ECONOMIC UPDATE
REGIONS
May 28, 2021

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April Personal Income/Spending: Wild Swings In Household Financial Flows Continue

- Personal income fell by 13.1 percent in April, personal spending rose by 0.5 percent, and the saving rate fell to 14.9 percent
- The PCE Deflator rose by 0.6 percent and the core PCE Deflator rose by 0.7 percent in April; on an over-the-year basis, the PCE Deflator is up 3.6 percent and the core PCE Deflator is up 3.1 percent

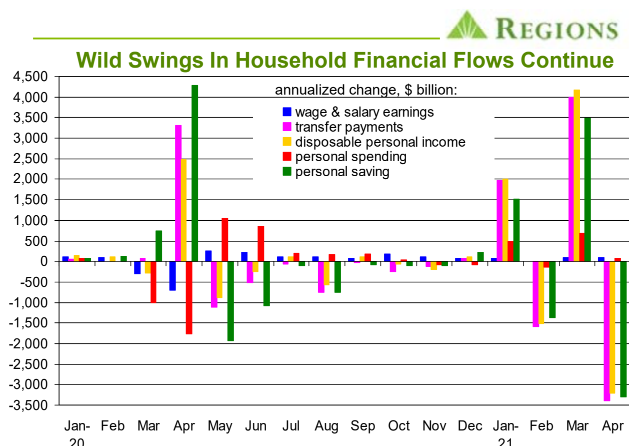
Total personal income fell by 13.1 percent in April, a slightly smaller decline than our forecast of 13.3 percent and less harsh than the 14.5 percent decline anticipated by the consensus forecast. The sizable drop in personal income simply reflects the unwinding of the third round of Economic Impact Payments, most of which hit the books in March, and should not deflect attention from another solid increase in total labor earnings. Total personal spending rose by 0.5 percent, matching the consensus forecast but well below our forecast of a 1.2 percent increase as services spending was not as robust as we anticipated. With the sharp decline in personal income and the increase in spending, the personal saving rate fell to 14.9 percent in April, but nonetheless remains roughly double the pre-pandemic trend rate. The PCE Deflator rose by 0.6 percent in April while the core PCE Deflator rose by 0.7 percent, each matching our forecast, good for over-the-year increases of 3.6 percent and 3.1 percent, respectively.

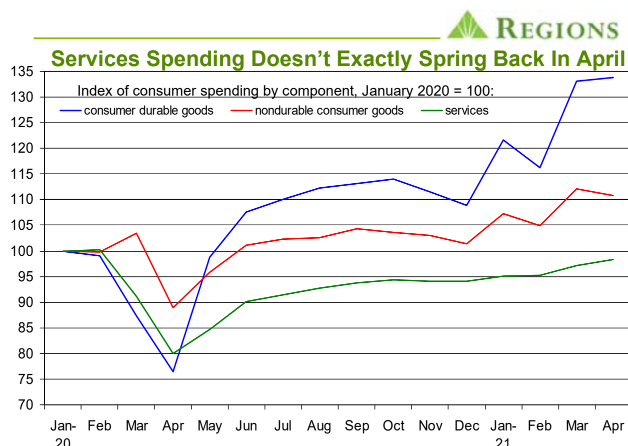
Total personal income fell by $3.205 trillion in April, more than fully accounted for by a $3.384 trillion decline in transfer payments (note that the data are reported in terms of annualized rates). As noted above, this reflects the unwinding of the third round of Economic Impact Payments (EIP), which pushed transfer payments up by $3.391 trillion. Note that some portion of the third round of EIP fell into April and will be reversed in the May data, thus acting as a drag on total personal income. As can be seen in our first chart below, there have been wild swings in household financial flows over the course of the pandemic, with the three rounds of EIP quite visible in the pattern of transfer payments over this time. Another support for transfer payments has been the expansion of unemployment insurance (UI) benefits, though a number of states have announced they will be pulling the plug on supplemental and pandemic-related UI payments beginning in June or July, which will be reflected in the data on transfer payments.

These swings should not deflect attention from private sector wage and salary earnings, which will resume their role as the primary driver of changes in total personal income as UI payments fade and labor market conditions continue to improve. Aggregate private sector wage and salary earnings rose by 1.1 percent in April, matching March's increase. This came despite a surprisingly small increase in nonfarm payrolls, but this was more than made up for by increases in average weekly hours worked and average hourly earnings, with the biggest increases in each coming in leisure and hospitality services. It is worth noting that firms are having increasing difficulty in filling open positions and have thus begun to offer meaningfully higher entry level wages, in a sense acting as a de facto increase in minimum wages, but this also filters up the earnings chain to the extent firms are compelled to adjust wages for existing workers in accordance with higher entry-level wages. This is a key reason that wage pressures are building so early in the current cycle, in terms of the remaining degree of labor market slack.

To the extent demand for services continues to rebound in the months ahead, service providers will continue to staff up. That rebound in services spending, however, was not nearly as robust in April as we anticipated would be the case. While consumer spending on services rose by 1.1 percent, we had expected a much larger increase, and this accounts for our forecast miss on total consumer spending. There is reason to believe that services spending will pick up at a much faster pace in the months ahead, with travel and lodging bookings rising and theme park attendance picking up. Keep in mind that services account for roughly two-thirds of consumer spending and, as seen in our second chart below, the level of services remains below the pre-pandemic peak. This is in stark contrast to spending on goods which, as of April, was 19.2 percent above the pre-pandemic peak. Spending on consumer durable goods advanced further in April, largely due to stronger motor vehicle sales. One potential drag on spending on goods in the months ahead is supply, or lack thereof, given growing reports of supplies of consumer goods growing thinner and thinner, including motor vehicles.

Accelerating inflation will be dismissed as transitory, though we're not so sure. Supply constraints, higher shipping costs, and rising labor costs suggest more staying power for inflation than many are now assuming.





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