ECONOMIC UPDATE

REGIONS

March 28, 2025

February Personal Income/Spending: Services Spending Softens

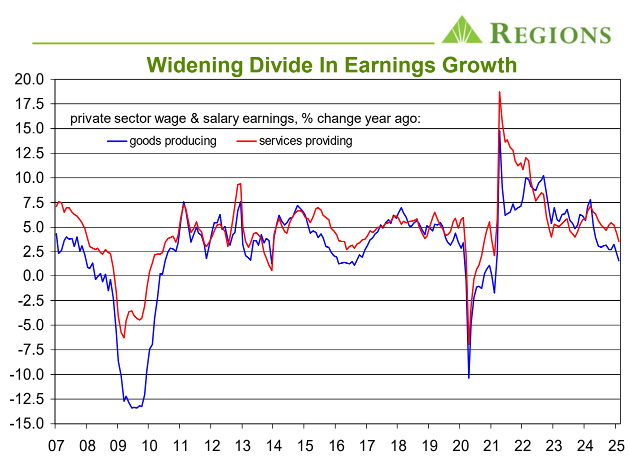
- Personal income rose by 0.8 percent in February, personal spending rose by 0.4 percent, and the saving rate rose to 4.6 percent
- The PCE Deflator rose by 0.3 percent and the core PCE Deflator rose by 0.4 percent in February; on an over-the-year basis, the PCE Deflator is up 2.5 percent and the core PCE Deflator is up 2.8 percent

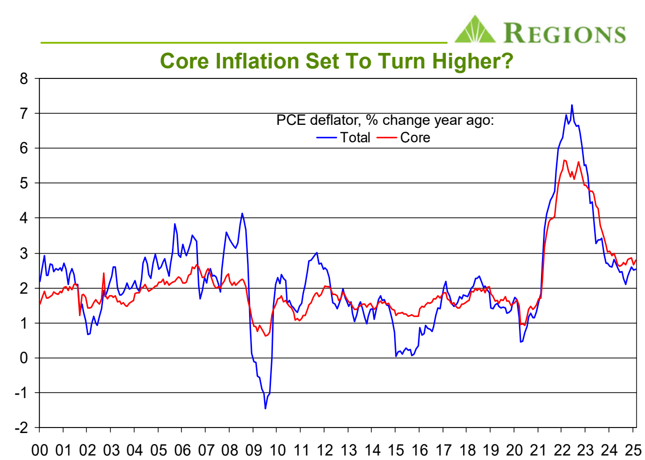
Total personal income rose by 0.8 percent in February, blowing past what we and the consensus expected, while total personal spending rose by 0.4 percent, right between what we (0.3 percent) and the consensus (0.5 percent) expected. With income growth easily outpacing spending growth, the personal saving rate rose to 4.6 percent from 4.3 percent in January though, as we'll explain below, there is less to the reported saving rate than meets the eye. The PCE Deflator, the FOMC's preferred gauge of price changes, rose by 0.3 percent in February, in line with expectations, while the core PCE Deflator rose by 0.4 percent, matching our above-consensus forecast. As of February, the total PCE Deflator is up 2.5 percent year-on-year and the core PCE Deflator is up 2.8 percent. Adjusting for price changes, total consumer spending was up 0.1 percent in February, retracing very little of the ground lost in January, when real spending fell by 0.6 percent. Barring a March binge of epic proportions, this leaves real consumer spending on course to at best post a negligible gain in Q1, which will act as a powerful drag on Q1 real GDP growth. As for the jump in the core PCE Deflator, many fear that is but a preview of what lies ahead as higher tariffs go into place and in turn unleash renewed upward pressure on goods prices, even if the extent to which either of those will actually occur is hard to get a grip on at present.

Our miss on our forecast of income growth owes mainly to a significantly larger increase in transfer payments than we anticipated. On the heels of January's 1.8 percent advance, total transfer payments rose by another 2.2 percent in February. February's increase in transfer payments in part reflects another round of sizable increases in Medicare and Medicaid outlays and in part, according to BEA, reflects payments of settlements of liability claims filed against a domestic medical device manufacturer and a social media company. A point we commonly make is that while transfer payments are included in personal income, a sizable portion of transfer payments do not reflect cash payments to consumers but instead, as in the cases of Medicare and Medicaid, reflect payments to providers of services made on behalf of consumers. As such, the measured personal saving rate can be skewed by sizable increases in non-cash transfer payments. This also goes to why we consider after-tax personal income excluding transfer payments as the more meaningful guide as to the funds available to consumers for consumption and debt service. To that point, after-tax personal income excluding transfer payments rose by 0.5 percent in February, leaving it up 3.3 percent year-on-year. Aggregate private sector wage and salary earnings, the largest single component of personal income were up by 0.5 percent in February, while rental income rose by 0.9 percent and asset-based income rose by 0.4 percent, a stronger gain than we anticipated which also helps account for our miss on growth in total personal income.

As we anticipated, services spending was notably soft in February, up by just 0.2 percent, which is the smallest monthly increase since last August. At the same time, spending on goods rose by 0.9 percent, slightly ahead of our forecast, which accounts for our forecast miss on the spending side of the ledger. We anticipated a marked slowdown in discretionary services spending, which proved to be the case, with our proxy for such spending up by just 0.2 percent and down after adjusting for price changes. After surging in December and January, utilities outlays fell in February, which acted as a drag on overall services spending. Spending on consumer durable goods was notably strong in February, with sizable increases in categories such as motor vehicles, furniture, and appliances, gains which in part could reflect consumers pulling purchases forward to avoid tariff-related price increases down the line.

Though down considerably from its peak, core inflation is proving to be frustratingly persistent. Moreover, many are concerned that higher tariffs will unleash another round of upward pressure on goods prices, pushing overall core inflation higher. Even aside from that, recent months have shown core inflation more or less leveling off, not getting worse but neither getting closer to the FOMC's 2.0 percent target rate. Core services prices excluding housing rose by 0.4 percent in February, though if we are correct in expecting discretionary services spending to slow further, that will take some of the steam out of services prices. Even so, inflation returning to 2.0 percent any time soon seems most unlikely.





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