ECONOMIC UPDATE
REGIONS
August 29, 2016

July Personal Income/Spending: Q3 Off To A Solid Start

- Personal income rose by 0.4 percent in July; personal spending rose by 0.3 percent, and the savings rate rose to 5.7 percent.
- The PCE deflator was unchanged and the core PCE deflator was up by 0.1 percent in July. On a year-over-year basis, the PCE deflator was up by 0.8 percent and the core deflator was up by 1.6 percent.

Total personal income rose by 0.4 percent in July while total personal spending rose by 0.3 percent, both in line with expectations. With the PCE deflator unchanged for the month, real personal spending also logged a 0.3 percent gain in July. The personal saving rate rose to 5.7 percent in July. To be sure, Q3 growth in inflation adjusted spending will not come close to the 4.4 percent annualized growth seen in Q2, but that was by no means a sustainable pace and the July spending data put Q3 off to a solid start.

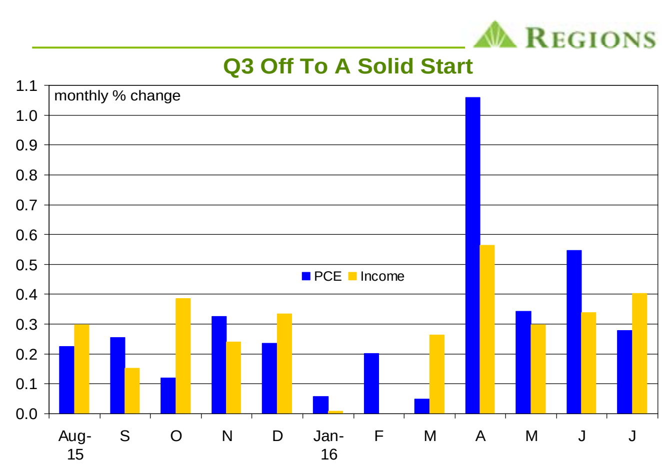
Private sector wage and salary earnings rose by 0.7 percent in July with government sector earnings up 0.3 percent. Growth in private sector earnings was a function of a sizeable increase in employment coupled with a one-tenth of an hour increase in the length of the average workweek. If that change seems minor, it is quite impactful as it added three-tenths of one percent to growth in private sector earnings in July. Indeed, our concern is the July increase in average hours will not have been sustained in August. If we are correct and the average workweek falls back to 34.4 hours, there will be very little growth in private sector wage and salary earnings. Either way, despite the normal month-to-month gyrations, the underlying trend shows growth in labor earnings remains comfortably ahead of inflation, which in turn remains the key support for growth in real personal income.

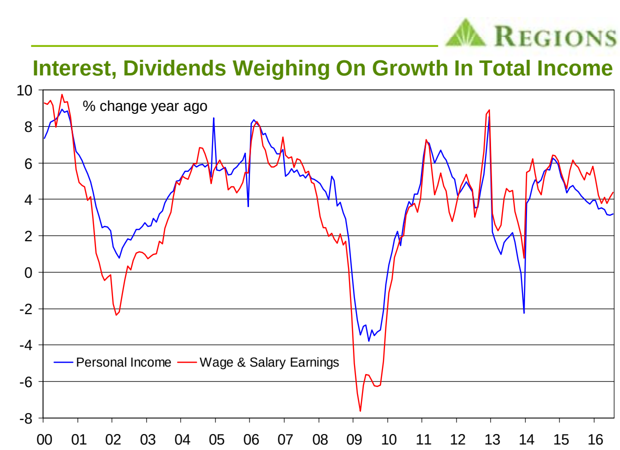
Rental income was up 0.4 percent in July, leaving it up 6.5 percent year-on-year. While still solid, growth in rental income has decelerated from the better than nine percent pace seen at this time last year, and growth in rental income will likely slow further over coming quarters. Dividend income was up 0.5 percent in July, a solid gain but one that comes amidst highly uneven month-to-month changes. To illustrate this point, on a year-to-date basis through July dividend income is down 1.5 percent in 2016 and growth will likely remain challenged over coming months. Interest income fell 0.3 percent in July and continues to decline on a year-over-year basis. Combined interest and dividend income is down 0.4 percent on a year-to-date basis through July, and the sharp deceleration in growth in income from these sources has been a prime factor behind the deceleration in growth in total personal income.

Growth in personal spending was led by spending on consumer durable goods, which was up 1.6 percent in July mainly due to strong motor vehicle sales. Higher utilities outlays contributed to a 0.4 percent increase in spending on household services. It is interesting to note that after accounting for price changes, spending on consumer durable goods was up 1.9 percent in July while spending on household services was up 0.2 percent and spending on nondurable consumer goods was flat even as nominal spending on nondurable goods was down 0.5 percent. These figures illustrate a pattern that, despite having been in evidence for quite some time, is still consistently missed by many – in order to make a meaningful assessment of consumer spending one must account for falling prices of consumer goods. This is a point we consistently make when discussing the monthly retail sales data, which are reported in nominal terms and do not account for spending on services.

Over the past several quarters, consumers have taken advantage of solid income growth and falling goods prices to increase discretionary spending, pare down debt, and build up saving. Oddly, however, we have sometimes found ourselves feeling compelled to point out there is not actually anything wrong with the latter two activities. The saving rate is jumpy on a month-to-month basis but our view is the saving rate will settle between 5.5 and 6.0 percent which, given steady growth in disposable income, still allows for growth in discretionary spending. One thing we have not seen during this cycle is the use of debt to finance current consumption to anywhere near the degree seen in the past. To us this is a sign consumers are on far more stable financial footing than was the case last time around.

Even if Q2's growth rate was a bit overstated, consumers are clearly the driver of growth in the U.S. economy. Barring a sharp and sustained downturn in job growth, this will remain the case over coming quarters.





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