Macro

(NEVER)MIND THE GAP

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Since the start of the year, the markets and, more recently, the Fed have revised up their core PCE inflation forecasts far more aggressively than we have. Notably, these upward revisions have been disproportionately larger than those made to CPI forecasts, despite a much less pronounced upgrade to the growth outlook. In our view, this largely reflects expectations that the gap between core PCE and core CPI inflation would remain unusually wide.

We have never been convinced that such a large divergence was likely to persist. We believe that recent developments support our baseline. Specifically, the Bureau of Economic Analysis (BEA) has announced a set of methodological revisions to the National Economic Accounts that will affect the measurement of several components of PCE inflation.

The revisions will impact computer software and accessories, portfolio management and investment advisory services, and legal services, indeed the three categories within the core PCE basket that have increased disproportionally year-to-date.

In this note, we show that the planned methodological changes are likely to lower measured core PCE inflation and improve consistency between PCE and CPI inflation. As a result, the upcoming revisions should help reduce the unusually wide gap between the two inflation measures.

We are not changing our 2026 core PCE inflation forecast. This is because our baseline already incorporated the possibility of methodological revisions by the BEA. Historically, periods of unusually wide divergence between PCE and CPI inflation have tended to be followed by convergence toward their long-run relationship within a few quarters.

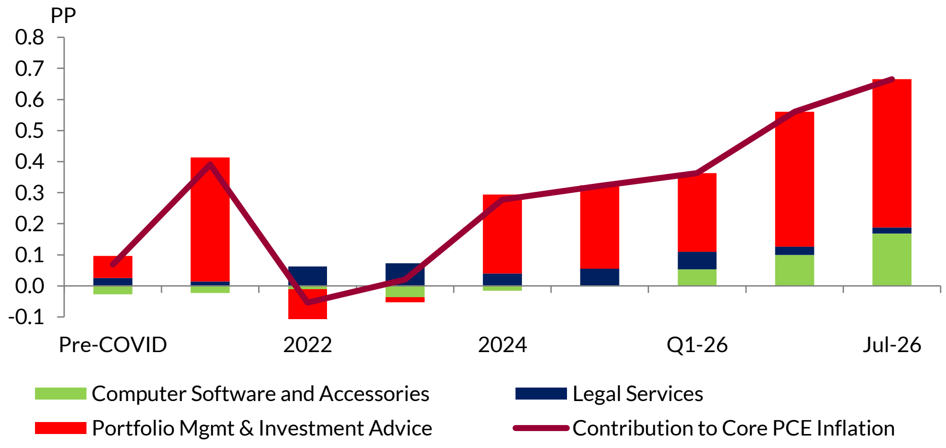
Against this backdrop, we continue to expect core PCE inflation to average 2.7% in 2026.

Taking stock of recent core PCE developments

Since January 2026, core PCE inflation has proven to be stickier than core CPI inflation. This divergence is mainly explained by a small group of components that carry greater weight in core PCE than in core CPI. More specifically, these components are: 1) **PCE for computer software and accessories**—due to the surge in prices of chips, memory, and semiconductors driven by demand for AI; 2) **PCE for portfolio management and investment advisory services**—due to the strong performance of the stock market in Q1; and, to a lesser extent, 3) **PCE for legal services**—a component that has relatively little weight in core PCE compared to the former but that typically exhibits highly volatile swings. Indeed, these three categories together account for roughly 4% of the core PCE price index and contributed around 0.6pp to core PCE inflation in Q2-26 on a year-over-year basis and reached 0.7pp in July (**Figure 1**).

Figure 1

Three components are substantially boosting core PCE inflation



Source: Haver Analytics, ANIMA Research

The BEA revision

At the end of June, the BEA published a preview of the 2026 annual update of the National Economic Accounts (see here), which is expected to be implemented on September 30, 2026. The update introduces a set of targeted methodological changes to the measurement of PCE inflation. Annual updates are typically applied retroactively, and this revision is likely to affect data back to Q1-21. If the proposed methodological changes are indeed implemented on a retroactive basis (as is standard practice by the BEA), they could have meaningful implications for the level of core PCE inflation this year.

