ECONOMIC UPDATE

REGIONS

March 1, 2017

January Personal Income/Spending: Soft Start For Q1 Consumer Spending

- Personal income <u>rose</u> by 0.4 percent in January; personal spending <u>rose</u> by 0.2 percent, and the savings rate <u>rose</u> to 5.5 percent.
- The PCE deflator <u>rose</u> by 0.4 percent and the core PCE deflator was <u>up</u> by 0.3 percent in January. On a year-over-year basis, the PCE deflator was <u>up</u> by 1.9 percent and the core deflator was <u>up</u> by 1.7 percent.

Total personal income rose by 0.4 percent in January, slightly ahead of our forecast of a 0.3 percent increase, while total personal spending rose by 0.2 percent, matching our forecast. On an over-the-year basis, total personal income is up 4.0 percent. The PCE deflator was up by 0.4 percent, with the core PCE deflator up 0.3 percent; these translate into year-on-year increases of 1.9 percent and 1.7 percent, respectively. One implication of the spike in the PCE deflator in January is that real, i.e., inflation adjusted, personal spending fell by 0.3 percent in January, which sets a soft tone for Q1 consumer spending after real consumer spending rose at an annualized rate of 3.0 percent in Q4 2016. This in turn means Q1 real GDP growth will also be on the soft side as well.

Growth in total personal income was driven by solid growth in wage and salary earnings, which were up 0.4 percent for a second straight month. Private sector earnings were up 0.4 percent while, helped along by cost of living increases, public sector earnings were up 0.5 percent in January – that we underestimated the extent of these cost of living adjustments accounts for our miss on headline income growth. Private sector wage and salary earnings are up 4.8 percent year-on-year, while government sector earnings are up a more modest 3.0 percent. Keep in mind, however, that aggregate wage and salary earnings encompass the number of people working, the number of hours they work, and how much they earn for each hour they work. Both average weekly hours and growth in average hourly earnings are below where they would be were we at full employment, which would translate into growth of close to six percent in aggregate wage and salary earnings.

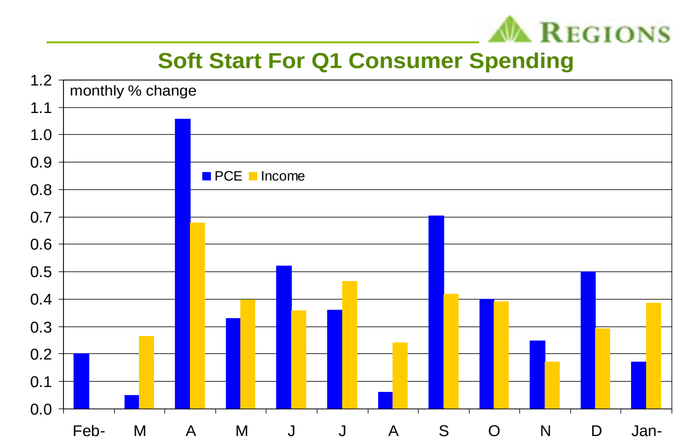
Rental income was up 1.0 percent in January, matching December's increase and leaving it up 7.3 percent year-on-year. Transfer payments rose 0.8 percent in January, reflecting in part upward adjustments to Social Security and other entitlement payouts. While this year's cost of living adjustment was modest – a 0.3 percent increase for Social Security – recall that last year there was no adjustment. In any event, growth in transfer payments will settle back into trend over coming months. Asset-based income has basically flat-lined over the past three months, but what is noteworthy is the shift in the mix of such income. Dividend income has declined in each of the past three months, with 0.6 percent declines in both December and January, but at the same time interest income has logged solid growth, which figures to continue as interest rates rise further over coming months.

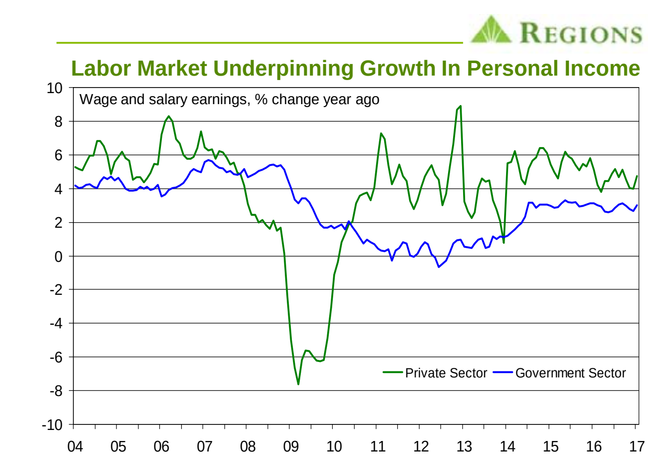
Disposable personal income was up 0.3 percent in January, but on a real basis disposable income fell 0.2 percent, leaving it up 2.0 percent year-on-year. Growth in real disposable income has settled into a slower pace over recent months; while we expect further gains in wage and salary earnings to provide some support over coming months, the possibility of, at some point, lower personal income tax rates offers another channel through which disposable income can grow at a faster pace.

To be sure, growth in real disposable income is also a function of inflation, which has showed some signs of firming over recent months. Rising energy prices are the main driver of faster headline inflation while core PCE inflation has settled into a 1.7 percent pace over the past several months. The PCE is the FOMC's preferred gauge of inflation, and while core PCE inflation will continue to move towards 2.0 percent, there is little to suggest it will accelerate sharply in the months ahead.

Total consumer spending rose by 0.2 percent in January. Spending on consumer durable goods fell, mainly due to the decline in motor vehicle sales, while sharply lower utilities outlays held down spending on services. As such, growth in total spending was more than accounted for by a 0.9 percent increase in spending on nondurable goods, though this in part reflects higher retail gasoline prices. As noted above, however, real spending declined in January and growth for Q1 as a whole will be significantly slower was growth in Q4 2016.

Ongoing labor market improvement means consumers will remain a key driver of growth in the U.S. economy. What we are all waiting to find out, however, is how much help consumers will get in 2017.





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