Watch for consumer stress as inflation remains top concern

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Next week the focus will be on the PCE deflators as inflation pressures remain a top concern. We expect core PCE to report a 0.2% m/m rise, keeping the y/y pace at 3.3%. We look for headline PCE to rise 0.1% m/m, knocking the y/y pace lower to 3.6%. On net we expect the PCE deflators to report in line with CPI – the July core CPI print reported a 0.2% m/m rise that was helped by notable declines in leisure and hospitality related sectors (hotel prices and auto rentals). But those sectors will be less impactful in PCE because of weighting. Importantly, the heavier weighted PPI components that matter most for PCE were a mixed bag.

PPI for portfolio management and investment advice spiked in July alongside nursing care. But PPI for hospitals was benign and PPI for domestically scheduled air transportation was negative (in contrast to airline fares in CPI which is due to methodological differences). But the trajectory of y/y pace of core inflation is unlikely to improve this year. Core goods prices re-accelerated in July due to demand-driven technology input price surges, and persistent pressure on energy prices, which we expect will continue to push up transportation costs and weigh on trade margins. A new round of tariffs won’t help the trend. In fact, even in a scenario where core PCE prints 0.1% m/m for the remainder of the year, we would not see core PCE return to the Fed’s 2.0% y/y target (see chart below). Nonetheless, we continue to expect the Fed will remain on pause for the rest of 2026.

On the consumer front, we expect personal spending will continue to slow to 0.1% m/m in July, as the tailwinds from tax returns dissipate, and elevated gas prices weigh on household budgets. In part, the July slowdown reflects goods spending that was pulled forward – Amazon Prime Day fell in June instead of July this year, and Apple announced price increases at the end of June. The fall in gas prices also contributed to the decline in retail sales, but in the broader spending report, we continue to monitor the strength in services sector spending (we look for services spending to rise 0.4% m/m) against the backdrop of consumer stress.

In our view, the US demand backdrop remains intact, supported by high-income households and retirement spending. We see this cohort driving recreational services spending as they continue to prioritize experiences. Transportation spending will likely moderate alongside energy prices, though higher utility costs and summer heatwaves will likely offset some of that reprieve. Meanwhile, strong gains in the S&P 500 should translate to a hotter financial services print.

But the personal saving rate has seen a steady decline since 2024 and currently sits at a concerning 2.7%, meaning an important buffer is eroding. Another headwind for households is the non-mortgage interest expense payment (i.e., interest on student and auto loans, credit cards, etc.). It has been hovering around 2.5% of disposable personal income for the past two years despite the Fed’s rate cuts. If the Fed were to hike interest rates, the interest payment burden would likely climb to concerning levels.

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