ECONOMIC UPDATE

REGIONS

June 28, 2019

May Personal Income/Spending: U.S. Consumers Still In A Good Spot

- Personal income rose by 0.5 percent in May, personal spending rose by 0.4 percent, and the saving rate held at 6.1 percent
- The PCE deflator rose by 0.2 percent and the core PCE deflator was up by 0.2 percent in May; year-on-year, the PCE deflator was up by 1.5 percent and the core deflator was up by 1.6 percent

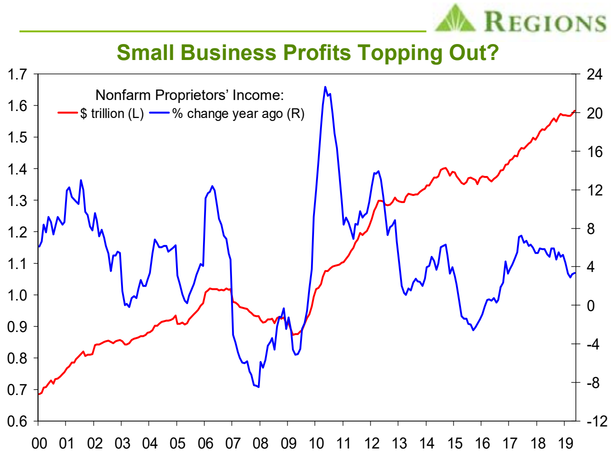
Total personal income rose by 0.5 percent in May, better than the 0.3 percent increase we and the consensus expected, while total personal spending was up by 0.4 percent, a bit below the 0.5 percent increase we and the consensus expected. May's increase in spending, however, comes off of an upward revision to the April data, and on net Q2 growth in real consumer spending is now tracking above what our forecast had anticipated. The personal saving rate remained steady at 6.1 percent in May. The PCE deflator, the FOMC's preferred gauge of inflation, rose by 0.2 percent in May, as did the core PCE deflator. The PCE deflator is up 1.5 percent and the core PCE deflator up 1.6 percent year-on-year.

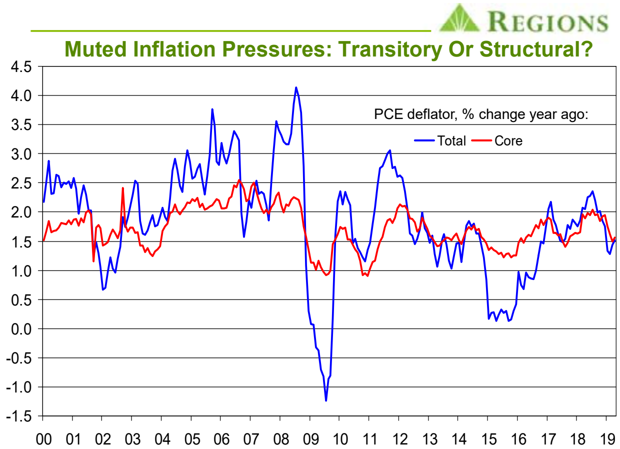
As we anticipated based on the earnings details in the May employment report, labor earnings posted a fairly tepid increase in May. Private sector wage and salary earnings logged a below-trend increase of 0.2 percent, while government sector wage and salary earnings were up by just 0.08 percent. Recall that private sector payrolls rose by just 90,000 jobs in May, with an increase of only 8,000 jobs amongst the goods producing industries, both of which weighed on growth in private sector wage and salary earnings. Keep in mind that labor earnings are easily the largest single component of personal income, so the May data merit attention. Next week's release of the June employment report will help put the May data in proper context, but if job growth really has slowed to the extent suggested in the May data, that would imply slower growth in total personal income, consumer spending, and GDP.

Our miss on our forecast of growth in total personal income stems from proprietors' income and income from assets topping our forecast. Interest income was up by 2.3 percent in May, after a 2.4 percent increase in April, but with market interest rates having fallen sharply since late-May, it is unlikely these gains will be repeated. Dividend income was up by 0.5 percent in May, after a solid 0.6 percent increase in April. Nonfarm proprietors' income, a proxy for small business profits, was up by 0.7 percent in May, the largest gain since October. We have been pointing to how weak this category has been over the past several months, and have wondered whether small business owners were lacking the pricing power to keep pace with faster growth in input costs, particularly labor costs. Note that year-on-year growth slowed sharply as 2018 came to a close, as illustrated in our chart below. While the bounce in May is a welcome sight, it is too soon to know whether the prior five months were just a soft patch or whether small business profits are topping out. This bears watching over coming months.

As noted before, while growth in total consumer spending in May fell short of our forecast, the upward revision to the initial estimate of April spending growth puts Q2 growth on a higher trajectory than our forecast had anticipated. Spending on goods was notably strong in the first two months of Q2, with strong motor vehicle sales supporting spending on consumer durable goods in May. Recall that yesterday's release of the third estimate of Q1 GDP included a downward revision to growth in real consumer spending, with annualized Q1 growth in real consumer spending now put at just 0.9 percent. That downward revision, however, reflected cuts to prior estimates of spending on services, most notably nonprofit hospital services, net foreign travel, and financial services. While we thought those to be some odd revisions, we were not at all concerned about the state of U.S. consumers, and the Q2 data on spending on consumer goods affirms our view that Q2 growth in real consumer spending will be much stronger than was the case in Q1.

The core PCE deflator was up by 0.2 percent in May, leaving it up 1.6 percent on an over-the-year basis. Core goods prices were up by 0.09 percent in May, not much but that they were up at all is worth noting given how weak core goods prices have been for an extended period – even with the small increase in May, core goods prices are down 1.1 percent year-on-year. This category bears watching, because if tariffs are applied to all imports from China this is where any pass-through to U.S. consumers will be evident. For now, though, the services sector remains the primary source of upward pressure on core inflation, but even there the pace of price increases has slowed. Still, as 2019 wears on, the over-the-year comparisons will become easier, making it likely that inflation moves back towards the FOMC's 2.0 percent target.





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