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Inflation rises less than expected in August; consumer spending surges

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WASHINGTON • U. S. inflation increased less than expected in August, which could see financial markets further reduce the odds of another interest rate increase from the Federal Reserve next month.



PCE
Personal
consumption
Expenditure

The Personal Consumption Expenditures Price Index rose 0.3% last month after a downwardly revised 0.1% gain in July, the Commerce Department's Bureau of Economic Analysis said Wednesday. Economists polled by Reuters had forecast the PCE price index rising 0.4% after a previously reported 0.2% gain in July. In the 12 months through August, PCE inflation advanced 3.4% after increasing by a downwardly revised 3.4% in July. PCE inflation was previously reported to have increased 3.7% in July on a year-on-year basis. The BEA changed its methodology for calculating prices for software and accessories, portfolio management fees and legal services in the PCE price index. It also revised the inflation data going back to 2021.

Excluding the volatile food and energy components, the PCE Price Index climbed 0.2% over the month after a downwardly revised 0.1% rise in July.

The so-called core PCE inflation was previously estimated to have gained 0.2% in July.

Core PCE inflation increased 3.0% year-on-year in August after a downwardly revised 3.0% advance in July. Underlying inflation was initially estimated to have risen 3.3% in the 12 months through July.

The US central bank tracks the PCE price measures for its 2% inflation target. The Fed this month raised its benchmark overnight interest rate to the 3.75%- 4.00% range, the first rate hike in three years, and flagged further increases in borrowing costs in the months ahead.

The odds of an October rate hike were diminished by New York Fed President John Williams' comments on Tuesday that he saw "no urgency" for further action. Prior to the inflation data, financial markets priced in a roughly 51.5% chance of further policy tightening next month down from 70% on Monday, CME's FedWatch Tool showed.

Higher inflation and borrowing costs could crimp consumer spending. A survey from the Conference Board on Tuesday showed consumer confidence plummeting to a near 12 1/2-year low in September. There are, however, no signs yet of consumers significantly dialing back.

Consumer spending, which accounts for more than two-thirds of economic activity, surged 0.9% last month after a downwardly revised 0.1% gain in July, the BEA said. Spending was previously estimated to have gained 0.2% in July.

Meanwhile, according to another report Wednesday from Commerce Department's Bureau of Economic Analysis, the U. S. economy grew at a solid clip in the second quarter, driven by robust consumer spending and business investment related to the buildout of AI infrastructure.

Gross domestic product increased at a 2.2% annualized rate, revised up from the previously estimated 1.5% pace, the BEA said in its third estimate of second-quarter GDP.

Evidence keeps coming that investment and growth are picking up.

2026-10-1

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The U.S. Economy Is Accelerating

REVIEW & OUTLOOK

You'd be forgiven for thinking the U.S. is slouching toward recession based on the gloomy headlines. But cheer up—the Commerce Department on Wednesday made an unusually large upward revision in its economic growth estimate for the first half of the year. Might rising yields on the 10-year Treasury reflect accelerating economic growth?

The Commerce Department raised its GDP growth estimate for the first quarter to 2.5% from 2.1%, as well as for the second to 2.2% from 1.5%. These large revisions reflect newly available data as well as updates to annual benchmarks that include refinements in methodology since 2021.

The upward revisions to real GDP growth stem partly from reduced inflation estimates. But the bigger story is that business investment and consumer spending have been stronger than economists thought. Business investment was revised up half a percentage point to 9% thanks to higher spending on intellectual property and structures tied to AI. Commerce says data centers drove the increase, while information processing equipment contributed to stronger consumer spending.

Admissions to spectator amusements also buoyed consumer spending during the second quarter. A World Cup dividend? Regardless, higher gasoline prices don't seem to be restraining consumers. Consumer spending has been growing faster than personal incomes in recent quarters, perhaps in part owing to the wealth effect from a booming stock market. Fidelity recently reported that the number of Americans with more than a \$1 million in the company's 401(k)s surged 19% during the second quarter to a record 769,000.

