ECONOMIC UPDATE

REGIONS

June 30, 2023

May Personal Income/Spending: Slowing Spending Growth A Harbinger Of What's To Come

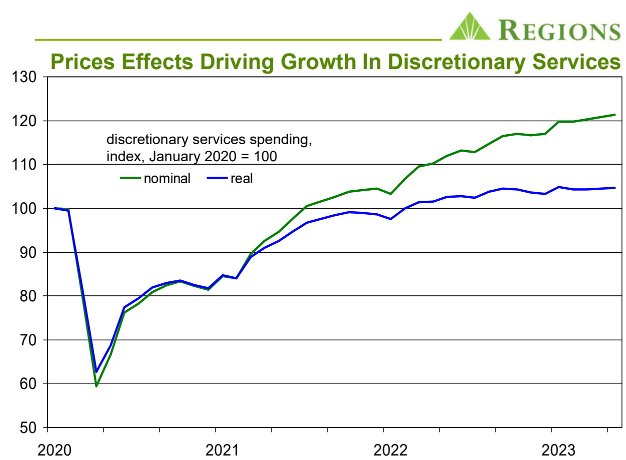
- Personal income rose by 0.4 percent in May, personal spending rose by 0.1 percent, and the saving rate rose to 4.6 percent
- The PCE Deflator rose by 0.1 percent and the core PCE Deflator rose by 0.3 percent in May; on an over-the-year basis, the PCE Deflator is up 3.8 percent and the core PCE Deflator is up 4.6 percent

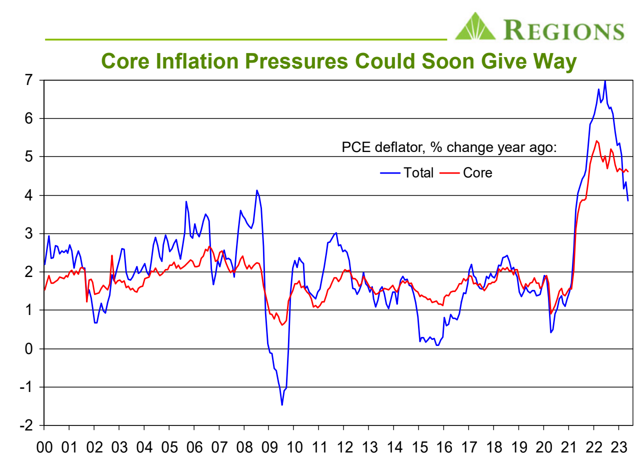
Total personal income rose by 0.4 in May, matching our above-consensus forecast, while total personal spending rose by just 0.1 percent, lagging what we and the consensus expected. With growth in disposable personal income outpacing spending growth, the personal saving rate rose to 4.6 percent. The PCE Deflator, the FOMC's preferred gauge of inflation, rose by 0.1 percent in May while the core PCE Deflator rose by 0.3 percent, each matching what we and the consensus expected. On an over-the-year basis, the PCE Deflator is up by 3.8 percent with the core PCE Deflator up by 4.6 percent, with the change in the total index benefitting from favorable base effects not in play in the core index, though both remain far above the FOMC's target. Inflation-adjusted consumer spending was flat in May, while at the same time the initial estimate of real spending in April was revised downward. As such, through May Q2 growth in real consumer spending is tracking at an annual rate of less than 1.0 percent. If it seems like only yesterday that we were being bombarded with headlines of how strong the U.S. economy is, how resilient U.S. consumers are, and how all of that means the FOMC will have to be even more aggressive in raising the Fed funds rate, that's because it was only yesterday. Those headlines were in reaction to the upward revision in Q1 real GDP growth, which included an upward revision to Q1 consumer spending. A look at the details of the GDP data, however, shows that to be a function of an upward revision to health care expenditures which, even if those expenditures actually came out of consumers' pockets (they don't), would hardly be a sign of upbeat free-spending consumers. The May data are more in keeping with the trends evident in the details of the data for some time, i.e., slowing growth in total consumer spending with discretionary services spending remaining a key support. How much longer that support will last, however, remains to be seen.

Aggregate private sector wage and salary earnings rose by 0.5 percent, a larger increase than we anticipated given the decline in aggregate private sector hours worked. Wage and salary earnings amongst the goods producing industries rose by 0.6 percent in May with earnings amongst services providing industries up by 0.5 percent. Slowing growth amongst the broad trade, transportation, and utilities segment is holding down growth in overall services earnings, with stronger earnings growth amongst discretionary services. That is relevant in that, as the FOMC sees the world, wage growth is a key determinant of services sector inflation.

Nonfarm proprietors' income, a proxy for small business profits, rose by 0.5 percent in May, but that comes on the heels of a sharp downward revision to the initial estimate of April, leaving the category basically treading water in Q2. There were, however, meaningful upward revisions to Q1 nonfarm proprietors' income incorporated into the revised Q1 GDP data, but the trend in this category remains weak. Our premise is that small businesses are being squeezed more tightly by rising costs than is the case with large corporations, as small firms in general do not possess the same degree of pricing power and, as such, must absorb larger shares of increases in costs for labor and other inputs.

Nominal spending on goods declined by 0.5 percent in May, in line with our forecast, but the 0.4 percent increase in services spending was smaller than we anticipated, hence our forecast miss on growth in total personal spending. Real spending on goods has declined in five of the past seven months, reflecting the dimming spending on goods that we've been discussing for some time now. Our proxy for discretionary services spending rose by 0.5 percent in May, one of the larger increases over the past several months. But, steadily rising prices for discretionary services are making growth in such spending look stronger than is actually the case, as indicated in our first chart below. Our sense is that discretionary services spending will slow come the end of summer, but if we are correct on that point, that could take the form of a sudden stop rather than a gradual deceleration, as is the nature of such spending. This very much matters in terms of the path of spending growth, as discretionary services spending is one of the key pillars of what growth we are seeing in consumer spending at present, motor vehicle purchases being another. The flip side of such a scenario, however, would be a more pronounced easing in services price inflation, and in turn overall inflation, than many, including the FOMC, are now expecting.





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