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## December Personal Income/Spending: Strong Spending Sets Higher Q1 Base

- › Personal income rose by 0.3 percent in December, personal spending rose by 0.7 percent, and the saving rate fell to 3.7 percent
- › The PCE Deflator rose by 0.2 percent and the core PCE Deflator rose by 0.2 percent in December; on an over-the-year basis, the PCE Deflator is up 2.6 percent and the core PCE Deflator is up 2.9 percent

Total personal income rose by 0.3 percent in December, topping the 0.2 percent increase we anticipated, while total personal spending rose by 0.7 percent, topping our above-consensus forecast of a 0.6 percent increase. With spending growth outpacing income growth, the personal saving rate fell to 3.7 percent in December from 4.1 percent in November. Not only was December spending stronger than anticipated, but the prior estimate of November personal spending was revised higher. The monthly data were incorporated into the Q4 GDP data showing growth in real consumer spending surprised to the upside. Both the PCE Deflator and the core PCE Deflator rose by 0.2 percent in December, as anticipated, but the year-on-year increases, 2.6 percent and 2.9 percent, respectively, were a touch lighter than anticipated. Real consumer spending rose by 0.5 percent in December, which not only lifted Q4 growth but sets a higher base for current quarter growth, as the level of real spending in December was well above the Q4 average. As such, even if real consumer spending were flat in each month of Q1, that would still yield annualized Q1 growth of better than two percent, more than what we and most others had been anticipating. To be sure, much can, and probably will, change by the end of Q1, but the trajectory of growth seems to be firmer than had been expected coming into 2024. Perhaps the more significant questions, however, are to what extent inflation will continue to slow and at what point will the FOMC feel confident enough that inflation is on a path that would open the door for them to begin cutting the Fed funds rate.

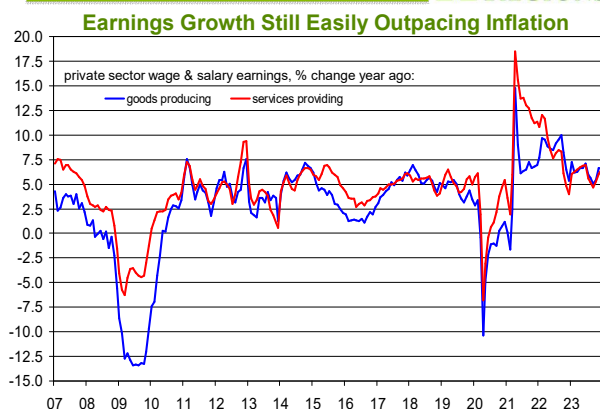
As our forecast anticipated, growth in aggregate private sector wage and salary earnings slowed in December, largely reflecting a decline in total hours worked, and was outpaced by growth in public sector wage and salary earnings. Reflecting robust hiring on the state and local levels, government sector earnings have grown faster than private sector earnings in each of the past three quarters. We noted in our weekly *Economic Preview* that we expected a further modest decline in transfer payments to weigh on top-line income growth, but if that did not happen our forecast would be too low. That proved to be the case, with transfer payments flat between November and December. Growth in asset-based

income slowed sharply in December, but that reflected a decline in dividend payments as interest income logged a third straight monthly increase of 0.8 percent. Growth in nonfarm proprietors' income, a proxy for small business profits, also slowed sharply in December and has taken on a softer tone over the past few months, which could reflect diminishing pricing power with little relief on the cost side of the ledger. This is clearly something worth watching in the months ahead.

Consumer spending on goods rose by 0.9 percent in December, with spending on consumer durable goods up by 1.1 percent. Those changes, however, do not account for price changes, and with core goods prices having fallen further in December, real spending on goods was up 1.1 percent with real spending on consumer durable goods up 1.5 percent. We've noted in our write-ups of the monthly retail sales data that falling prices were making spending in categories such as household furnishings, appliances, and electronics look weaker than was actually the case, as the retail sales data are not adjusted for price changes. The data on real (i.e., adjusted for price changes) spending, shows still-strong consumer demand. While discretionary services spending has consistently surprised us to the upside, the December data show spending on restaurants and lodging was basically flat. This leads us to wonder if the sharp slowdown in discretionary service spending we've been anticipating is at hand.

With the December print, the three-month annualized percentage change in the core PCE Deflator slipped to 1.5 percent, which is where it was in December 2019 prior to the onset of the pandemic. The alternative gauge emphasized by the FOMC, core services excluding housing, prints at 3.3 percent year-on-year, higher than desired but nonetheless the smallest such increase since early 2021. We have for some time contended there has been more progress on inflation than the FOMC has been willing to acknowledge and, granted, they see risk management as part of their role, in this case guarding against inflation reaccelerating. That said, as inflation continues to slow, the real Fed funds rate pushes higher, which we think is grounds for the FOMC to be closer to cutting the funds rate than they're willing to acknowledge.

### Earnings Growth Still Easily Outpacing Inflation



### Price Effects Driving Growth In Discretionary Services