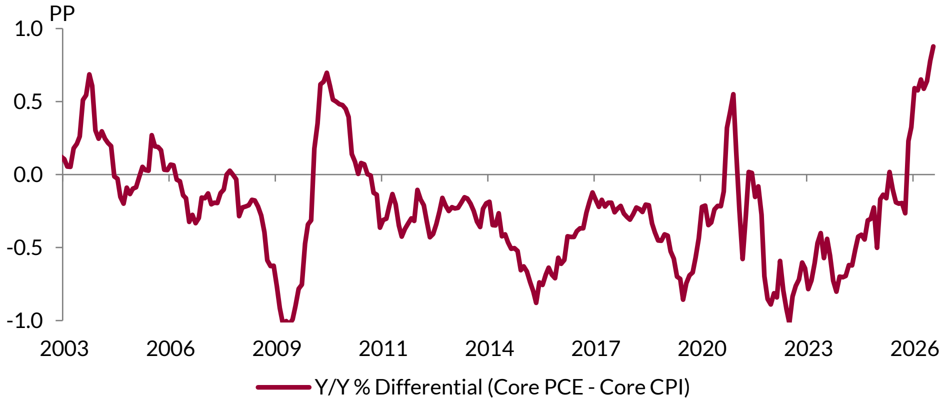
What is interesting is that the methodological changes will be applied specifically to the three components that are currently pushing core PCE inflation, namely: **PCE for computer software and accessories**, **PCE for portfolio management and investment advisory services,** and **PCE for legal services**. Each one appears to be aimed at limiting monthly volatility and improving the accuracy of the components being measured.

Why is this revision necessary?

In 2026, the core PCE-CPI inflation gap has reversed, turning into positive territory and widening to unusual levels. Currently, the PCE measure is running above the CPI measure—which in itself is unusual, given that since 2003, the gap has been negative in 78% of observations—and, moreover, the gap reached its highest level since 2010 (**Figure 2**). This has led to questions about which measure is providing more reliable signals for underlying inflation, what is driving this unusual positive wedge, whether we should expect this to continue, and implications for Fed policy.

Figure 2

PCE-CPI gap at highest level since 2010



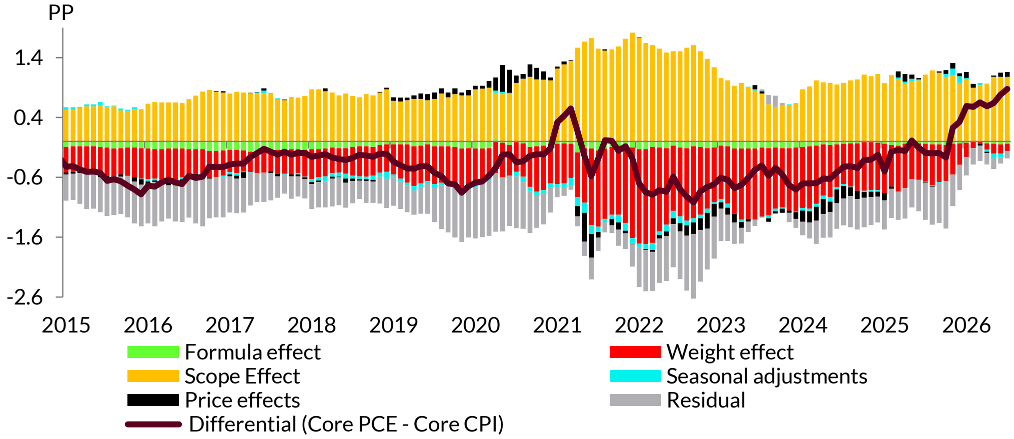
Source: Haver Analytics, ANIMA Research

Unpacking the core PCE-CPI gap. Historically, differences in category weights, particularly shelter, and "out-of-scope" PCE categories have driven the divergence in the two core measures (**Figure 3**).

