Firm spending and softer inflation boost the US soft landing thesis

Consumers continued to spend in respectable moderation in June while inflation data softened further and key labour cost metrics undershot expectations, boosting hopes that inflation can return to target without the need for further Fed rate hikes and a recession

1% QoQ increase in 2Q employment costs

Healthy spending and encouraging inflation boost soft landing hopes

This morning's US macro data is another nice combination that fits the soft landing narrative the market is currently enamoured with. While strongly hinted at in yesterday's 2Q GDP report, we get confirmation of decent consumer spending in June, but not too hot with real personal spending up 0.4% month-on-month (consensus 0.3%) while May was revised up from 0.0 to 0.1%. Yet at the same time, the inflation metrics are softer with the core personal consumer expenditure deflator – a broader measure of inflation than CPI - confirmed at 0.2% month-on-month/4.1% year-on-year. This is down from 4.6% YoY and is lower than the 4.2% expected. In fact, if we look at three decimal places, we have a 0.161% MoM rise in the core PCE deflator.

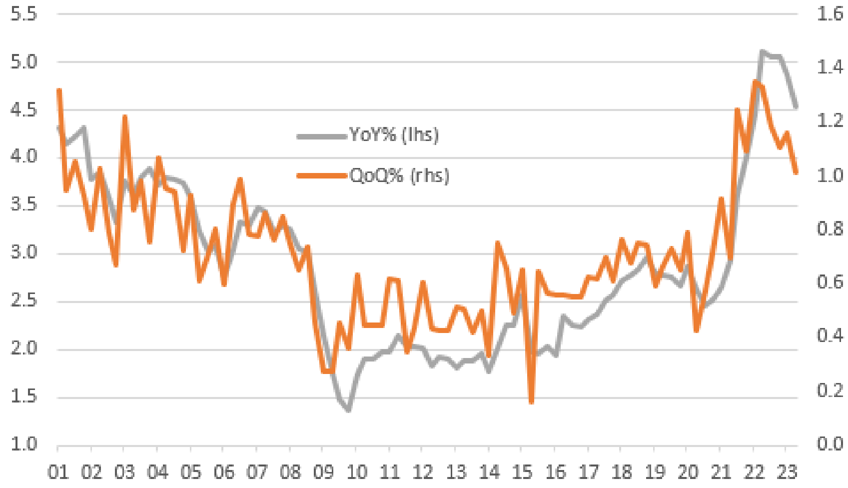
Key service sector inflation metrics (YoY%)

Source: Macrobond, ING

Labour costs are cooling, fuelling hopes of a sustainable return to 2%

Perhaps most significant is the softer employment cost index. It grew 1% quarter-on-quarter in 2Q down from 1.2% in 1Q and below the 1.1% rate expected. This is the slowest rate of increase since 2Q 2021 and importantly was referenced by Fed Chair Jerome Powell in his FOMC press conference earlier in the week as a really important metric officials are focused on. Wages slowed to 1% QoQ from 1.2% while benefits slowed to 0.9% QoQ from 1.2% and this tallies with the commentary from the Fed's own beige book that stated: "contacts in multiple Districts reported that wage increases were returning to or nearing pre-pandemic levels".

Employment cost index (QoQ%)



Source: Macrobond, ING

This should give us greater confidence that the Fed's focal point on inflation - core services ex shelter – will continue to slow, just as goods prices and housing are slowing and we can realistically get back to the 2% target without much further, if any, policy tightening.

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