ECONOMIC UPDATE

REGIONS

February 28, 2020

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January Personal Income/Spending: One-Off Factors Lift Income Growth, Trend Is Unclear

- Personal income rose by 0.6 percent in January, personal spending rose by 0.2 percent, and the saving rate rose to 7.9 percent
- The PCE deflator rose by 0.1 percent and the core PCE deflator was up by 0.1 percent in January; year-on-year, the PCE deflator was up by 1.7 percent and the core deflator was up by 1.6 percent

Total personal income rose by 0.6 percent in January, besting our above-consensus forecast of a 0.5 percent increase, while total personal spending rose by 0.2 percent, matching our below-consensus forecast. In any given year, January personal income growth is boosted by a series of once-a-year factors such as bonus payouts that boost labor earnings, cost of living adjustments to programs such as Social Security, and other cost of living adjustments to other forms of income. This year was no exception to that general rule, and top-line income growth was also boosted by a sharp increase in dividend income. Consumer spending played out as we anticipated – spending on goods was weak, while spending on household services was weighed down by lower utilities outlays. With income growth having easily outpaced spending growth, the personal saving rate jumped to 7.9 percent in January from 7.5 percent in December. The PCE Deflator and the core PCE Deflator each rose by 0.1 percent in January, half the increases we and the consensus expected; on an over-the-year basis, the total PCE Deflator is up 1.7 percent and the core PCE Deflator is up 1.6 percent.

Total wage and salary earnings rose by 0.5 percent in January. That this is a stronger gain than implied by the earnings details in the January employment report in part reflects one-off payouts in January that come on top of regular wage earnings. Government sector wage and salary earnings rose by 0.3 percent, with this growth capturing any annual cost of living adjustments that took effect in January. Transfer payments rose by 1.6 percent in January, again reflecting annual cost of living adjustments. But, with inflation having been much more mild in 2019 than had been the case in 2017 and 2018, this January's increase in transfer payments lagged those of the prior two years. Dividend income jumped 1.1 percent in January, while nonfarm proprietors' income, a proxy for small business profits, rose by 0.8 percent, following up on a 0.6 percent increase in December.

To the extent that annual adjustments boosted growth, January's pace of growth in personal income is clearly not sustainable. Our estimate of what a sustainable pace of growth is has been called into question by revisions to prior estimates of growth in wage and salary earnings over the back half of 2019. The most recent installment of the Bureau of Labor Statistics' *Quarterly Census of Employment and Wages* (QCEW) resulted in sharp downward revisions to prior estimates of growth in labor earnings, which we summarize in our second chart below. For each category, the green and blue bars reflect annualized growth in Q3 and Q4, respectively, as initially estimated, while the black and gold bars reflect revised growth in Q3 and Q4, respectively. As indicated, the QCEW data led the BEA to significantly lower its estimates of growth in wage and salary earnings, the largest single component of personal income. As such, growth in both labor earnings and in total personal income entered 2020 on a much weaker trajectory than had previously been thought to be the case. It should be noted that the most recent QCEW data are for Q3 2019 which, given how weak the Q3 data are, is likely biasing the BEA's current estimates of Q4 growth lower. As such, it will take a few more months to have a better sense of the run rate in growth of labor earnings and, in turn, total personal income.

That is something that will obviously have an impact on growth of consumer spending. As it is, Q1 growth got off to a notably weak start. Spending on consumer durable goods did increase by 0.6 percent, but this in part reflects a faster pace of motor vehicle sales that we do not expect to be sustained over coming months. Spending on nondurable consumer goods fell by 0.2 percent. Services account for roughly two-thirds of all consumer spending as measured in the GDP data, and for a second consecutive month atypically warm winter weather held down household outlays on utilities, resulting in below-trend increases in spending on household services. Though the lower trajectory of growth in personal income can be expected to impact growth in consumer spending, one mitigating factor is the size of the cushion households have in the form of an elevated saving rate. But, whether, or to what extent, consumers are willing to tap into savings will largely be a function of how consumer confidence holds up in the face of plunging equity prices in the midst of unsettling news on the coronavirus. At this point, it is simply too soon to draw any definitive conclusions.