ECONOMIC UPDATE

REGIONS

June 26, 2014

May Personal Income/Spending: Income Posts A Solid Gain, Spending Not So Much

- Personal income rose by 0.4 percent in May; personal spending rose by 0.2 percent, and the savings rate rose to 4.8 percent.
- The PCE deflator rose by 0.2 percent and the core PCE deflator was also up by 0.2 percent in May. On a year-over-year basis, the PCE deflator was up by 1.8 percent and the core deflator was up by 1.5 percent.

Total personal income rose by 0.4 percent in May while total personal consumption expenditures rose by a more modest 0.2 percent. The monthly personal spending data have been revised in line with the revised Q1 GDP data that caused such a stir yesterday, reflected in sharp downward revisions to prior estimates of spending in January and February. Spending on services took the brunt of the downward revisions and services spending was weak in both April and May.

May's income growth was broad based, with private sector wage and salary earnings rising by 0.5 percent. Through the first two months of Q2 private sector wage and salary earnings rose at an annualized rate of 5.8 percent, reflecting a stepped up pace of job growth and faster growth in aggregate hours worked. Earnings in the government sector rose by 0.1 percent in May, for an over-the-year increase of 1.2 percent. If that seems hardly worth meriting notice, what makes it so is this being the largest over-the-year increase in government sector earnings since July 2010. It was the period following the 2010 Census in which job losses in the government sector worsened and that was reflected in weak earnings in the sector, including nine consecutive months in 2013 in which earnings fell on an over-the-year basis. While unlikely to post meaningful growth over coming quarters, payrolls in the government sector have at least stabilized and government sector earnings should no longer act as a drag on overall income growth.

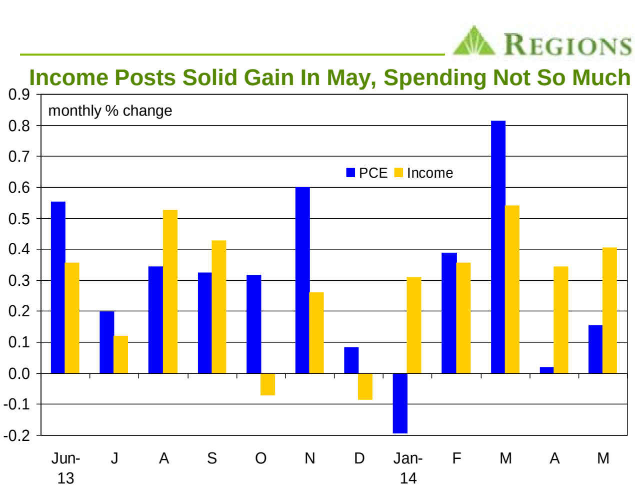
Also posting solid gains in May were dividend income (up 1.2 percent), rental income (up 0.4 percent), and interest income (up 0.3 percent). Transfer payments rose by 0.4 percent in May, and over the past several months growth in transfer payments has been boosted by the implementation of the Affordable Care Act, under which expanded Medicaid coverage and subsidies for insurance premiums for ACA enrollees are booked as transfer payments.

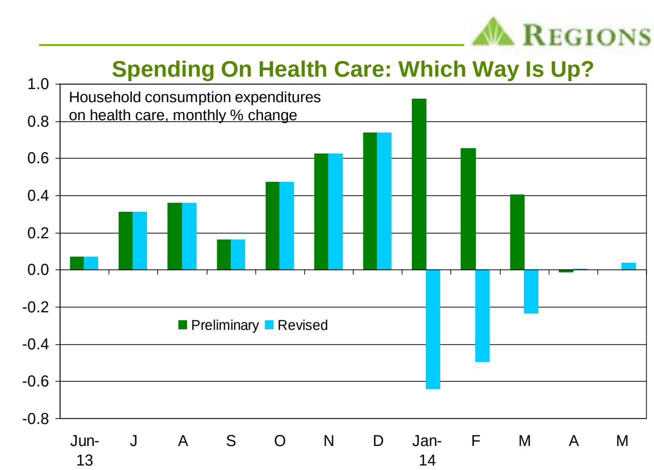
It remains far less clear how the ACA is impacting the spending side of the ledger. Recall in the first estimate of Q1 real GDP spending on health care was reported to have risen at an annualized rate of 9.9 percent, with the growth attributed to increased outlays on health care fostered by the ACA. That, however, was an estimate made by the BEA in the absence of actual data on health care spending. When the data did turn up, in the form of the Quarterly Services Survey, the BEA reported health care expenditures fell at an annualized rate of 1.4 percent in Q1.

While reasonable to assume expanded access to health care under the ACA will lead to higher consumer outlays, that growth in spending is coming at a much slower rate than the BEA assumed and judging by the scant growth in health care spending in both April and May (see chart below), spending on health care has yet to be meaningfully impacted by the ACA. With the Q2 Quarterly Services Survey not due until September 11, we could very well repeat this episode, with the BEA's estimate again used in the first report on Q2 GDP due on July 30.

With the PCE deflator rising by 0.2 percent in May, real consumer spending fell by 0.1 percent in May following a 0.2 percent decline in April. But, these declines are from March's base (which was well above the Q1 average) and still leave real consumer spending up at an annualized rate of 1.2 percent thus far in Q2, though this does not bode well for the anticipated bounce back in real GDP in Q2. The problem, however, is that spending on services (including health care) is acting as a major drag on overall consumer spending, and at this point we simply have no confidence in the data. We by no means are questioning the competence of anyone involved in gathering or reporting the data, but simply acknowledging the difficulty inherent when such a sweeping change is implemented and the hard data come with such a long lag.

The soft consumer spending data are at odds with improving income growth, which will be sustained by sturdier job growth. Still, it could be months before we have a better handle on the true underlying trend in consumer spending, which will heighten the significance of the monthly retail sales data, which do not include spending on services.





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