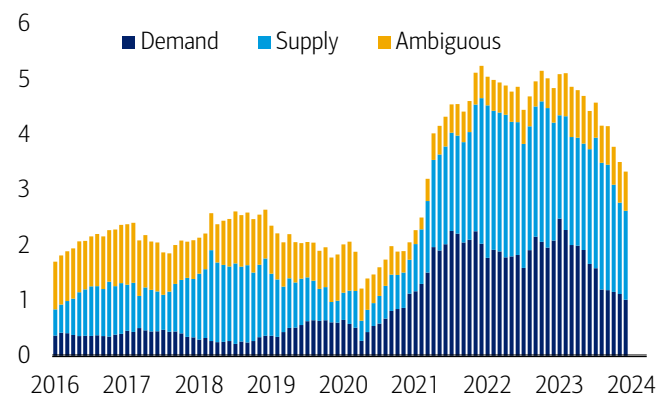


Source: BEA, Haver Analytics

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**Exhibit 6: Contributions of supply and demand to y/y core PCE services inflation ex housing (pp)**

Both supply- and demand-driven inflation have cooled off in core services ex housing

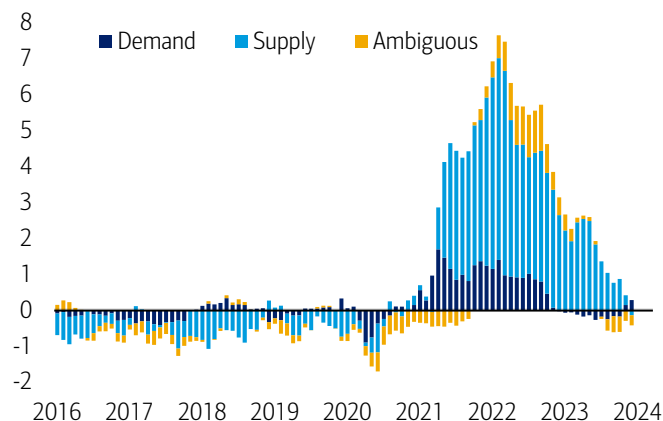


Source: BofA Global Research, Federal Reserve Bank of San Francisco, BEA

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### Exhibit 7: Contributions of supply and demand to y/y core PCE goods inflation (pp)

Supply chain normalization has driven the sharp drop in core goods inflation

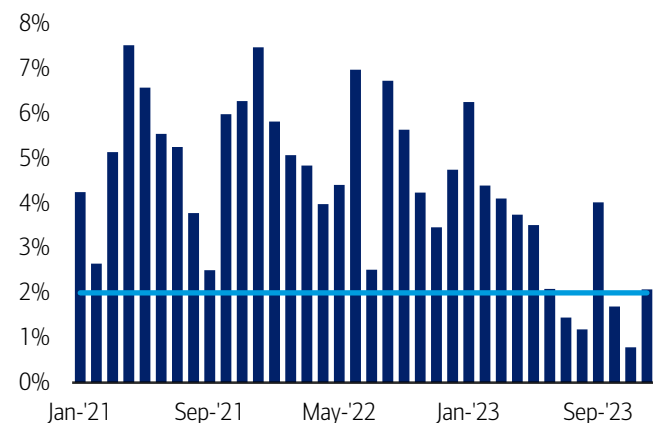


Source: BofA Global Research, Federal Reserve Bank of San Francisco, BEA

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### Exhibit 8: Core PCE inflation (m/m annualized)

Core PCE inflation has been close to or below 2% annualized in six of the last seven months



Source: BEA

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### Exhibit 9: Real consumer spending heat map (% m/m)