- **The weight difference has generally boosted the CPI over the PCE**. With shelter carrying twice as much weight in the CPI as in the PCE, and usually running at, or above, overall core inflation in the pre-COVID era, core CPI inflation has tended to run structurally higher, explaining the historically negative PCE-CPI wedge.
- **The scope effect has tended to boost the PCE price index**. The "out-of-scope" PCE categories are those that have no comparable counterparts in the CPI measure and are imputed by the BEA, such as financial services, and have tended to provide a partial offset to the weight effect, attenuating fluctuations in the gap.
- **Zooming into the recent episode, both the weight and scope effects are moving in the same direction to boost the PCE over the CPI**. This is highly unusual but was quite evident in the monthly prints, especially with core goods PCE inflation running higher than the CPI measure, despite using the same underlying CPI inputs.

Figure 3

Lately we are seeing an unusual widening of the PCE-CPI gap



Source: Haver Analytics, ANIMA Research

Given that such a large gap is unsustainable and that convergence has always occurred, the BEA decided to make methodological adjustments to the three components that caused high stickiness in PCE inflation in 2026: 1) **Computer software and accessories**; 2) **Portfolio management and investment advice services**, and 3) **Legal services**.

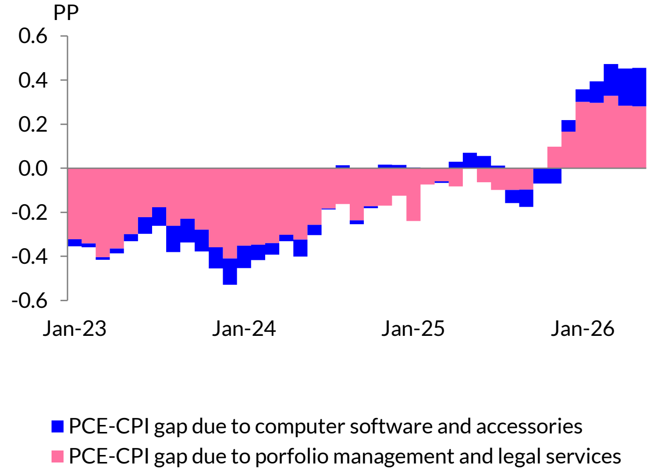
<u>In our view, the net effect of these revisions will help narrow the gap between PCE and CPI inflation.</u>

- Our analysis suggests that more than half of the PCE-CPI gap from January 2026 can be attributed to these three categories alone (**Figure 4**).
- Given that, for two of the three categories, the revisions planned by the BEA are likely to result in a lower inflation run rate than is currently embedded in the data (see below for further details), we expect the divergence between the two core inflation measures to narrow going forward.
- This convergence will occur primarily through the weight effect. Specifically, if the BEA computes the weight contribution to the PCE-CPI differential as *(PCE weight − CPI weight) × PCE inflation*, then a lower inflation rate in these categories would mechanically increase the drag from the weight effect on the differential, even if expenditure weights remain unchanged[1]. As a result, the contribution of the weight channel would become more negative, helping to reduce the gap between the two inflation measures (**Figure 5**).

[1] Unlike the Consumer Price Index (CPI), which updates its basket of goods annually, the BEA adjusts PCE weights based on updated nominal expenditure data. For this reason, no updates to PCE shares are scheduled.

