Daiwa Capital Markets

U.S. Data Review

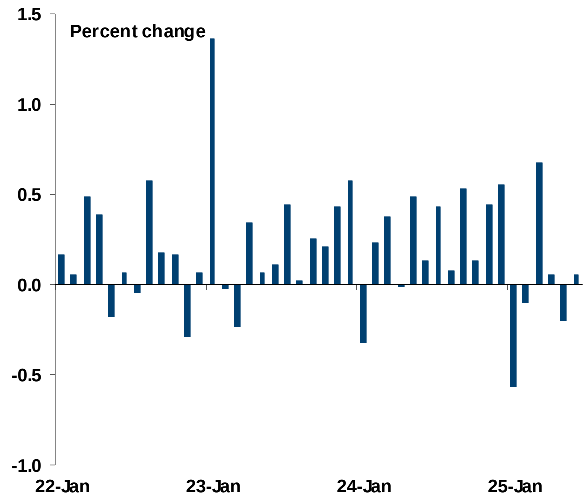
- Real consumer spending: tepid growth in June
- Personal income: constrained by moderating wage growth
- PCE price index: in line with consensus; awaiting brunt of tariff-related pressure
- Employment cost index: compensation growth higher than expected in Q2 though not problematic with respect to 2 percent inflation

Lawrence Werther
lawrence.werther@us.daiwacm.com
+1-212-612-6393
Brendan Stuart
brendan.stuart@us.daiwacm.com
+1-212-612-6172

Personal Income & Outlays

- The Personal Income and Outlays report for June contained few surprises, as tepid real consumer spending for Q2 was a focal point in yesterday's GDP release (+1.4 percent, annual rate, after a pickup of 0.5 percent in Q1) and also a topic of discussion in Chair Powell's post-FOMC press conference (where the Fed Chair speculated that the easing in household spending long anticipated by forecasters may now be coming to fruition). Additionally, views on the PCE price index were already shaped by previously released data on the consumer and producer price indexes. All told, household activity may be sending warning signs, and inflation bears watching as tariff-related price increases filter through the economy.

Real Consumer Spending Growth



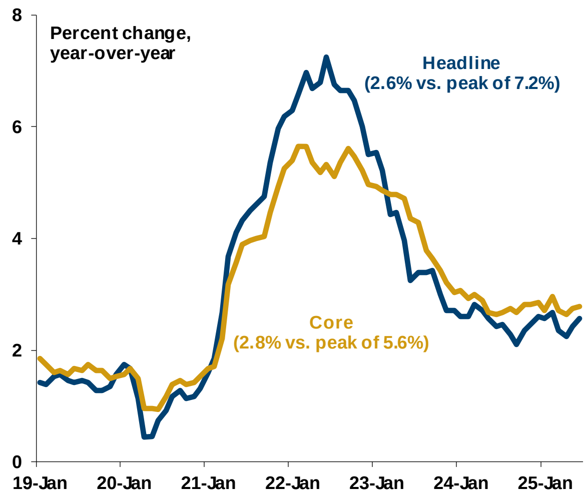
Source: Bureau of Economic Analysis via Haver Analytics

- On the spending front, the increase of 0.3 percent in nominal personal consumption expenditures lagged the Bloomberg median expectation of an advance of 0.4 percent, with the results translating to a real pickup of 0.1 percent (matching expectations, but rounding up to that tally: +0.058 percent; chart). The latest gain followed a dip of 0.2 percent in the prior month and reflected significantly a jump of 1.9 percent in outlays for gasoline and other energy goods. Contrastingly, many other areas recorded declines. On the goods front, total real outlays rose only 0.1 percent (spending on durable contracted 0.5 percent, while those of nondurable items – which included household energy expenditures – rose 0.4 percent). Real outlays for services were soft (+0.1 percent), including a drop of 0.7 percent in recreation services, a category encompassing mostly discretionary areas.

- Corresponding to the lackluster consumption numbers, nominal personal income rose moderately (+0.3 percent versus +0.2 percent expected). While the headline number was a bit better than anticipated, it followed a decline in the prior month and was below the trailing 12-month average of 0.4 percent. Government transfer payments, which have been volatile lately, accounted for much of the weakness in total income in the prior month and contributed to the latest advance, while wage growth (a key determinant of household spending) recorded its slowest advance since July 2024 and could be beginning to reflect softening labor market conditions.