Real spending ended the year on a strong note

Dec 23 wt	PCE category	Dec 23	Nov 23	Oct 23	Sep 23	Aug 23	Jul 23	Jun 23	May 23	Apr 23	Mar 23	Feb 23	Jan 23
100.0%	Headline PCE	0.5%	0.5%	0.0%	0.4%	-0.1%	0.5%	0.3%	0.1%	0.1%	-0.2%	0.1%	1.0%
88.2%	Core PCE	0.6%	0.5%	0.0%	0.4%	0.0%	0.4%	0.3%	0.2%	0.2%	-0.4%	0.0%	1.4%
23.0%	Core goods	1.3%	1.0%	-0.5%	1.0%	-0.2%	1.3%	0.0%	0.4%	0.6%	-1.4%	-0.2%	3.1%
11.7%	Durable goods	1.5%	1.1%	-0.7%	1.0%	-0.3%	1.3%	0.0%	0.6%	0.7%	-1.6%	-0.3%	5.0%
4.0%	Motor vehicles & parts	1.6%	-0.7%	-1.1%	1.7%	-1.0%	1.2%	-1.6%	-1.0%	-0.2%	-2.0%	1.1%	9.3%
2.5%	Furnishings & durable HH equip.	0.6%	2.2%	-0.7%	0.5%	-0.8%	0.6%	1.1%	1.3%	0.8%	-1.9%	-2.1%	3.3%
3.7%	Recreational goods & vehicles	2.8%	2.2%	-0.4%	0.8%	0.5%	2.2%	0.9%	2.0%	1.6%	-0.9%	0.0%	2.1%
1.5%	Other durable goods	-0.1%	1.9%	-0.5%	0.9%	0.6%	0.7%	0.1%	0.7%	0.5%	-1.3%	-1.6%	3.3%
11.3%	Core nondurable goods	1.0%	0.8%	-0.2%	1.0%	-0.1%	1.2%	0.1%	0.1%	0.6%	-1.3%	-0.2%	1.1%
2.8%	Clothing & footwear	1.7%	1.7%	-0.4%	0.3%	-0.1%	1.7%	-0.3%	0.1%	0.1%	-2.0%	-1.5%	2.0%
8.5%	Other nondurable goods	0.7%	0.5%	-0.1%	1.2%	-0.1%	1.1%	0.2%	0.1%	0.8%	-1.0%	0.3%	0.8%
65.2%	Core services	0.3%	0.4%	0.1%	0.2%	0.0%	0.1%	0.3%	0.1%	0.1%	0.0%	0.0%	0.8%
15.4%	Housing	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
49.8%	Core services ex housing	0.4%	0.5%	0.1%	0.3%	0.0%	0.1%	0.4%	0.1%	0.1%	0.0%	0.0%	1.1%
16.1%	Health care	0.4%	0.2%	0.1%	0.5%	0.2%	0.2%	0.1%	0.1%	-0.1%	0.5%	0.9%	1.0%
3.3%	Transportation services	1.5%	-0.6%	0.3%	1.3%	0.6%	-0.3%	-1.0%	1.2%	1.1%	-1.1%	0.1%	0.2%
4.0%	Recreation services	0.9%	1.0%	0.7%	-0.9%	0.2%	0.2%	1.6%	-1.5%	1.4%	-0.7%	-0.3%	1.5%
7.5%	Food services & accommodations	-0.3%	1.0%	0.4%	1.1%	0.3%	0.7%	0.4%	0.6%	0.2%	-0.4%	-2.2%	3.2%
7.1%	Financial services & insurance	0.8%	0.9%	-0.5%	-1.2%	-0.8%	0.1%	1.7%	-0.1%	0.5%	0.0%	0.3%	0.0%
0.7%	Water supply & sanitation	0.0%	0.0%	0.0%	0.0%	-0.1%	-0.2%	-0.1%	-0.2%	-0.3%	0.2%	0.4%	0.5%
8.2%	Other services	0.2%	0.4%	-0.1%	1.2%	-0.8%	-0.8%	0.2%	0.2%	-1.2%	0.2%	0.5%	1.2%
3.0%	Final consumption exp. of NPISH	0.3%	0.2%	0.2%	-1.3%	1.0%	0.3%	-0.1%	0.6%	0.4%	-0.8%	-1.5%	-0.8%
11.8%	Non-core PCE	0.3%	-0.1%	0.2%	-0.2%	-0.2%	1.1%	0.2%	-0.3%	-0.4%	1.2%	0.7%	-1.8%
7.7%	Food	0.4%	0.5%	-0.1%	0.1%	-0.2%	0.4%	0.1%	0.2%	0.4%	-0.6%	0.1%	-0.1%
4.1%	Energy goods & services	0.1%	-1.1%	0.7%	-0.7%	-0.2%	2.5%	0.4%	-1.4%	-1.8%	4.5%	1.9%	-4.9%

