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# Economics Group

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# Spending Bounces Back in July but Income Is Still Lagging

***Consumer spending jumped 0.8 in July, more than making up for the 0.1 percent drop in June. Spending for services and durable goods accounted for most of the increase. Income growth continues to lag, however.***

## Spending Bounces Back in July

Consumer spending jumped 0.8 percent in July as consumers cranked up their air conditioners and apparently boosted purchases of big ticket items. The 0.8 percent nominal increase in consumer spending was the largest gain since February and follows a rare 0.1 percent drop in June. Declines in nominal consumer outlays are rare outside of recessionary periods and today's figures should allay some of the fears that began to crop up earlier this month. Even with July's increase, spending is still clearly decelerating. Nominal personal consumption has risen at a 2.7 percent annual rate over the past three months, which is the slowest pace since August of last year.

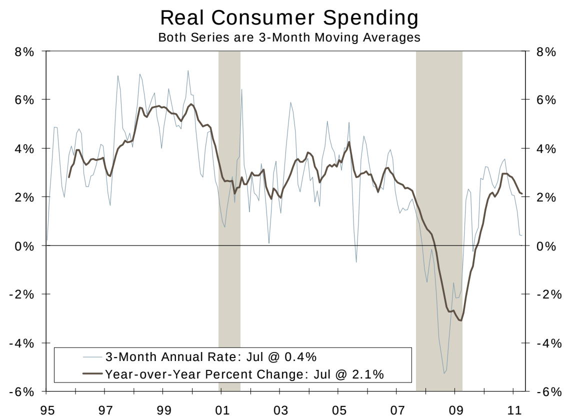
Higher inflation takes some of the shine off of July's increase. The personal consumption deflator rose 0.4 percent in July and increased 0.2 percent after excluding food and energy prices. Over the past three months, the PCE deflator has risen at a 2.3 percent annual rate, leaving spending up at just a 0.4 percent rate after adjusting for inflation.

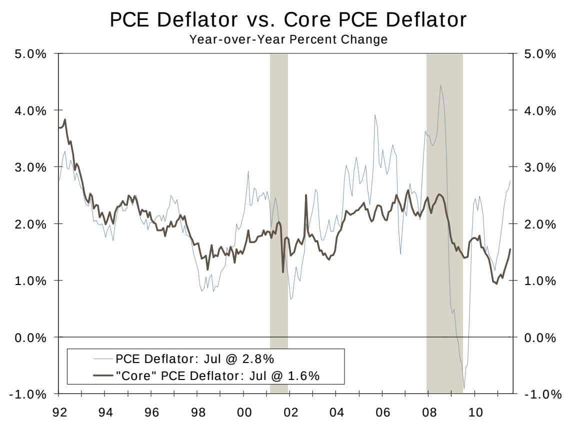
Spending for durable goods rose 2.0 percent in July, marking the largest gain in 9 months. Outlays for services, which account for nearly 65 percent of consumer spending, rose 0.5 percent. The rise in services outlays is likely tied to the unusually hot weather much of the country endured in July. Most services outlays are essentially on auto-pilot from month to month and big swings like we saw in July often reflect shifts in electricity use.

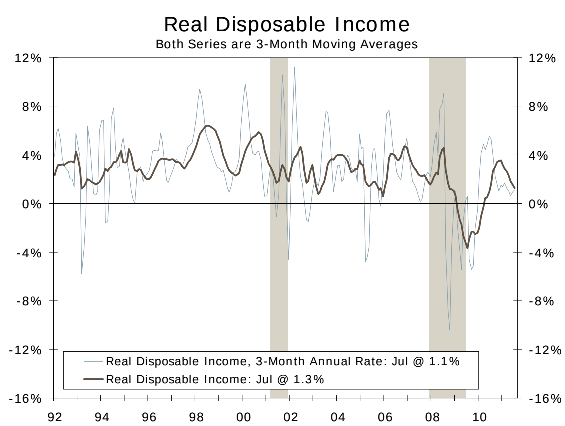
## Third Quarter Growth Estimates Will Likely Be Bumped Up

While there are an abundance of special circumstances in almost every report, this morning's stronger personal consumption figures will likely cause economists to ratchet up their third quarter real GDP estimates. Most forecasts currently peg third quarter real GDP growth somewhere between 1.0 and 2.5 percent. With July's big increase, consumer spending is now likely to grow at around a 2.0 percent pace in the third quarter. That still leaves GDP growth within that range, but now closer to the top.

Sluggish real income growth remains the biggest impediment to stronger economic growth. Wages and salaries rose a solid 0.4 percent in July, which helped push personal income up 0.3 percent. Personal income has risen at a 3.3 percent pace over the past three months and is up 2.8 percent year-to-year. Unfortunately, inflation has risen nearly as fast, climbing at a 2.8 percent pace over the past three months and 2.8 percent year-to-year. As a result, real after-tax income has barely budged, particularly after adjusting for taxes. Real after-tax income fell 0.1 percent in July and is up at just a 1.2 percent pace over the past three months, and by that same amount over the past year. That is simply not enough real income growth to promote a self-reinforcing recovery, particularly with transfer payments such as unemployment insurance and Medicaid payment being scaled back.




Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

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