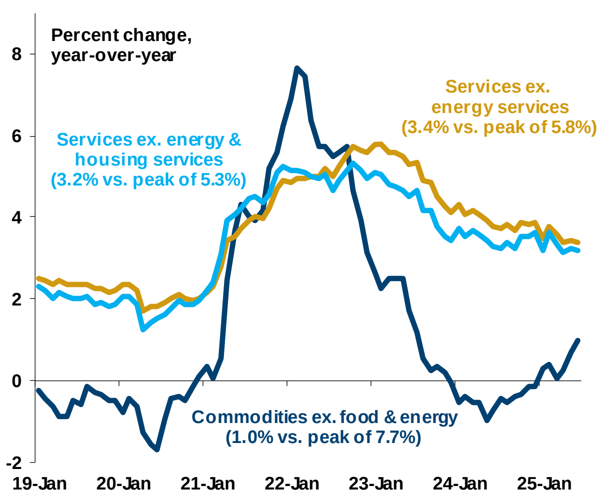
- On the inflation front, both the headline and core Personal Consumption Expenditure Price Indexes rose 0.3 percent (+0.281 percent and +0.256 percent, respectively, with less rounding). The changes translated to year-over-year advances of 2.6 percent for the headline measure (versus +2.5 percent expected) and 2.8 for core (versus +2.7 percent anticipated; charts, next page). In his remarks yesterday, Chair Powell seemed sanguine about the trajectory of core service inflation, although he emphasized risks on the goods front generated by tariffs. In that regard, we expect the core PCE index to peak in the area of 3.2 percent in late 2025 before again slowing in 2026. Thus, as we still view tariff effects as likely to manifest in a one-off price level increase (rather than a more persistent inflation event), we expect rate cuts later this year in response to softening labor market conditions (-25 basis points expected at each of the September and December FOMC meetings).

PCE Inflation



Source: Bureau of Economic Analysis via Haver Analytics

Decomposition of Core PCE Inflation

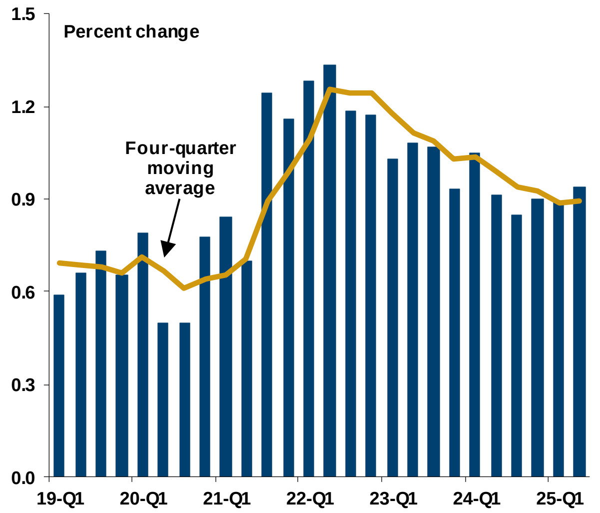


Source: Bureau of Economic Analysis via Haver Analytics

Employment Cost Index

- Total compensation costs increased 0.9 percent (not annualized) in the second quarter of 2025 – one tick faster than the Bloomberg survey median expectation of 0.8 percent and the third consecutive reading of that magnitude (chart). While the latest reading was close to other recent observations, it slowed from the 2023 and 2022 averages of +1.0 and +1.2 percent, respectively, which occurred during a period of tighter conditions in the labor market. On a year-over-year basis, compensation costs rose 3.6 percent in Q2, in line with the read in the previous quarter but down from the recent high of 5.1 percent in 2022-Q2.

Employment Cost Index: Total Compensation



Source: Bureau of Labor Statistics via Haver Analytics

- The wages and salaries component advanced 1.0 percent in the latest quarter, faster than the 0.8 percent increase in Q1 but still off the cycle peak of 1.4 percent in 2022-Q2. Year-over-year wage growth, in turn, firmed up to 3.6 percent from 3.5 percent in the prior quarter, though it is down from the recent high of 5.3 percent in 2022-Q2.

- After an upside surprise of 1.2 percent in the opening quarter of the year, growth of benefits costs eased 0.5 percentage point to 0.7 percent in 2025-Q2 – a read markedly off the recent peak of 1.5 percent in 2022-Q1. The year-over-year gain of 3.5 percent eased from 3.8 percent in 2025-Q1 and the cycle peak advance of 4.9 percent in 2022-Q3.

- Broadly speaking, the ECI report, which Fed officials view as the more reliable data series on compensation trends on account of its fixed weights (i.e., it tracks compensation trends in the same positions over time versus being influenced by compositional shifts in hiring as average hourly earnings is), supports the notion that labor costs have cooled in response to the recent recalibration in previously tight labor market conditions. In other words, wage growth is no longer inconsistent with the Federal Reserve's 2 percent inflation target.