Growth Revised Higher with Sticky Inflation

A wave of economic data this morning showed economic growth revised higher while business investment remained firm. Meanwhile, strong spending alongside elevated inflation continues to cloud the Fed's outlook, as markets appear to be leaning toward lower inflation readings ahead.

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May PCE Inflation

The Fed's preferred inflation measure rose 0.4% in May, below the 0.5% expectation, while core PCE increased 0.3%, in line with forecasts. However, the Bureau of Economic Analysis also revised the April PCE core higher, reinforcing recent price pressure.

On a year-over-year basis, headline PCE rose to 4.1%, the highest in over three years, while core increased to 3.4%. The monthly readings were soft enough to ease near-term concerns, but the broader trend still reflects sticky inflation.

The early read on June inflation is more encouraging. The Cleveland Fed's Inflation Nowcast estimates June CPI at 0.0% month-over-month and core CPI at 0.2%, while PCE is tracking near 0.1% and core PCE around 0.3%. On a year-over-year basis, the nowcast shows headline PCE easing to 3.8% in June, while core PCE is estimated at 3.3%, slightly below May's reading. If these estimates hold, May could be the near-term peak in inflation, giving markets some confidence that the worst of the recent price pressures might be behind us.

Personal Income and Spending

Both personal income and spending rose 0.7% in May, beating expectations. After adjusting for inflation, real spending increased 0.3%, a modest improvement from April that should support second-quarter growth.

However, spending continues to outpace real income growth, suggesting consumers are maintaining their ability to purchase goods and services but gradually losing purchasing power and drawing down savings.

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Q1 GDP Revision

First-quarter GDP was revised higher to 2.1% from 1.6%, though the breakdown was less encouraging. Consumer spending was revised lower, while a significant downward revision to imports accounted for most of the improvement in growth.

Net exports were a much smaller drag in the final estimate. The takeaway is that headline growth was stronger than initially reported, but underlying demand was somewhat softer.

Durable Goods Orders

Durable goods orders, as reported by the Census Bureau, fell 4.5% in May following an

8.5% gain in April, reflecting volatility in aircraft orders. The more important signal came from core capital goods orders (nondefense ex-aircraft), which rose 1.6% and have remained strong in recent months. This points to continued momentum in business investment, suggesting the capital spending cycle remains a positive contributor to overall economic growth.

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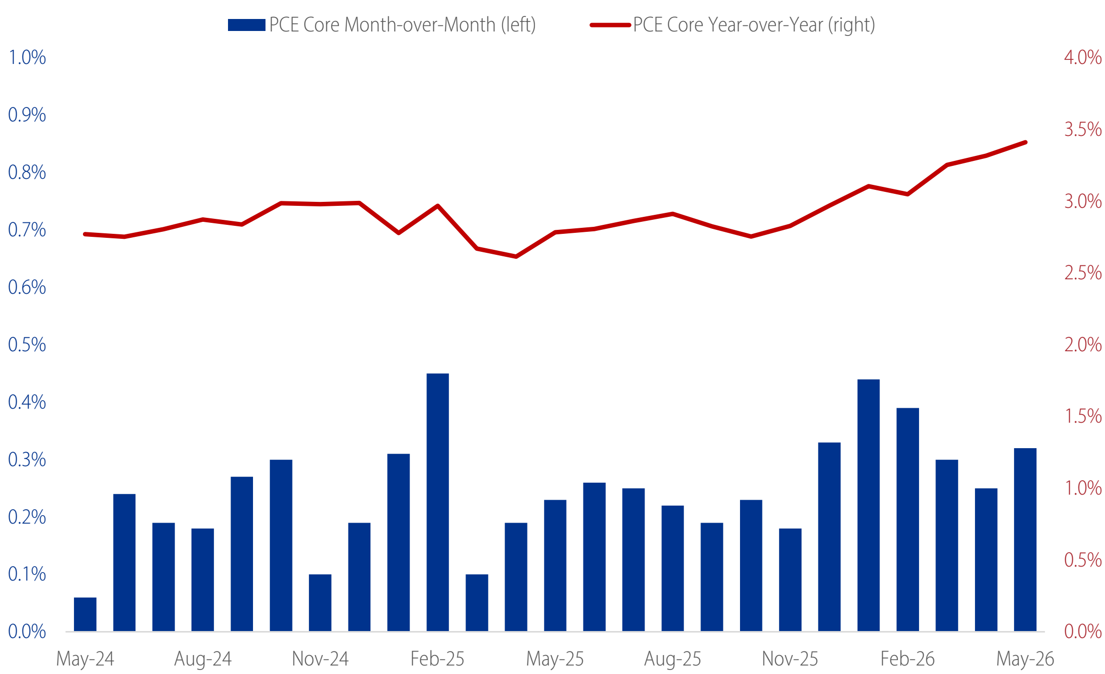
Market Reaction

Markets reacted positively to the inflation data, with Treasury yields moving lower on the day, down about 8–10 basis points over the past two sessions in a modest rally. Looking ahead, tomorrow's University of Michigan Consumer Sentiment report will provide an updated read on confidence and inflation expectations. The June final measure is expected to improve from May's all-time low, though sentiment remains historically weak. Overall, rate expectations have edged lower, with markets pulling back modestly on the likelihood of additional Fed tightening.

Personal Consumption Expenditures Core Price Index (Percent Change)

Core PCE is running 0.3% MoM and 3.4% YoY, elevated, but inflation may be starting to stabilize, with some relief ahead.



Source: Bureau of Economic Analysis

Market Indications as of 12:02 P.M. Central Time

DOW	Up 200 to 52,049 (NEW HIGH)
NASDAQ	Down -149 to 25,328 (HIGH: 27,094)
S&P 500	Down -6 to 7,352 (HIGH: 7,610)
1-Yr T-bill	current yield 3.94%; opening yield 3.96%
2-Yr T-note	current yield 4.11%; opening yield 4.15%
3-Yr T-note	current yield 4.11%; opening yield 4.15%
5-Yr T-note	current yield 4.15%; opening yield 4.19%
10-Yr T-note	current yield 4.38%; opening yield 4.40%
30-Yr T-bond	current yield 4.85%; opening yield 4.85%