ECONOMIC UPDATE

REGIONS

September 28, 2018

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August Personal Income/Spending: Labor Earnings Put Solid Floor Under Consumers

- Personal income rose by 0.3 percent in August, personal spending rose by 0.3 percent, and the saving rate was unchanged at 6.6 percent.
- The PCE deflator rose by 0.1 percent and the core PCE deflator was unchanged in August. Year-on-year, the PCE deflator was up by 2.2 percent and the core deflator was up by 2.0 percent.

Total personal income and total personal spending each rose by 0.3 percent in August, less than the 0.4 percent our forecast anticipated in each category. With income growth matching spending growth, the personal saving rate held steady at 6.6 percent in August. The PCE deflator, the FOMC's preferred gauge of inflation, rose by 0.1 percent in August while the core PCE deflator was unchanged, each matching our forecast. On a year-on-year basis, the PCE deflator is up 2.2 percent and the core PCE deflator is up 2.0 percent. Real personal spending rose by 0.2 percent in August, leaving annualized growth in real consumer spending running at a better than 3.0 percent pace.

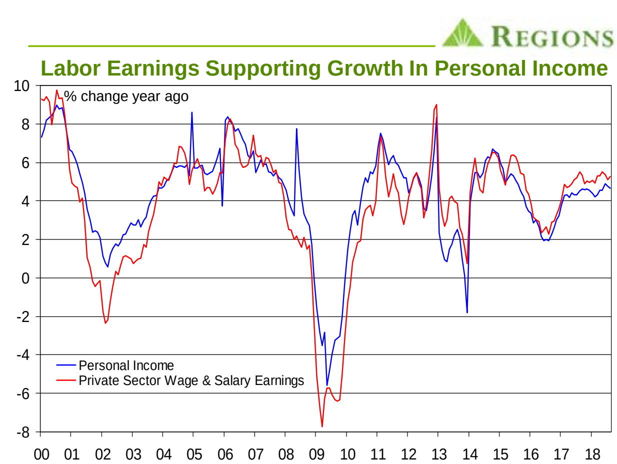
Our miss on our forecast of personal income growth comes courtesy of a decline in investment income. Interest income dropped by 0.3 percent in August while dividend income rose by only 0.1 percent, with each component softer than our forecast anticipated. Farm income fell sharply in August, with the 10.9 percent decline coming on the heels of a 9.9 percent decline in July. Though a relatively small share of total personal income, farm income has weakened considerably over recent months which at least to some degree reflects the impact of trade policy on the farm sector.

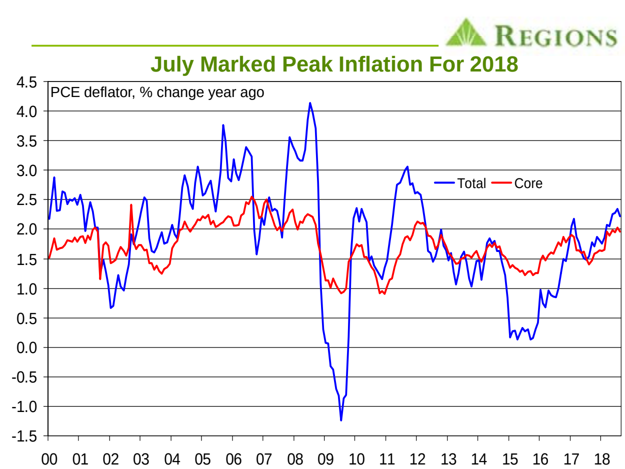
The 0.5 percent increase in aggregate wage and salary earnings matched our forecast. Private sector wage and salary earnings rose by 0.5 percent and public sector wage and salary earnings were up 0.2 percent. Private sector wage and salary earnings have been growing at better than a 5.0 percent pace over the past 20 months. This is meaningful because this is the largest single component of total personal income, but that point is generally overlooked given the attention paid to average hourly earnings as an indicator of the health of the labor market. As we often note, average hourly earnings are but one component of aggregate wage and salary earnings, the other two being the number of people working and the number of hours they work in each time period. In the wake of the August employment report, which showed average hourly earnings had risen by 2.9 percent year-on-year, there were some who dismissed this as being of "no use" to workers since wage growth was barely running ahead of inflation as measured by the Consumer Price Index. Leaving aside the issue of inflation as measured by the CPI running well ahead of inflation as measured by the PCE deflator, the more relevant point is that growth in aggregate earnings is running far ahead of any measure of inflation and has been for some time. As labor market conditions tighten further over coming months, which will be evident not only in faster growth in average hourly earnings but also by average weekly hours increasing, growth in aggregate wage and salary earnings will accelerate and, in turn, support stronger growth in personal income.

Our miss on our forecast of growth in personal spending comes courtesy of a rounding error; unrounded, total personal spending rose by 0.331 percent in August while our forecast anticipated an increase of .355 percent, which we rounded up to 0.4 percent. In any event, with unit motor vehicle sales falling in August and a dip in spending on home furnishings, total spending on consumer durable goods fell modestly in August. Spending on nondurable consumer goods was up by 0.5 percent and spending on household services was up 0.4 percent. Rounding issues aside, data through August are in line with our expectation that Q3 growth in real consumer spending will fall between the middling pace logged in Q1 and the blistering pace seen in Q2.

August saw the largest monthly decline in core goods prices since May 2003, reversing the modest firming seen over the prior few months. This leaves core goods prices down year-on-year for a 70th consecutive month. The path of core goods prices over coming months be a key determinant of the path of core inflation. Core services inflation has been fairly steady over recent months but could pick up over coming months as labor costs grow at a faster pace. Even so, there is little to suggest the FOMC will see inflation as a major threat any time soon.

The FOMC is more than justified in its present policy course. With growth in labor earnings putting a firm floor beneath them, consumers will withstand the shift in the stance of monetary policy.





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