Source: BEA

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**Exhibit 10: Personal income and spending**

## Summary table

	Dec-23	Nov-23	Oct-23	Sep-23	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22
<b>Personal income</b>													
%m/m	0.3%	0.4%	0.3%	0.3%	0.4%	0.2%	0.2%	0.3%	0.2%	0.5%	0.5%	1.0%	0.2%
%y/y	4.7%	4.6%	4.3%	4.6%	4.8%	4.8%	5.4%	5.6%	5.7%	5.8%	5.7%	5.8%	4.5%
<b>Compensation of employees</b>													
%m/m	0.4%	0.5%	0.2%	0.4%	0.5%	0.4%	0.5%	0.4%	0.4%	0.5%	0.6%	1.5%	0.1%
%y/y	6.5%	6.2%	5.5%	5.1%	5.4%	5.7%	6.6%	6.5%	6.3%	6.1%	5.9%	5.9%	4.3%
<b>Wages and salaries</b>													
%m/m	0.4%	0.5%	0.2%	0.4%	0.5%	0.4%	0.5%	0.4%	0.4%	0.6%	0.6%	1.6%	0.0%
%y/y	6.8%	6.4%	5.7%	5.2%	5.6%	5.8%	6.9%	6.8%	6.6%	6.4%	6.2%	6.1%	4.4%
<b>Disposable personal income</b>													
%m/m	0.3%	0.4%	0.3%	0.3%	0.4%	0.1%	0.1%	0.4%	0.5%	0.6%	0.6%	2.6%	0.4%
%y/y	6.9%	7.1%	6.9%	7.3%	7.5%	7.8%	8.7%	9.1%	9.2%	9.0%	8.9%	8.9%	4.5%
<b>Personal consumption expenditure</b>													
%m/m	0.7%	0.4%	0.0%	0.8%	0.3%	0.6%	0.4%	0.2%	0.4%	-0.1%	0.4%	1.6%	0.3%
%y/y	5.9%	5.5%	4.9%	5.5%	5.4%	5.9%	5.3%	5.9%	6.1%	6.3%	7.6%	7.9%	6.8%
<b>Goods</b>													
%m/m	0.9%	-0.1%	-0.5%	0.8%	0.7%	0.6%	0.1%	0.1%	0.8%	-1.2%	0.3%	2.6%	-0.6%
%y/y	5.0%	3.4%	2.1%	3.4%	3.0%	2.7%	1.4%	2.5%	2.6%	2.3%	5.3%	5.4%	4.2%
<b>Durable goods</b>													
%m/m	1.1%	0.7%	-1.0%	0.9%	-0.6%	0.6%	-0.4%	0.9%	0.8%	-1.6%	-0.5%	5.2%	-0.4%
%y/y	6.1%	4.5%	0.9%	2.6%	2.2%	3.8%	3.7%	4.4%	1.9%	2.4%	4.4%	3.7%	1.7%
<b>Nondurable goods</b>													
%m/m	0.8%	-0.6%	-0.3%	0.7%	1.4%	0.6%	0.4%	-0.3%	0.9%	-1.0%	0.7%	1.1%	-0.8%
%y/y	4.5%	2.8%	2.8%	3.8%	3.5%	2.1%	0.1%	1.5%	3.0%	2.3%	5.9%	6.3%	5.6%
<b>Services</b>													
%m/m	0.6%	0.6%	0.3%	0.7%	0.1%	0.6%	0.6%	0.3%	0.3%	0.5%	0.4%	1.1%	0.8%
%y/y	6.3%	6.5%	6.3%	6.6%	6.7%	7.6%	7.4%	7.6%	7.9%	8.4%	8.8%	9.3%	8.2%
<b>Saving rate (%)</b>													
	3.7	4.1	4.1	3.8	4.4	4.4	4.8	5.3	5.2	5.2	4.7	4.4	3.4
<b>PCE inflation</b>													
