ECONOMIC UPDATE
REGIONS
March 29, 2018

February Personal Income/Spending: Slower Spending Growth In Q1 No Surprise

- Personal income rose by 0.4 percent in February, personal spending rose by 0.2 percent, and the saving rate rose to 3.4 percent.
- The PCE deflator rose by 0.1 percent and the core PCE deflator rose by 0.2 percent in February. Year-on-year, the PCE deflator was up by 1.8 percent and the core deflator was up by 1.6 percent.

Total personal income rose by 0.4 percent and total personal spending rose by 0.2 in February, each matching our forecast and the consensus forecast. With income growth outpacing spending growth, the personal saving rate rose to 3.4 percent. The PCE deflator, the FOMC's preferred gauge of inflation, rose by 0.1 percent with the core PCE deflator up 0.2 percent, matching our forecasts and yielding year-on-year changes of 1.8 percent and 1.6 percent, respectively.

Growth in personal income was led by a jump in proprietors' income in the nonfarm business sector, which was up 1.0 percent in February. This is a proxy for small business profits, the growth of which has been no match for growth in corporate profits over the course of the expansion. Over the past year or so, however, growth in small business profits has accelerated, and February's increase reflects year-on-year growth of 4.5 percent. Aggregate private sector wage and salary earnings were up by 0.5 percent in February, as a longer workweek more than compensated for a puny increase in hourly earnings. As we discussed in our March *Monthly Economic Outlook*, while many analysts and policy makers are obsessed with growth in hourly earnings, it is growth in aggregate earnings that is the main driver of growth in consumer spending.

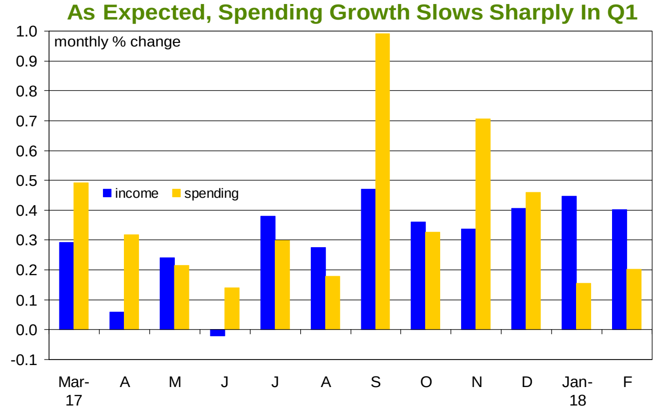
Reflecting the lower personal income tax rates that took effect on January 1, the January data showed the largest monthly increase in disposable (i.e., after tax) income since December 2012. At the time, we noted the January data did not fully reflect the effects of the tax cuts, so we expected the February data to show another sizeable, but less so than in January, increase in disposable income. Revisions now put January's increase at 1.0 percent (originally reported as a 0.9 percent increase), while the initial estimate for February shows a 0.4 percent increase, better than the monthly average for 2017. This leaves disposable personal income up 4.0 percent year-on-year thus far in Q1, with real (i.e., inflation adjusted) disposable income up 2.2 percent.

Ongoing improvement in labor market conditions is supportive of steady growth in aggregate wage and salary earnings, easily the largest single component of total personal income, while lower tax rates have boosted growth in disposable income. As such, we're not concerned with the middling growth seen in consumer spending thus far in 2018. That growth in consumer spending has slowed Q1 2018 should surprise no one, it was simply a matter of the extent to which growth would slow. Revised data show real consumer spending grew at an annualized rate of 4.0 percent in Q4, but Q1 growth will be closer to 1.0 percent.

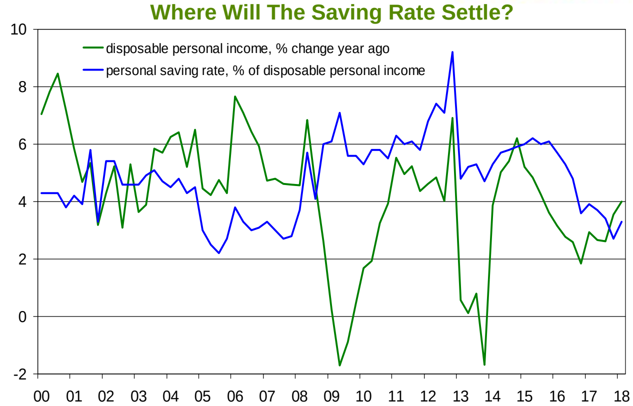
As to which reflects the true state of U.S. consumers, that's easy – the answer being neither. Recall that Q4 spending was boosted by post-hurricane spending, which basically reflected replacement demand for a range of consumer goods from cars to clothing. Indeed, real spending on consumer durable goods grew at an annualized rate of 13.7 percent in Q4, the fastest growth since Q3 2009 – the first quarter of recovery from the 2007-09 recession. It wasn't all replacement demand, however, as the 2017 holiday shopping season was the strongest since 2005. It was only natural that growth in consumer spending would slow in Q1, but apparently not everyone got the memo, as the "what's wrong with U.S. consumers" narrative is once again upon us.

One byproduct of the strong growth in spending in Q4 was the decline in the personal saving rate. We're not sure we've ever seen a single variable around which there is so much nonsense passing for actual analysis. One analyst pointed to the "massive" increase in the saving rate between December and January as a sign of stressed consumers but in the very next sentence stated consumers were having to run down savings to finance spending on clothing, shelter, and food. It can't be both, at least not in the same month. Another tied monthly swings in the saving rate to monthly swings in the stock market. Good grief. Aside from the should-have-been-expected-after-a-robust-Q4-but-apparently was-not-by-some slowdown, spending adjusts gradually to changes in disposable income brought about by changes in tax rates. With labor income growing as rapidly as it is, record household net worth, and elevated consumer confidence, there should be little cause for concern as to the health of U.S. consumers despite the soft Q1 spending data.

As Expected, Spending Growth Slows Sharply In Q1



Where Will The Saving Rate Settle?



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