ECONOMIC UPDATE

REGIONS

June 27, 2013

May Personal Income/Spending: Income, Spending Bounce Back In May

- Personal income rose by 0.5 percent in May; personal spending rose by 0.3 percent, and the savings rate rose to 3.2 percent.
- The PCE deflator rose by 0.1 percent and the core PCE deflator was up by 0.1 percent in May. On a year-over-year basis, the PCE deflator was up by 1.0 percent and the core deflator was up by 1.1 percent.

Wow, it seems like only yesterday the release of revised Q1 data showing growth in consumer spending was slower than previously estimated led to much hand wringing about the demise of the U.S. consumer under the weight of higher interest rates and a still sluggish labor market. Wait, that was only yesterday. Presumably the May data on personal income and spending will help ease those concerns, even if only a little bit. Total personal income was up by 0.5 percent in May, with April's data revised to show income was up slightly not unchanged as initially estimated. Personal consumption expenditures (PCE) rose by 0.3 percent in May, with April's (price induced) decline now shown to be smaller than the initial estimate.

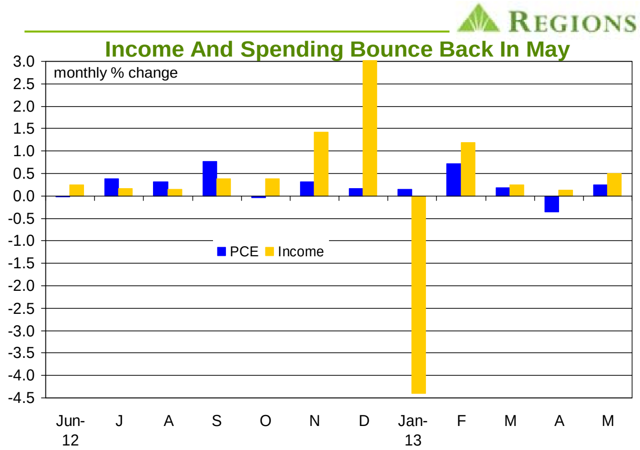
May's growth in personal income was led by gains in private sector wage and salary earnings, transfer payments, dividend payments, and interest income, all of which posted solid gains. To our surprise, though, rental income fell slightly during the month, but this is likely a one-off occurrence given the vitality of the rental market. Total transfer payments rose by 0.8 percent in May, but this comes on the heels of a 0.6 percent decline in April, with Social Security payments and Medicare payments both exhibiting sharp month-to-month swings. The increase in transfer payments was good for one-tenth of a point on growth in total personal income in May, which still leaves a decent gain in income from other sources.

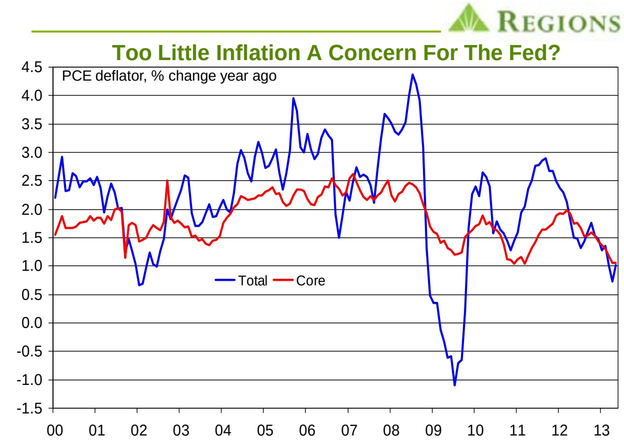
Government sector earnings were up by 0.1 percent in May after having been unchanged over the previous two months, but on a year-over-year basis government sector earnings are up by just 0.6 percent. This is a reflection of what remain ongoing, albeit moderating, job losses in the government sector as well as furloughs of federal government workers due to the sequestration spending cuts. These furloughs will remain in place until the end of Q3 (the end of the fiscal year) and, as such, will remain a drag on earnings in the government sector. In contrast, given our expectations for private sector job gains to pick up over the second half of the year, private sector earnings growth should build upon the 4.4 percent over-the-year increase seen in May.

Overall consumer spending, as measured by the PCE data, rose by 0.3 percent in May, with spending on consumer durable goods (mainly motor vehicles and home furnishings/appliances) up by 0.9 percent, spending on nondurable consumer goods up by 0.3 percent after sharp declines in March and April, and spending on household services up by 0.1 percent. It was a downward revision to spending on services, which accounts for roughly two-thirds of consumer spending as measured in the GDP accounts, which led to the downward revision in growth in real consumer spending in Q1. With income having grown faster than spending during the month, the personal saving rate edged higher to 3.2 percent from an upwardly revised 3.0 percent rate in April. Still, the saving rate is about half a point below where it had settled in the months before the wild swings seen in late 2012/early 2013 as changes in tax rates led to spikes in dividend payouts and accelerated bonus payments.

The PCE deflator rose by 0.1 percent in May, as did the core PCE deflator, which translate into over-the-year increases of 1.0 percent and 1.1 percent, respectively. The PCE deflator measure of inflation is the Fed's preferred measure and it remains well below the Fed's 2.0 percent target rate. While this might be viewed as giving the Fed greater latitude in the timing of any changes to its current rate of asset purchases, most FOMC members view low, and falling, inflation as transitory. And, as we discussed in our June *Economic Outlook*, the CPI is at present likely a more reliable indicator of core inflation than is the PCE deflator and core CPI inflation is running well ahead of the PCE measure.

The bottom line is the May data on inflation, personal income, and consumer spending do not change our outlook for the economy and are unlikely to change the view from either the markets or the Fed. The reaction to yesterday's revised GDP data was overstated, and the key going forward remains the labor market, which we expect to improve over the remainder of 2013.





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