%m/m	0.2%	-0.1%	0.0%	0.4%	0.4%	0.1%	0.2%	0.1%	0.3%	0.1%	0.3%	0.6%	0.2%
%y/y	2.6%	2.6%	2.9%	3.4%	3.3%	3.3%	3.2%	4.0%	4.4%	4.4%	5.2%	5.5%	5.4%
<b>Core PCE inflation</b>													
%m/m	0.2%	0.1%	0.1%	0.3%	0.1%	0.1%	0.2%	0.3%	0.3%	0.3%	0.4%	0.5%	0.4%
%y/y	2.9%	3.2%	3.4%	3.6%	3.7%	4.2%	4.3%	4.7%	4.8%	4.8%	4.8%	4.9%	4.9%
<b>Billions of Chained 2012 Dollars</b>													
<b>Personal income</b>													
%m/m	0.1%	0.5%	0.2%	-0.1%	0.1%	0.1%	0.0%	0.2%	-0.1%	0.4%	0.2%	0.4%	0.0%
%y/y	2.0%	1.9%	1.4%	1.2%	1.4%	1.5%	2.2%	1.6%	1.2%	1.3%	0.5%	0.3%	-0.9%
<b>Personal income ex transfer payments</b>													
%m/m	0.1%	0.6%	0.3%	0.1%	0.2%	0.3%	0.1%	0.2%	0.0%	0.4%	0.2%	0.6%	0.0%
%y/y	3.1%	3.0%	2.2%	1.6%	1.8%	1.9%	2.6%	2.1%	1.8%	1.8%	1.0%	0.6%	-0.6%
<b>Disposable personal income per capita</b>													
%m/m	0.0%	0.4%	0.3%	-0.1%	0.0%	-0.1%	-0.1%	0.3%	0.2%	0.4%	0.3%	2.0%	0.2%
%y/y	3.7%	3.8%	3.4%	3.3%	3.5%	3.8%	4.8%	4.5%	4.0%	3.9%	3.0%	2.8%	-1.4%
<b>Personal consumption expenditures</b>													
%m/m	0.5%	0.5%	0.0%	0.4%	-0.1%	0.5%	0.3%	0.1%	0.1%	-0.2%	0.1%	1.0%	0.1%
%y/y	3.2%	2.7%	1.9%	2.1%	2.0%	2.5%	2.1%	1.8%	1.6%	1.7%	2.3%	2.3%	1.3%
<b>Goods</b>													
%m/m	1.1%	0.6%	-0.2%	0.6%	-0.1%	0.9%	0.2%	0.2%	0.5%	-1.0%	0.1%	2.0%	-0.1%
%y/y	5.0%	3.7%	1.9%	2.5%	2.3%	2.9%	1.8%	1.3%	0.4%	0.4%	1.7%	0.9%	-0.5%
<b>Durable goods</b>													
%m/m	1.5%	1.1%	-0.7%	1.0%	-0.3%	1.3%	0.0%	0.6%	0.7%	-1.6%	-0.3%	5.0%	-0.2%
%y/y	8.5%	6.7%	3.1%	5.1%	4.1%	4.8%	4.3%	4.0%	1.4%	2.0%	4.1%	3.1%	0.2%
<b>Nondurable goods</b>													
%m/m	0.9%	0.3%	0.1%	0.4%	0.0%	0.7%	0.3%	0.0%	0.5%	-0.7%	0.3%	0.4%	-0.1%
%y/y	3.1%	2.1%	1.3%	1.1%	1.3%	1.9%	0.4%	-0.1%	-0.1%	-0.5%	0.4%	-0.4%	-0.9%
<b>Services</b>													
%m/m	0.3%	0.4%	0.1%	0.2%	0.0%	0.3%	0.3%	0.1%	-0.1%	0.2%	0.0%	0.5%	0.2%
%y/y	2.3%	2.3%	1.9%	1.9%	1.8%	2.3%	2.2%	2.1%	2.2%	2.5%	2.6%	3.1%	2.2%

Source: BEA, Haver Analytics, BofA Global Research

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