

Consumer Spending Continues to be Buffeted by High Inflation

Updated 26 August 2022

Real consumer spending and income increased modestly in July starting the third quarter off on better footing compared to the end of the second quarter. However, overall consumer inflation remained near 40-year peaks driven higher by food and services prices. Less food and energy, core consumer inflation ticked lower but also remained elevated and well above the Fed's 2-percent inflation target.

Insights for What's Ahead

- The data suggest that real consumer spending may be tepid in the third quarter. Spending in July was up just 0.8 percent annualized above the entirety of the second quarter level. We project spending to rise by just 0.5 percent annualized in 3Q 2022 and for real GDP growth to be flat.
- Consumer inflation readings suggest that year-over-year increases in prices likely peaked around mid-year, consistent with our forecast. Still, we anticipate that the PCE deflator both overall and less food and energy may not retreat to the Fed's 2-percent target until sometime in 2024.
- The slower US economic growth presently is to be expected given Fed monetary policy tightening. Weak consumption growth notwithstanding, we still expect the Fed to continue to raise rates (likely to 3.75-4.00 percent) into 2023 to tackle persistently high inflation.

Data Overview

Nominal consumer spending rose by 0.2 percent month-over-month in July after rising by 1.0 percent in June. In real terms, spending was also up 0.2 percent in the month, but after being flat at the end of the second quarter. Real spending on goods were 0.2 percent

higher but weighed down slightly by nondurable goods, which fell in the month. Services continued to steadily rise as households rebalance their consumption of goods versus services post-pandemic.

Nominal personal income increased by 0.2 percent month-over-month, but was up 0.3 percent in real terms as inflation was slightly less intense. Still, year-over-year real income growth continues to be negative, and spending is increasingly being financed by credit according to consumer credit data.

The headline personal consumption expenditures (PCE) deflator dipped by 0.1 percent month-over-month, but remained near 40-year highs year-over-year at 6.3 percent. The monthly decline reflected lower prices for select durable goods and gasoline. Grocery prices continued to rise. Less food and energy, the core PCE deflator increased by 0.1 percent month-over-month but slowed to 4.6 percent year-over-year. The slower pace of increase is constructive, but still shows a glacial rate of easing in inflationary pressures. Within the detail, energy related services prices (e.g., natural gas and airline transportation) cooled, but costs for most other services, especially rents (actual and imputed), continued to levitate.

Consumer Price Inflation Remains Extremely Elevated

US Consumer Price Inflation (Y/Y%)



Source: Bureau of Economic Analysis and The Conference Board.

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