Figure 4

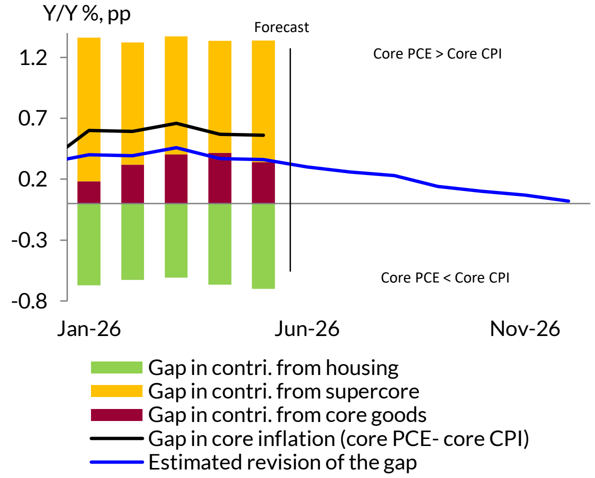
Accounting for more than half of the gap



Source: Haver Analytics, ANIMA Research

Figure 5

The revision will reflect a narrowing of the gap



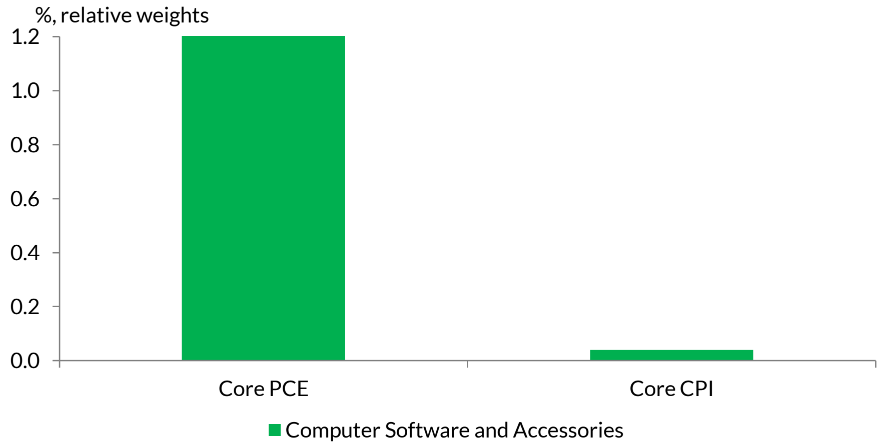
Source: Haver Analytics, ANIMA Research

Computer software and accessories

This category is currently deflated using only the CPI for software and accessories measure, but has come under a lot of scrutiny lately, given its exponential increase this year, which was further amplified by the fact that its weight is greater in PCE terms than in CPI terms (**Figure 6**).

Figure 6

The difference in relative weight between the PCE and the CPI is significant



Source: Haver Analytics, ANIMA Research

Under the new methodology, BEA will use a “composite price index” to measure computer software and accessories prices, though it will not change its weight. This new “composite price index” will be made up of two PPI data series alongside the old CPI for software and accessories:

1) PPI: Game Software Publishing

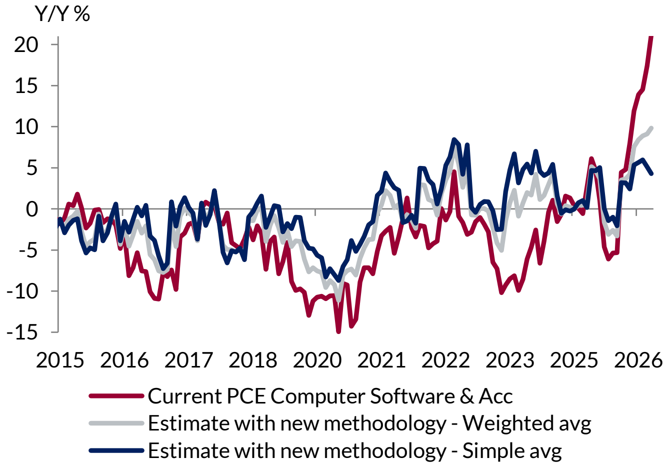
2) PPI: Hosting, ASP & Other IT Infrastructure Services

This is to address the issue of potential misalignment in the composition of products that make up the CPI and PCE categories (which was also noted by the Fed in a recent note – see here). In **Figure 7 - LHS** we show the actual PCE computer software and accessories component along with our estimates of the effect of the methodological change. We show two potential estimates because it is unclear what weights the BEA will assign to these new deflators, given there is little to no public information about the weights for "software" versus "accessories" in this category.