Americans can thank the AI boom, assisted by the GOP tax bill, for lifting corporate profits and equity prices. Corporate profits in the second quarter rose 20.8% from a year earlier. Even if some company valuations are stretched, increases in stock prices are broader than a couple of years ago when indexes were driven by the so-called Magnificent Seven. Net exports subtracted 1.1 percentage points from GDP in the calculation, as AI companies imported more chips and equipment for their data center build-out. But this is a positive for U.S. domestic investment and growth. Imports aren't a sign of economic weakness.

The larger story here is that the economy as a whole looks to be on a stronger footing than during the Biden years when growth was driven by government handouts. Recall how the Biden team boasted that its climate spending was increasing construction and even defended its endless student loan forbearance as propping up consumer spending.

Last year's tax bill phased out green-energy subsidies and made much-needed reforms to food stamps that have reduced enrollment to pre-pandemic levels. The Trump team also made student loan borrowers make payments again. Democrats said this would imperil the economy. Apparently not.

The press has been in a panic over the rising yield on the 10-year Treasury, which has crept up 100 basis points this year to 5.29%. The conventional wisdom is that higher energy prices and expectations of more debt issuance are the culprit, but faster growth and competition for capital are contributing. Estimates for third quarter GDP growth have also been rising as September looks strong.

So if the economy is good, why do Americans feel so glum? The likely answer is the hangover from the Biden inflation, which continues to erode wage gains and make it hard to save. Border taxes and higher gas prices haven't helped. Yet despite the prophecies that the war in Iran would plunge the U.S. into a recession, the evidence is that America's economic animal spirits are alive and well.

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Gross Output Signals an Economic Surge

By Mark Skousen

Last year stagflation was a legitimate concern. Real gross domestic product rose only 2.2%, while business-to-business spending declined in real terms. In the fourth quarter last year, real GDP rose at an annual rate of 0.5%, and B2B spending declined 2.2%, according to my calculations based on Bureau of Economic Analysis and Census Bureau data. The supply chain experienced stagflation. Consumer spending was robust, but there was a mild business recession in 2025.

The economic picture is changing, and we can see it thanks to a little-known but powerful macrostatistic that measures spending at all stages of production. GDP leaves out the all-important supply chain, a leading indicator.

There is a better, broader statistic that tells what's really going on in the economy. Known as gross output, or GO, it measures spending at all stages of production.

Supply-chain economics is big business. Total spending in the U.S. in the intermediate stages of production amounted to about \$35 trillion in 2025, more than GDP (\$31 trillion). Business spending in the supply chain is much bigger and more volatile than final consumption and does a better job of measuring the ups and downs of the business cycle.

Good news: Business activity is quickly changing this year and is exploding upward, at double-digit rates.

It started in the first quarter and now has been confirmed. In the first quarter, the BEA reported a pickup in gross output. On Wednesday it was revised upward by 0.6% for a real return of 2.3% for the first quarter. Unlike GDP, it includes the value of the supply chain and all B2B spending.

Wednesday's release of second-quarter GO was a blockbuster. GO is suddenly growing faster than GDP, a significant positive trend, and one that suggests real GDP in the third quarter could be explosive.

Second-quarter GO grew 5% in real terms, compared with real GDP growth of only 2.2%.

The difference is in the value of the supply chain. Business to business more than doubled compared with the first quarter and grew 13.8% in the second quarter. This is the fastest growth in business activity since the bureau started measuring the GO statistic in 2005 (excluding the postpandemic rebounds 2021-22).

Moreover, business spending is growing faster than consumer spending, which grew only 3.8% in the second quarter compared with business increasing at a double-digit rate.

Spending on AI and data centers is undoubtedly behind the explosive growth in business activity, and capital spending by foreign investment in the U.S. might also be contributing.

Most economists focus on GDP when gauging economic outlook. But GO should be viewed as the top line in national income accounting, and GDP as the bottom line. Both metrics are essential to understanding where the economy is headed.

Mr. Skousen holds a chair in free enterprise at Chapman University and is author of "The Making of Modern Economics."

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