ECONOMIC UPDATE

REGIONS

March 31, 2023

February Personal Income/Spending: Discretionary Spending Clearly Softening

- Personal income <u>rose</u> by 0.3 percent in February, personal spending <u>rose</u> by 0.2 percent, and the saving rate <u>rose</u> to 4.6 percent
- The PCE Deflator <u>rose</u> by 0.3 percent and the core PCE Deflator <u>rose</u> by 0.3 percent in February; on an over-the-year basis, the PCE Deflator is <u>up</u> 6.4 percent and the core PCE Deflator is <u>up</u> 4.7 percent

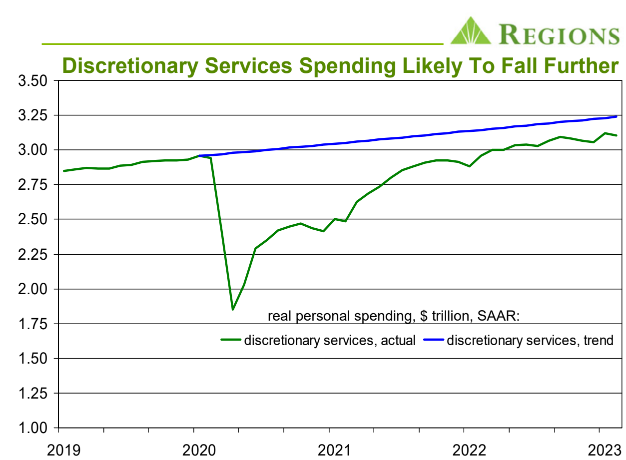
Total personal income rose by 0.3 in February, better than the 0.2 percent increase we and the consensus expected, while total personal spending rose by 0.2 percent, matching our below-consensus forecast. With growth in disposable personal income outpacing spending growth, the personal saving rate rose to 4.6 percent. The PCE Deflator, the FOMC's preferred gauge of inflation, rose by 0.3 percent in February, as did the core PCE Deflator, both falling short of expectations. On an over-the-year basis, the PCE Deflator is up by 6.4 percent with the core PCE Deflator up by 4.7 percent, both well off their peaks but nonetheless well above the FOMC's target. Inflation adjusted consumer spending fell by 0.1 percent in February, but with an upward revision to the original estimate for January, real consumer spending is on course to grow at an annual rate of over 4.0 percent in Q1 2023, though this heady growth will not last.

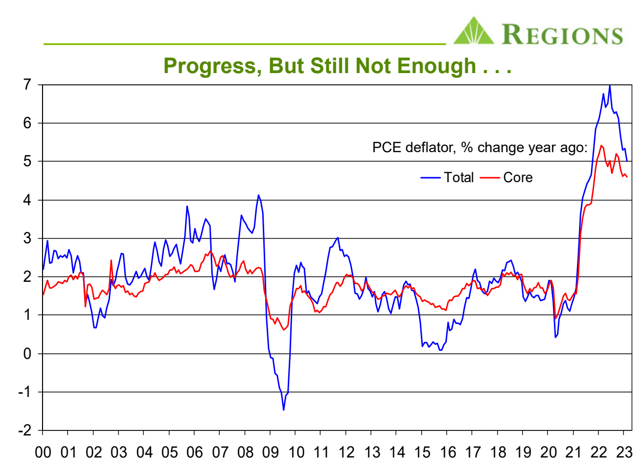
Aggregate private sector wage and salary earnings rose by 0.3 percent in February while the 1.0 percent increase originally reported for January was revised down to a 0.9 percent increase. Wage and salary earnings amongst the goods producing industries declined in February, with earnings in the manufacturing falling by 0.5 percent. While this followed a 1.5 percent increase in January, the weak February print also reflects declines in manufacturing payrolls during the month. Wage and salary earnings amongst service providing industries rose by 0.4 percent in February, settling back in line with the trend that had prevailed prior to the 0.9 percent increase in January. Services sector wage growth is, as the FOMC sees the world, a key determinant of services sector inflation, and growth settling back into a more moderate pace should give some confidence that services sector inflation pressures will ease.

As we noted in our weekly *Economic Preview*, our forecast of February income growth anticipated the expiration of remaining supplemental SNAP benefits acting as a drag on growth in transfer payments. As such, we were surprised by the 0.5 percent increase in transfer payments in February, with another hefty increase in Medicare payments propping up total transfer payments. Nonfarm proprietors' income, a proxy for small business profits, was flat in February after a string of middling increases over prior months. The weak trend in nonfarm proprietors' income at least in part reflects small businesses lacking the same degree of pricing power as larger firms possess, hence small businesses must absorb larger shares of increases in costs for labor and other inputs.

Nominal personal spending was up 0.2 percent in February after having risen by 2.0 percent in January. As we noted last month, January spending growth was significantly boosted by seasonal adjustment, making it likely that the February print would be much weaker. Nominal spending on goods was flat, with higher spending on nondurable goods offsetting a decline in spending on consumer durable goods which in large measure reflected a decline in unit motor vehicle sales. Nominal services spending rose by just 0.2 percent, the smallest increase since January 2022. Our proxy for discretionary services spending, which excludes housing, utilities, health care, and financial services, fell by 0.6 percent in February after adjusting for inflation, marking the fourth decline in the past five months, the only exception being a 2.1 increase in January that was bolstered by seasonal adjustment. Though getting underway slightly later than we had anticipated, fading discretionary services spending was a key component of our forecast of meaningfully slower growth in real consumer spending in 2023.

Core goods prices rose by 0.1 percent in February, which is noteworthy given that prices for used motor vehicles fell by 2.8 percent, meaning that increases in other categories, particularly apparel, took up the slack. Core services prices were up by 0.4 percent, which to some degree reflects continued hefty increases in rents. Excluding housing and energy, upward pressure on services prices has been fueled by lodging, recreation, and entertainment, among other categories. With wage growth in these industry groups having slowed, those who see a strong link between wage growth and output prices should have some confidence that services sector inflation will slow over coming months. For now, though, inflation remains too high for the FOMC's comfort and, barring more widespread stress in the banking system, the FOMC is unlikely to see their work, i.e., raising the Fed funds rate, as being done.





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