ECONOMIC UPDATE

REGIONS

June 30, 2022

May Personal Income/Spending: Pullback In Goods Spending Has Further To Run

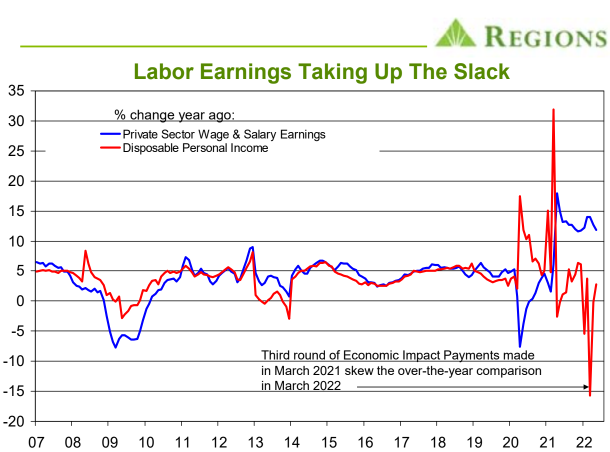
- Personal income rose by 0.5 percent in May, personal spending rose by 0.2 percent, and the saving rate rose to 5.4 percent
- The PCE Deflator rose by 0.6 percent and the core PCE Deflator rose by 0.3 percent in May; on an over-the-year basis, the PCE Deflator is up 6.3 percent and the Core PCE Deflator is up 4.7 percent

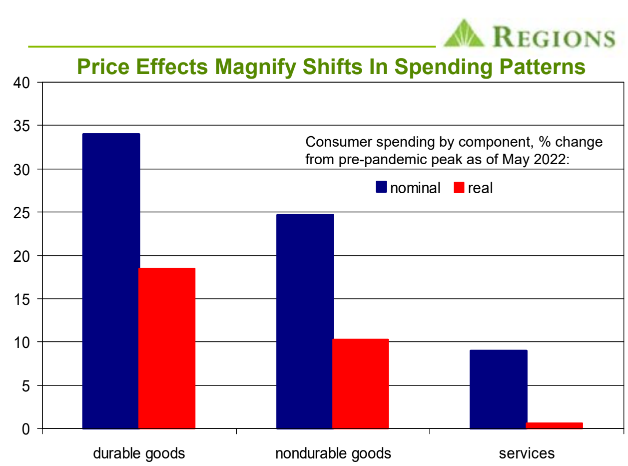
Total personal income rose by 0.5 percent in May, a touch stronger than the 0.4 percent increase we anticipated, while total personal spending rose by just 0.2 percent, well short of our forecast of a 0.5 percent gain. With income growth outpacing spending growth, the personal saving rate rose to 5.4 percent, while previously reported saving rates for April and March were revised higher as personal spending growth in each month was revised down. Recall that the third estimate of Q1 GDP showed a markedly slower pace of growth in consumer spending than was reported in the first two estimates, and that slower pace of growth carried into Q2, which is one reason expectations for Q2 real GDP growth are being scaled down. The PCE Deflator rose by 0.6 percent in May while the Core PCE Deflator rose by 0.3 percent, each one-tenth shy of the increases we and the consensus expected; on a year-on-year basis, the PCE Deflator is up 6.3 percent and the Core PCE Deflator is up 4.7 percent, with May the third straight month in which core inflation as measured by the PCE Deflator has decelerated.

Aggregate private sector wage and salary earnings rose by 0.6 percent in May, matching our forecast, leaving them up 11.9 percent year-on-year, the 14th straight month with a double-digit year-on-year increase. Proprietors' income posted a solid 1.5 percent increase, handily beating our forecast. We had expressed concern over the path of nonfarm proprietors' income, a proxy for small business profits, which had been notably weak over prior months. In general, small businesses have less latitude to pass higher input and labor costs along to customers in the form of higher prices than is true of larger corporations. The sizable increase in May doesn't necessarily render our concerns moot as the May gain is so out of line with the weakness seen over prior months, but this is clearly something worth watching going forward. Rental income was up 1.9 percent in May, matching April's increase, while asset-based income (dividends and interest) was up 0.5 percent. On the flip side, transfer payments were down by 0.2 percent in May; aside from Medicare and Medicaid, there were declines in most forms of transfer payments, including unemployment insurance benefit payouts, which continue to decline at a rapid clip as greater numbers of people drop off the benefit rolls.

While our forecast anticipated a sizable decline in spending on consumer durable goods in May, the 3.2 percent decline was larger than we expected. Recall that unit motor vehicle sales fell sharply in May, which we saw as being more of a (lack of) supply story than a demand story, even if that distinction doesn't matter to the data. At the same time, the data on May retail sales showed declines in sales of other types of consumer durable goods, including furniture, appliances, and electronics. It is worth noting that waning demand for durable goods is being reflected in falling prices in some categories, which is one factor contributing to the deceleration in core inflation. While spending on nondurable consumer goods was up 0.7 percent, this largely reflected substantially higher gasoline prices, which of course wash out in the real (inflation adjusted) data. Spending on services was up 0.7 percent, a smaller gain than we anticipated given rising demand and higher prices.

We have talked for some time of a rotation in consumer spending patterns, with less emphasis on goods and more emphasis on services. Recall that spending on goods had been amped up by the substantial transfer payments distributed while much of the services sector was either shuttered or operating at limited capacity. At a time when global production was sharply curtailed, this contributed to significantly higher goods prices. The burst in goods spending never figured to be sustained, it was instead a matter of when and how rapidly it would unwind. Still, even with spending on goods looking wobbly over recent months, the level of spending on consumer durables remains substantially above the pre-pandemic peak, only part of which is due to higher prices. We think it likely that coming months will see sharper declines in spending on consumer durables. At the same time, real services spending is barely above the pre-pandemic peak, and we expect services spending to cool after the summer months, if not before. In total, this suggests a meaningfully slower pace of growth in real consumer spending over 2H 2022, which will be reflected in slower top-line real GDP growth.





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