ECONOMIC UPDATE

REGIONS

September 30, 2016

August Personal Income/Spending: One-Off Or Something More Ominous?

- Personal income rose by 0.2 percent in August; personal spending was unchanged, and the savings rate rose to 5.7 percent.
- The PCE deflator rose by 0.1 percent and the core PCE deflator was up by 0.2 percent in August. On a year-over-year basis, the PCE deflator was up by 1.0 percent and the core deflator was up by 1.7 percent.

Total personal income rose by 0.2 percent in August while total personal spending was unchanged after July's spending growth was revised higher. The PCE deflator rose by 0.1 percent in August with the core PCE deflator up 0.2 percent; these gains translate into over-the-year increases of 1.0 percent and 1.7 percent, respectively. With income growth outpacing spending growth, the personal saving rate rose to 5.7 percent in August from 5.6 percent in July. While no one expected growth in inflation adjusted consumer spending in Q3 to match the 4.3 percent growth logged in Q2, the decline in real consumer spending in August is nonetheless disconcerting. Still, we expect data over coming months to bear out our view that the August data are a one-off soft spot rather than the start of something more ominous.

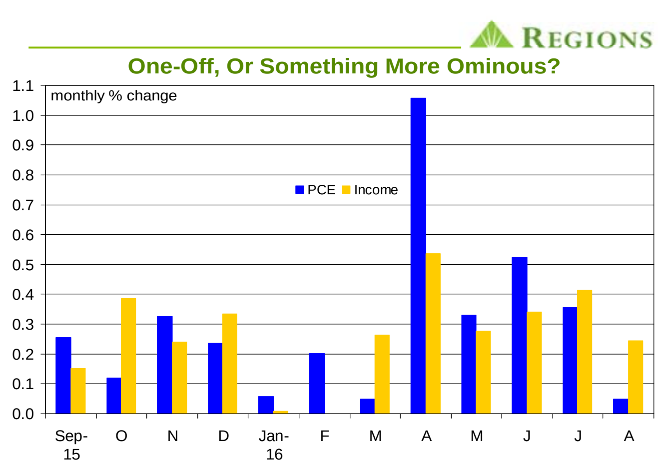
Growth in total personal income was held down by private sector wage and salary earnings, which rose by just 0.1 percent. This paltry gain is in line with the earnings details in the August employment report. We think, however, there is a lot of seasonal adjustment noise in the August data on employment, hours, and earnings, so expect growth in aggregate private sector earnings to fall back in line with the underlying trend over coming months. Government sector wage and salary earnings were up 0.3 percent in August, continuing a run of solid gains corresponding to larger increases in government sector payrolls. Here too, however, we see seasonal adjustment noise, but here that noise is making the data look better than is actually the case. Private sector earnings were up 3.9 percent, year-on-year, with government sector earnings up 2.8 percent.

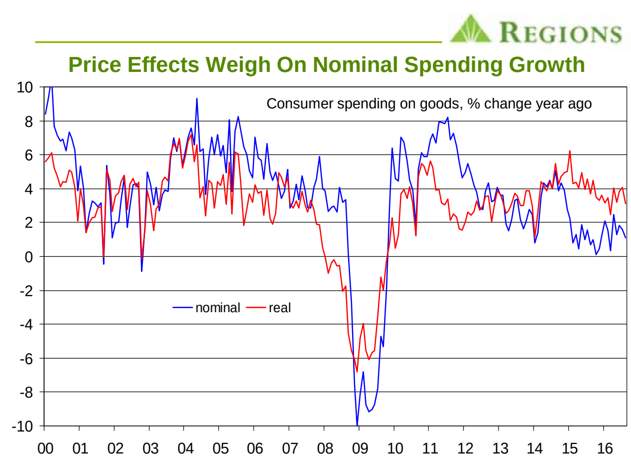
There was strength in other income categories in August. Dividend income was up 0.8 percent, rental income up 0.7 percent, transfer payments up 0.4 percent, and interest income up 0.3 percent. For a fourth consecutive month, total personal income was up 3.1 percent year-on-year in August, with real disposable personal income up 2.8 percent year-on-year.

Consumer spending on goods was down 0.6 percent in August, with declines in spending on both durable and nondurable consumer goods. Primarily due to sharply motor vehicle sales, spending on consumer durables was down 1.3 percent in August, negating a good portion of the 2.1 percent increase posted in July. Spending on household services rose by 0.3 percent in August, which is the smallest increase since March. It is worth keeping in mind spending on services accounts for roughly two-thirds of all consumer spending but is not captured in the monthly retail sales report. As such, it is not until we have the monthly report on personal income and spending that we have a full view of consumer spending in any given month. It is also worth keeping in mind that, unlike the retail sales data which are reported in nominal terms only (i.e., not adjusted for price changes), the personal spending data are reported in both nominal and real terms. This is important because for some time now goods prices have been falling almost across the board and, as seen in the chart below, growth in real consumer spending has been much stronger than has been implied by the monthly retail sales reports. Still, many analysts remain flummoxed by these falling prices and, as a result, reflexively offer up off-the-mark diagnoses of the health of U.S. consumers.

While the decline in real spending in August may seem to play right into the hands of these analysts, it is highly unlikely this is the start of a new trend. As is always the case with the economic data, while the month-to-month data are jumpy, the underlying trend shows consumers continue to benefit from steady wage growth that is easily outpacing inflation and anchoring healthy growth in total personal income. Consumers continue to pare down debt – having remained very disciplined in the use of credit to finance current consumption – and build up saving, all the while engaging in discretionary spending.

That Q3 growth in real consumer spending won't match that seen in Q2 does not imply a sudden deterioration in household finances. Barring a sharp and sustained downturn in job growth, consumer spending will remain the key driver of GDP growth over coming quarters.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com