ECONOMIC UPDATE

REGIONS

March 2, 2015

January Personal Income/Spending: Labor Market Fueling Faster Income Growth

- Personal income rose by 0.3 percent in January; personal spending fell by 0.2 percent, and the savings rate rose to 5.5 percent.
- The PCE deflator fell by 0.5 percent and the core PCE deflator was up by 0.1 percent in January. On a year-over-year basis, the PCE deflator was up by 0.2 percent and the core deflator was up by 1.3 percent.

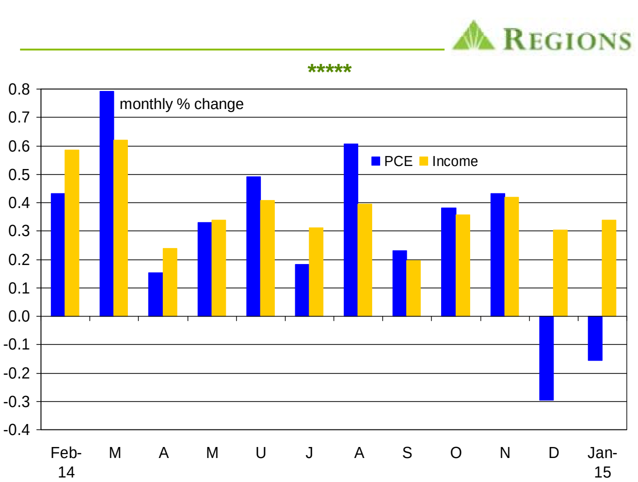
On a nominal, i.e., not adjusted for inflation, it doesn't look like U.S. consumers had much of a month in January, as total personal income was up 0.3 percent increase and total personal spending fell by 0.2 percent. On a real, i.e., inflation adjusted, basis, however, January looks like a much better month. Real disposable personal income jumped 0.9 percent and real personal spending was up 0.3 percent. The disparity is due to a 0.5 percent decline in the PCE deflator, the Fed's preferred measure of inflation, which resulted in an over-the-year increase of just 0.2 percent. The core PCE deflator was up 0.1 percent in January, for a year-over-year increase of 1.3 percent.

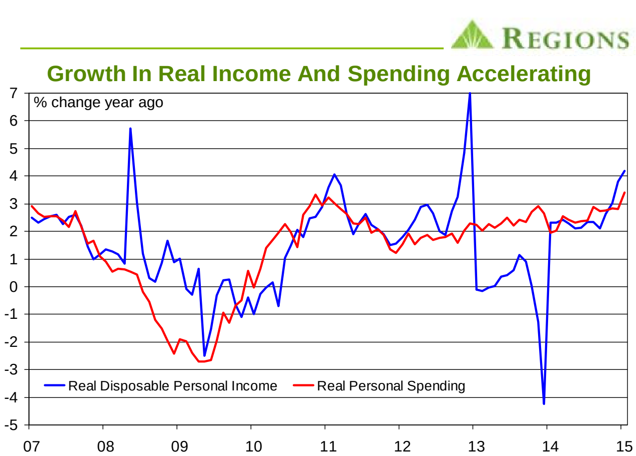
Lower inflation is clearly benefitting U.S. consumers. On a year-over-year basis, real disposable personal income was up 4.2 percent in January. Save for months in which either transitory stimulus measures or tax-induced shifts in the realization of income skewed the number – see if you can guess which months these are in the chart below – this marks the fastest growth in real disposable personal income since late 2006. It would be wrong, however, to attribute January's growth as no more than a one-off spurt due to an abnormally low headline inflation print. Nominal income growth has accelerated steadily over recent months as steadily improving labor market conditions have fueled faster growth in private sector wage and salary earnings. On a year-over-year basis, private sector wage and salary earnings have risen by better than five percent for seven consecutive months. At the same time, wage and salary earnings in the government sector are growing at a still-low but improving pace of late, after years of steady job losses and little or no cost of living increases in that sector. It is worth noting that one additional factor behind January's sizeable gain in real personal income was a jump in transfer payments, reflecting annual cost of living adjustments for several federal entitlement programs.

As we routinely point out, it is growth in aggregate wage and salary earnings that is relevant in assessing the outlook for growth in consumer spending, as labor earnings make up far and away the largest single component of personal income. What has been steadily accelerating growth in aggregate wage and salary earnings has been overlooked, to a large degree, in the discussion over what remains sluggish growth in average hourly earnings. It has, to this point, been growth in aggregate hours worked – the product of the number of people working and average weekly hours – that has been the prime source of growth in aggregate wage and salary earnings. As the labor market continues to tighten, however, growth in average hourly earnings – the third component of aggregate wage and salary earnings – will improve and help generate even faster growth in wage and salary earnings which, in turn, will underpin faster growth in disposable personal income.

This labor driven growth in real personal income is far more meaningful than gains induced by falling retail gasoline prices, which indeed have already reversed somewhat in recent weeks. These lower retail gasoline prices are the main driver of the decline in headline inflation seen in both the CPI and the PCE deflator. In both measures, however, core inflation has been fairly stable in recent months – the core PCE deflator is running below the core CPI mainly because rents are weighted far more heavily in the CPI than in the PCE deflator – which will help alleviate concerns over broadening disinflation.

While the nominal spending data continue to be distorted by low readings on headline inflation, real personal spending rose 3.4 percent on a year-over-year basis in January, which is the fastest such growth since October 2006. It seems lower retail gasoline prices have provided less of a lift to consumer spending than anticipated – the savings rate rose to 5.5 percent in January – but all in all conditions are in place for steady growth in real consumer spending in 2015. In addition to faster income growth, low interest rates have pushed monthly debt service burdens to all-time lows, and consumer confidence has trended higher despite the normal month-to-month gyrations. Improving labor market conditions will be a far more important driver of growth in consumer spending in 2015 than retail gasoline prices.





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