Since the two new PPI inputs series (i.e., PPI Game Software Publishing and PPI Hosting, ASP & Other IT Infrastructure Services) are currently running at a slower pace (**Figure 7 - RHS**) than the series for CPI software and accessories, this will likely result in a downward revision to core PCE inflation. Consequently, Q2-26 will likely mark the peak of the contribution from this item.

Figure 7 - LHS

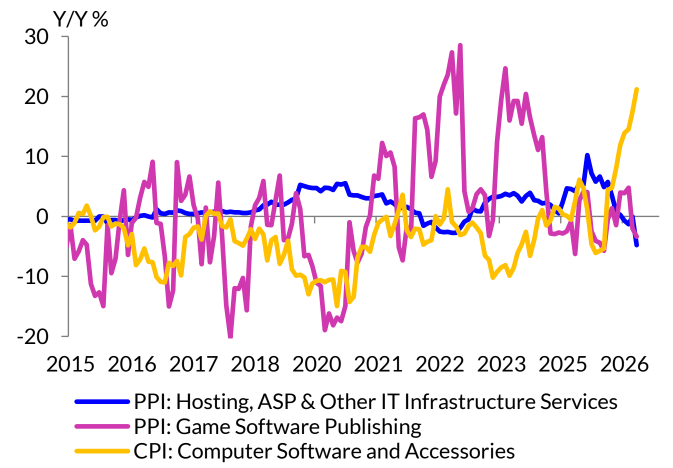
The revision is expected to show lower inflation



Source: Haver Analytics, ANIMA Research

Figure 7 - RHS

The new inputs run softer than the old one



Source: Haver Analytics, ANIMA Research

Portfolio management and investment advice services

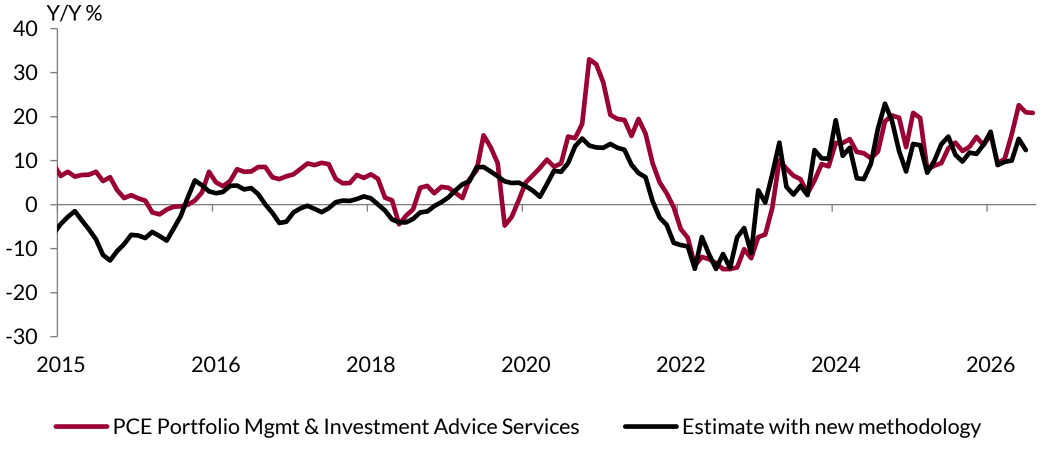
The BEA's current methodology relies on the PPI deflator for this category, whose construction is based on assets under management, resulting in a positive relationship with equity market movements. The portfolio management PPI interprets fee increases driven solely by changes in asset valuations as inflation. For example, when management fees are charged as a fixed percentage of AUM, a 15% market-driven increase in asset values is recorded as a 15% rise in prices, even though the underlying service provided is unchanged. The BEA has preferred this approach in the past because, under NIPA accounting, asset valuation changes should not mechanically affect real output. A useful discussion of this, and other potential approaches, can be found in Kornfeld (2021).

