

US inflation is too hot but softening fundamentals point to an eventual cooling

The Fed's favoured measure of inflation came in at 0.4% month-on-month, which is double the 0.2% rate we want to see, but cooling incomes and spending suggest inflation will moderate again in coming months, leaving the door open to a June Federal Reserve rate cut



The Fed's favoured measure of inflation came in at 0.2% month-on-month

0.4%
MoM

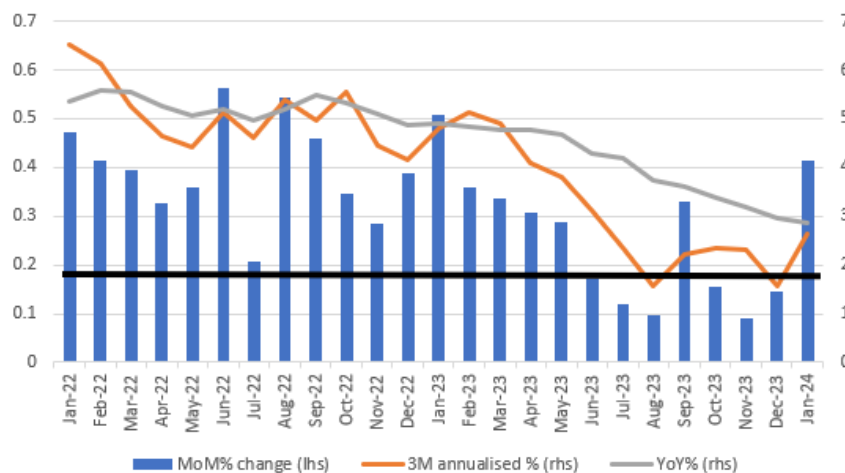
Increase in core personal consumer expenditure deflator

Inflation jumps 0.4% MoM, but at least no new surprises

So the core PCE deflator did indeed come in at 0.4% MoM/2.8% YoY as the market had anticipated following those elevated core CPI and PPI prints – but given the recent performance of US data the fear was we could get yet another upside surprise. This is the Fed's favoured inflation metric to follow (it is broader in coverage than CPI and in the Fed's view better represents the spending patterns of the US consumer). The super-core measure, which strips out housing from core services came in at 0.6% MoM. There was a downward revision to December, now reporting a 0.1% MoM increase versus 0.2% initially reported.

While today's number in itself is too hot for the Federal Reserve to contemplate an imminent rate cut, we have to acknowledge that for six out of the past eight months we have been tracking below the 0.17% MoM rate we need to consistently hit to bring annual inflation back to 2% over time. While February may also remain a little hot (remember lots of services change their fee structure at the start of the year), we look for a return to numbers in the 0.2% area from March onwards, helped by factors elsewhere in the personal spending and income report.

The core personal consumer expenditure deflator, MoM%, 3M annualised & YoY%



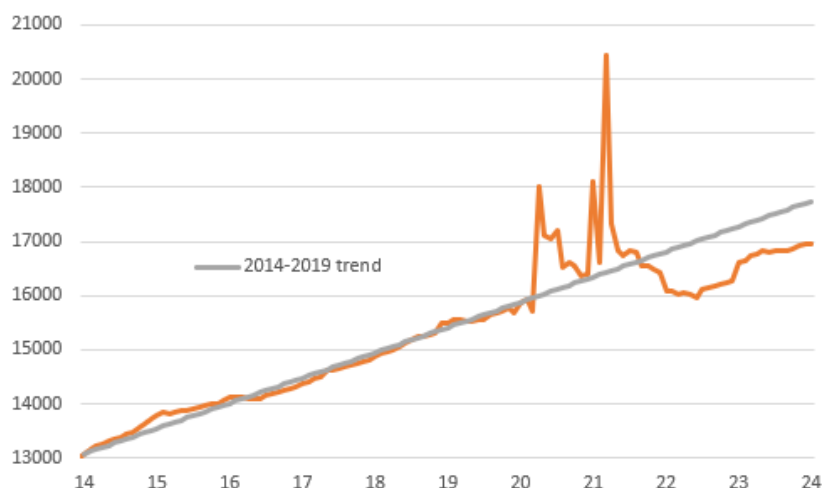
Source: Macrobond, ING

Softening income & spending should help deliver slower inflation

January personal income did rise a lot more than expected, increasing 1% MoM versus the 0.4% consensus with worker compensation increasing 0.4% MoM, dividend income jumping and a 2.6% increase in transfer payments, largely reflecting the cost of living adjustment (3.2%) for social security recipients. However, importantly, there was a 6% MoM increase in tax payments and with inflation still eating into spending power, real household disposable income was a very disappointing 0% MoM. Given this is the primary source of funds to fuel real consumer spending growth in an environment where households have largely run down pandemic era accrued savings and the costs of consumer credit are so high, this suggests that 2024 spending growth should trend quite a bit softer than in 2023.

Indeed, we got a negative 0.1% MoM reading for real consumer spending in January. Weaker spending growth should gradually help dampen inflation pressures so while there is little prospect of an imminent interest rate cut, we think there will be enough information to trigger a Federal Reserve response at the June FOMC meeting as it starts to move monetary policy back to a more neutral footing.

Real household disposable income (\$bn) versus pre-pandemic trend



Source: Macrobond, ING

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10

Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.