ECONOMIC UPDATE

REGIONS

January 31, 2025

December Personal Income/Spending: Strong Spending, Stubborn Inflation . . .

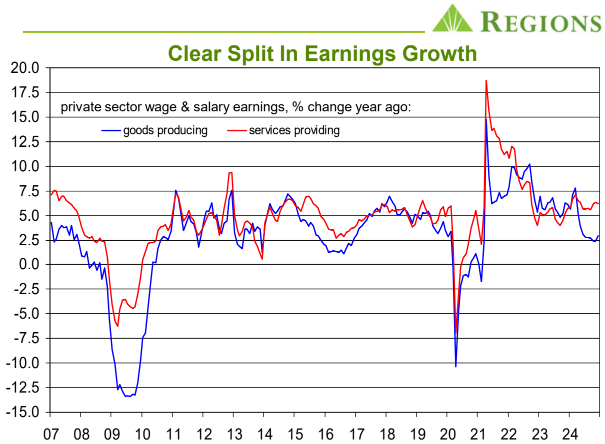
- Personal income rose by 0.4 percent in December, personal spending rose by 0.7 percent, and the saving rate fell to 3.8 percent
- The PCE Deflator rose by 0.3 percent and the core PCE Deflator rose by 0.2 percent in December; on an over-the-year basis, the PCE Deflator is up 2.6 percent and the core PCE Deflator is up 2.8 percent

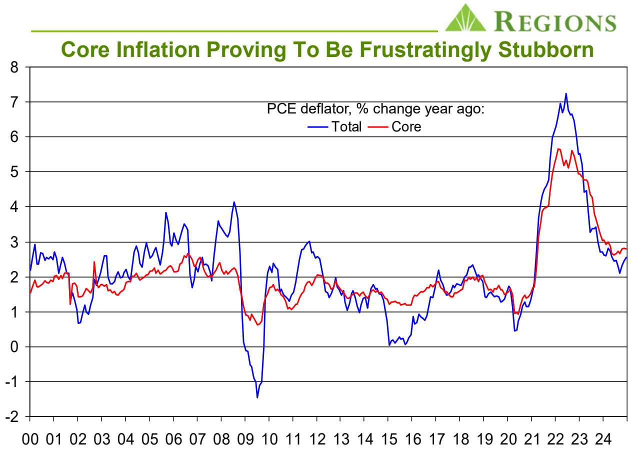
Total personal income rose by 0.4 percent in December, matching the consensus forecast but below our forecast of a 0.5 percent increase, while total personal spending rose by 0.7 percent, matching our forecast but above the consensus forecast of a 0.5 percent increase. With spending growth outpacing income growth, the personal saving rate fell to 3.8 percent in December. The robust December spending figures were incorporated into the BEA's first pass at Q4 GDP released yesterday, but the December data nonetheless set the base for Q1 2025 spending growth, and that the level of spending in December was well above the Q4 average gets Q1 growth off to a fast start. That said, we'll continue to monitor the monthly patterns for any signs of flagging spending in two key areas, consumer durable goods and discretionary services spending, neither of which we expect to be as strong in Q1 as was the case in Q4 2024. The PCE Deflator, the FOMC's preferred gauge of inflation rose by 0.3 percent while the core PCE Deflator rose by 0.2 percent, each matching the consensus forecast but each one-tenth more than our forecast anticipated. On an over-the-year basis as of December, the PCE Deflator is up 2.6 percent and the core PCE Deflator is up 2.8 percent, each (un)comfortably above the FOMC' 2,0 percent target.

Our forecast miss on personal income growth stems from private sector wage and salary earnings, up by 0.4 percent, and transfer payments, up 0.2 percent, falling short of our forecasts. Still, on an over-the-year basis, private sector wage and salary earnings were up 5.6 percent, easily outpacing inflation as has been the case over this episode of elevated inflation. The BEA data, however, show a stark divergence between growth in earnings amongst the goods producing and service providing industry groups, a split not present in the earnings details of the monthly employment reports. Our first chart below illustrates this split. The BEA data show a significantly slower pace of growth in earnings in the manufacturing sector than yielded by the details of the monthly employment reports, and the BEA data are more consistent with other indicators of a prolonged slump in the manufacturing sector. Keep in mind that the BEA's estimates of labor earnings are more or less continuously benchmarked to the data from the Quarterly Census of Employment and Wages (QCEW), a tally of payroll tax returns filed by almost all firms, whereas the BLS data are only benchmarked to the QCEW only once a year. As such, when the BLS releases the benchmark revisions to the recent historical data next Friday, look for the earnings details in the monthly employment reports to pick up this split that has been apparent in the BEA data for several months.

Total consumer spending rose by 0.7 percent in December, with spending on goods up by 0.9 percent and spending on services up by 0.6 percent. As tipped in the Q4 GDP data, spending on consumer durable goods such as motor vehicles, recreational vehicles, and household furnishings was up strongly in late-2024. It could be that, despite still-high financing costs, consumers pulled big-ticket purchases ahead into Q4 2024 to avoid any increases in tariffs that would make purchasing such goods more costly in 2025. This is one reason we point to consumer durable goods as a potential source of slower spending growth in Q1. Our proxy of spending on discretionary services, such as travel, lodging, dining out, entertainment, and recreation, was up strongly in December, rising 1.0 percent on a nominal basis and by 0.6 percent on a real basis. This is in keeping with reports from providers of such services and spending trackers showing growth in these areas. Solid advances in household net worth triggering wealth effects supportive of discretionary spending have contributed to a split in spending patterns between lower and upper income households, but a correction in equity prices and/or house prices could trigger a slowdown in discretionary services spending that would have an outsized impact on growth in total consumer spending.

Though down considerably from its peak, core inflation is proving to be frustratingly persistent. For some perspective, prior to the onset of the pandemic, you'd have to go back to September 1993 to find the rate of core PCE inflation as high as it was in December. Even if core inflation is stabilizing, not getting further away from the target isn't the same as getting closer to the target and the FOMC will likely remain on hold until they are convinced inflation is again firmly on a downward path.





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