ECONOMIC UPDATE

REGIONS

August 31, 2017

July Personal Income/Spending: Solid Start To Q3 For Consumers

- Personal income <u>rose</u> by 0.4 percent in July; personal spending <u>rose</u> by 0.3 percent, and the savings rate <u>fell</u> to 3.5 percent.
- The PCE deflator <u>rose</u> by 0.1 percent and the core PCE deflator <u>rose</u> by 0.1 percent in July. Year-on-year, the PCE deflator was <u>up</u> by 1.4 percent and the core deflator was <u>up</u> by 1.4 percent.

Total personal income rose by 0.4 percent in July after having been unchanged in June, while total personal spending was up 0.3 percent off of an upwardly revised increase of 0.2 percent in June. The personal saving rate slipped to 3.5 percent. Both the total PCE deflator and the core PCE deflator posted gains of 0.1 percent in July, leaving both up 1.4 percent year-on-year, well shy of the FOMC's 2.0 percent target. Real consumer spending was up 0.2 percent in July.

Our forecast of a 0.2 percent increase in total personal income was predicated on a solid gain in labor income being partially offset by a further decline in dividend income. Labor earnings did indeed post a solid gain, with a 0.5 percent increase in total wage and salary earnings, with private sector earnings up 0.6 percent and public sector earnings up 0.2 percent. Where our forecast went wrong, however, was dividend income. Recall that in May a special dividend payment by Costco led to a surge in dividend income, which was only partially reversed in June, leaving dividend income above trend. We had banked on a further decline in July, but instead dividend income rose 0.5 percent. We're not quite sure what to make of this, as the level of dividend income remains significantly higher than was the case prior to Costco's special dividend. So, either dividend income is on a higher trajectory or there will be further payback over coming months, and clearly the dollar volume is large enough to impact total personal income.

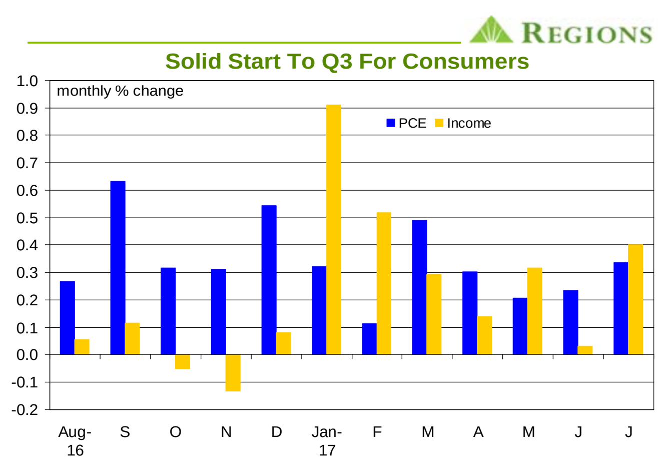
Interest income was up 0.5 percent in July, breaking a string of three consecutive monthly declines of at least 0.8 percent. We don't, however, look for July's growth to be sustained in the near term given movements in market interest rates over recent weeks. Rental income posted a below-trend increase of 0.4 percent in July, although this leaves rental income up 5.9 percent year-on-year. We have been looking for growth in rental income to settle into a slower trend rate, and the data over recent months suggest that is the case. Total personal income was up 2.7 percent year-on-year in July.

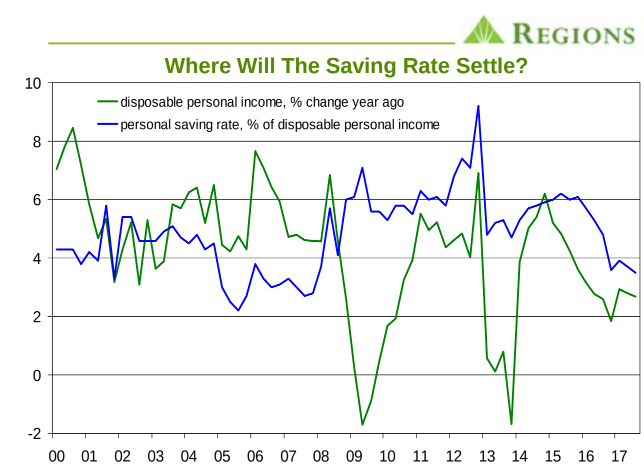
The 0.3 percent increase in total consumer spending was shy of our forecast of a 0.4 percent increase, which was also the consensus forecast. As we noted in our weekly *Economic Preview*, however, the upward revisions to Q2 spending incorporated into the GDP data made it difficult to gauge July's increase. Growth in total spending for June was revised from 0.1 percent to 0.2 percent, leaving the level of spending in July in line with our forecast. Spending was up in each of the three broad categories – durable and nondurable consumer goods, and household services – in July. It is worth noting that there is a good deal of play in estimates of spending on household services for the first two months of any given quarter, given the lack of complete source data, and the trend of late has been for initial estimates to be revised higher. This of course matters as services account for roughly two-thirds of all consumer spending as measured in the GDP accounts.

The personal saving rate slipped to 3.5 percent in July and, as can be seen in our chart below, the saving rate has fallen sharply over the past several months. We had expected the saving rate to ultimately settle between 5.5 and 6.0 percent but, at least as of yet, it has opted to go in a different direction. Part of the most recent declines in the saving rate stem from a sharp downward revision to disposable personal income in Q4 2016 and we just are not sure whether, or to what extent, the saving rate will reverse over coming months though we do expect continued steady income growth. This, along with the path of dividend income, will bear watching in the months ahead.

The same could be said about the inflation data, at least from the FOMC's perspective. With each passing month it looks less like the recent deceleration in inflation is transitory and more like structural forces, such as the shifting retail climate, are the root cause. That said, the impacts of Harvey will cloud the picture over coming months as they show up in different facets of the inflation data.

All in all, the July data show consumers remain on firm footing. Continued solid growth in labor income will underpin growth in consumer spending and, in turn, real GDP growth.





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