The BEA will now grow real output using a CES "quantity extrapolator" for the portfolio management and investment advice industry. The price index is then derived as the ratio of nominal spending to real output. We assume that the quantity extrapolator implies that output growth broadly tracks payroll hours worked, consistent with the methodology applied to certain government service categories, although this assumption cannot be verified with certainty. Because the required industry-level detail in the CES is available only with a one-month lag, we estimate current-month hours worked using growth in the broader financial activities sector.

In **Figure 8** we report our estimates of revised portfolio management services inflation in PCE, which we estimate as the difference between nominal spending as currently stated in the national accounts and our estimate of the BEA's new measure of real spending.

Figure 8

Portfolio management inflation will likely be revised down



Source: Haver Analytics, ANIMA Research

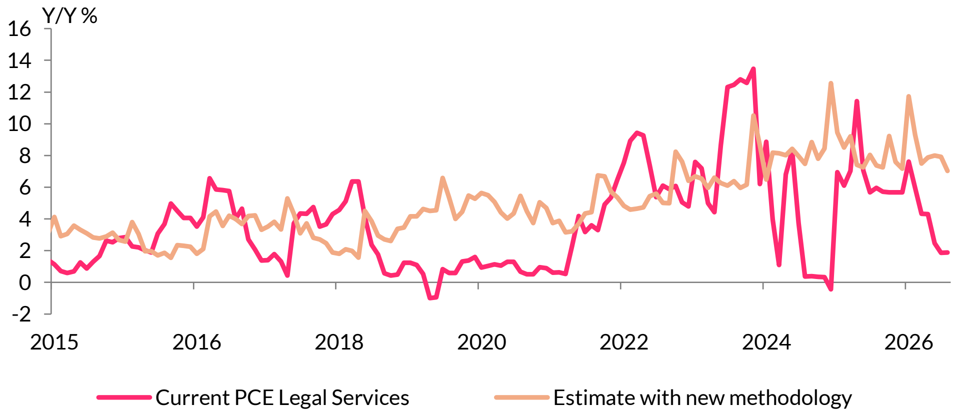
Legal Services

The BEA has historically used the CPI deflator for translating legal services inflation to the PCE price index. But since 2023, the CPI deflator for legal services has no longer been published, although unpublished estimates have continued to be supplied to the BEA. As a result, forecasters have had to infer legal services inflation indirectly from the broader CPI data. Going forward, the BEA will replace the CPI-based measure with a set of detailed PPI series for legal services. Given the relatively small weight of legal services in the core PCE basket, we expect the impact on overall core PCE inflation to be limited on average. However, the adoption of PPI-based measures should reduce the volatility of legal services PCE inflation.

In **Figure 9** we report our estimate of PCE for legal services under the new methodology: as is evident, the new series will likely be higher (albeit less volatile) than the current version. However, considering that the weight of this component in core PCE is rather marginal (0.8%), the revision should not be disruptive.

Figure 9

The new measure of legal services prices will likely be less volatile



Source: Haver Analytics, ANIMA Research

Bottom line

Taken together, we expect year-over-year core PCE inflation to be revised down retroactively by 0.1pp in Q1-26 and 0.2pp in Q2-26. However, we are not making any changes to our 2026 outlook for core CPE inflation. This is because our profile already factored in the effect of a possible methodological revision by the BEA; historically, whenever the gap between PCE and CPI widens, it converges toward its historical trend within a couple of quarters. Consequently, our baseline already factored in the start of core PCE's convergence toward core CPI around H2-26.

Against this backdrop we continue to expect core PCE inflation in 2026 of 2.7%.

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