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Goods inflation has temporarily returned

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- Monthly growth in core PCE services inflation has fallen back close to target, around 2% at an annual rate, but growth in core goods has entered positive territory after being deflationary since June of last year. Geopolitical risks stemming from the Red Sea have likely contributed to this growth, helping to raise import prices, but the effects are fading.
- Real income growth was comparatively weak in February, and spending remained relatively strong. Easing of labor market and wage pressures are helping to bring core services inflation back into balance, but the effect on real incomes is negative. Despite this, growth in household net worth may help sustain spending growth and keep savings rates relatively low.

Core goods inflation re-entered positive territory

February's PCE Price Index may be better news for the Fed than the top line figure suggests. Core inflation eased to 3.2% at an annualized monthly rate, down from 5.6% in January, but it is the second highest monthly growth rate since September of last year (Chart 1). This isn't particularly worrisome because growth in February was driven by core goods, which in this case, very well may be transitory.

Geopolitical risks stemming from the Red Sea likely contributed February's price growth. Around 30% of global container shipments transit through the Red Sea, and the average Drewry World Container Index level more than doubled from December 2023 to February 2024. The good news is that pressures have since subsided, evidenced by slower growth in container shipping indexes from Drewry and the Shanghai Shipping Exchange. The impact on prices will likely fade by March or April.

Month growth in core services excluding housing has fallen to 2.2% at an annual rate, the slowest growth since November 2023 (Chart 1), and annual growth eased to 3.3%, down from 3.5% in January (Chart 2).

Chart 1: Core goods have re-entered positive growth territory, but the effect will likely be transitory

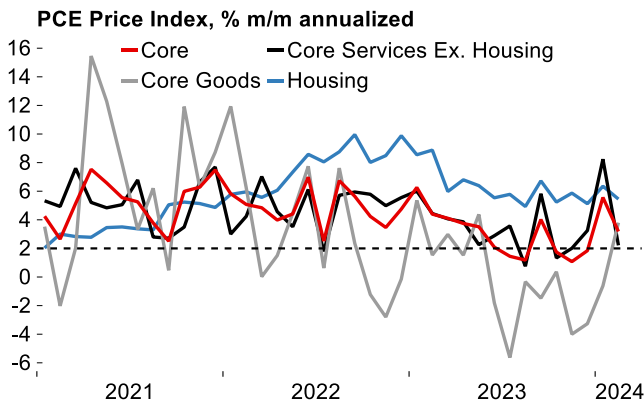
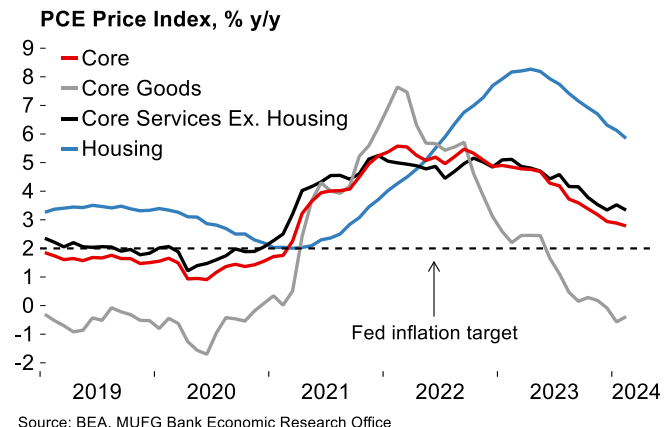


Chart 2: Inflation is generally headed toward the Fed's 2% target, though bumps are expected along the way



Rising household net worth may sustain spending

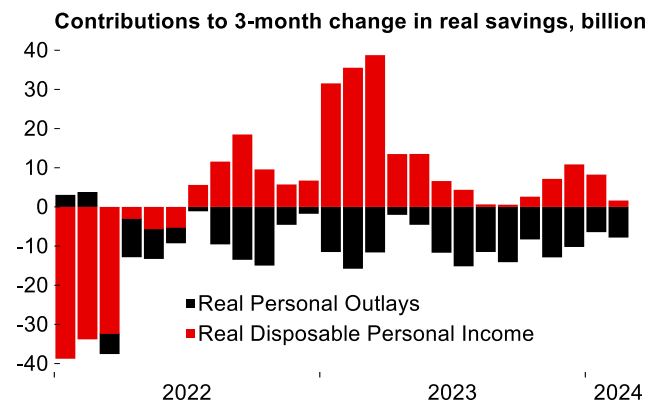
Real disposable personal income fell in February for the first time since September 2023. This is seemingly at odds with growth in personal spending, which entered positive territory this month after contracting in January. The general trend over the last few months can be characterized with dwindling household savings. Real income growth is fast approaching zero, while personal outlays have eased but remain comparatively strong (Chart 3).

Easing of labor market and wage pressures are welcomed developments with respect to services inflation, but the effect is not a positive one for real incomes. Even though wage growth remains elevated above overall inflation, employment growth in high paying industries such as professional and business services has been relatively slow, affecting aggregate income growth.

With excess household savings having likely been fully depleted, as discussed in a previous [brief](#), the current trend of real income growth is unlikely to fully sustain current spending rates. However, rising household net worth may be a factor in keeping spending high and savings rates low. Shown in Chart 4, the personal savings rate has an inverse relationship with household net worth as a share of disposable personal income (DPI).

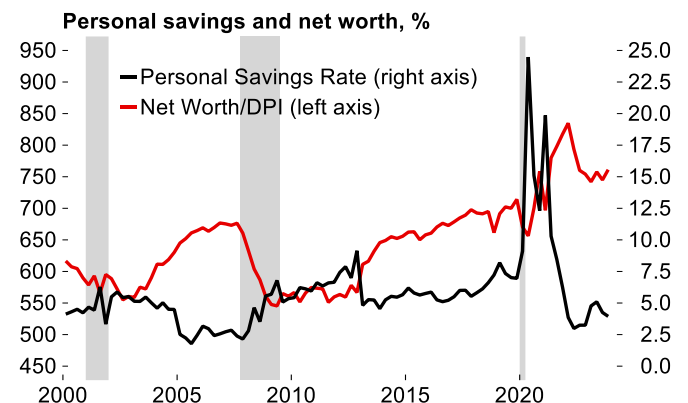
Expectations of future rate cuts and increased valuations of AI related companies has helped spur growth in household net worth, which can help keep spending growth in positive territory.

Chart 3: Real incomes are rising slower than expected, and spending momentum has only slightly eased



Source: BEA, MUFG Bank Economic Research Office

Chart 4: Net worth and personal savings as a share of disposable income have an inverse relationship



Source: BEA, Federal Reserve, MUFG Bank Economic Research Office

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