ECONOMIC UPDATE
REGIONS
April 26, 2024

March Personal Income/Spending: Is Discretionary Services Spending Faltering?

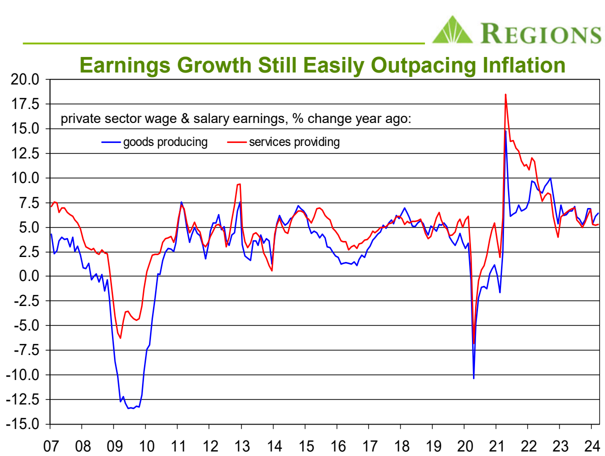
- Personal income rose by 0.5 percent in March, personal spending rose by 0.8 percent, and the saving rate fell to 3.2 percent
- The PCE Deflator rose by 0.3 percent and the core PCE Deflator rose by 0.3 percent in March; on an over-the-year basis, the PCE Deflator is up 2.7 percent and the core PCE Deflator is up 2.8 percent

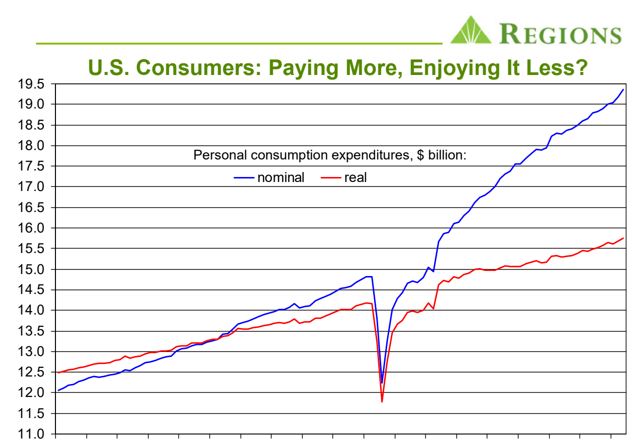
Total personal income rose by 0.5 percent in March, in line with the consensus forecast but shy of the 0.7 percent gain we anticipated, while personal spending rose by 0.8 percent, matching our above-consensus forecast. With spending growth outpacing income growth, the personal saving rate fell to 3.2 percent in March from 3.6 percent in February. The PCE Deflator and the core PCE Deflator each rose by 0.3 percent in March, the former as we expected and the latter topping our forecast of a 0.2 percent increase, yielding year-on-year increases of 2.7 percent and 2.8 percent, respectively. That the core PCE Deflator "only" rose by 0.3 percent in March is, at least thus far, being greeted with a collective sigh of relief amongst market participants after they were rattled yesterday by the GDP data showing the core PCE Deflator up at an annualized rate of 3.7 percent in Q1. Which, if you think about it, is kind of weird given that the core PCE Deflator was still up at an annualized rate of 3.7 percent in Q1. To us, perhaps the most relevant aspect of the March data is the pronounced softening of discretionary services spending in Q1. As our regular readers know, we've been surprised by the ongoing strength of discretionary services spending, having for some time now been on the lookout for signs of cracks. If this is the case, this will act as a meaningful drag on growth in overall consumer spending over coming months.

Before dealing with the income and spending data, we'll address the elephant in the room, i.e., the inflation data, particularly since yesterday we were asked more than once why we did not touch on that in our note on the Q1 GDP data. The simple answer is that we didn't see much in the data, specifically the reported increase in the core PCE Deflator, that we didn't already know. It was no secret that inflation was more stubborn in Q1 than many had anticipated. To that point, the core CPI rose at an annualized rate of 4.2 percent in Q1, which seemed to have largely gone unnoticed. Moreover, we've noted that the three-month annualized changes in the core PCE Deflator, which some see as the better gauge of inflation momentum, were moving in the wrong direction – our forecast of a 0.2 percent increase in the core PCE Deflator would have yielded a three-month annualized change of 3.9 percent. Finally, the BEA noted yesterday that housing costs were a primary driver of that annualized change in the core PCE Deflator – owners' equivalent rents rose at an annualized rate of 5.9 percent in Q1, faster than the Q4 2023 increase – while imputed costs for financial services also posted a hefty increase, the key word here being "imputed." Sure, we get that inflation being more stubborn than many had anticipated changes expectations about the path of the Fed funds rate, but our point is the past two days have brought nothing new, unless you count changes in perceptions of the data.

Our miss on our forecast of income growth is due to private sector wage and salary earnings rising by 0.7 percent, shy of the 0.8 percent increase we anticipated, less growth in nonfarm proprietors' income (a proxy for small business profits) than we anticipated, and interest income logging a third straight monthly decline, contrary to our expectations. Still, the key point here is that growth in aggregate labor earnings continues to easily run ahead of inflation, putting a solid floor under consumer spending in the face of elevated inflation and interest rates. We will, however, note that growth in earnings amongst the goods producing industries has been running ahead of growth amongst the services providing industries, calling into question the premise that it is the latter that is acting as the primary force behind services sector inflation.

Spending on consumer goods rose by 1.3 percent in March, which is not only stronger growth than our forecast anticipated but which is also at odds with the retail sales data. Recall that the March retail sales data showed weakness amongst the durable goods categories, such as motor vehicles, furniture, appliances, and electronics, while the BEA data show growth in these areas. Stronger goods spending than we anticipated offset services spending being weaker than we anticipated, with the 0.6 percent increase coming in shy of our forecast. Real discretionary services spending fell for the second time in the past three months, though there are variances amongst the individual components. It is too soon to know whether the Q1 data reflect pent-up demand for discretionary services being increasingly fulfilled or something more fundamental, but this is clearly something to watch heading into the summer months.





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