ECONOMIC UPDATE
REGIONS
March 30, 2015

February Personal Income/Spending: Consumers Saving Like There's A Tomorrow

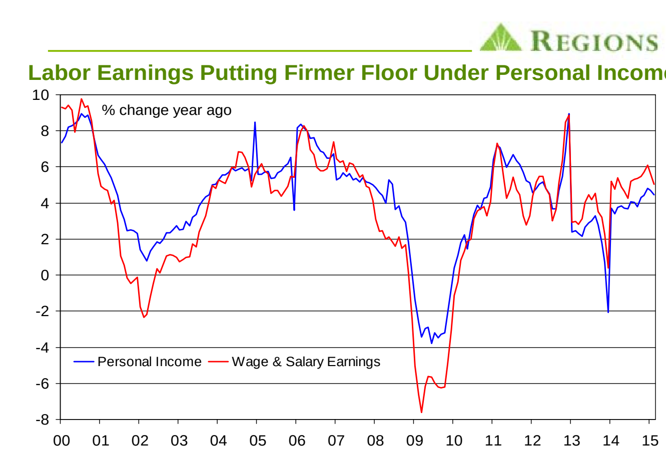
- Personal income rose by 0.4 percent in February; personal spending rose by 0.1 percent, and the savings rate rose to 5.8 percent.
- The PCE deflator rose by 0.2 percent and the core PCE deflator was up by 0.1 percent in February. On a year-over-year basis, the PCE deflator was up by 0.3 percent and the core deflator was up by 1.4 percent.

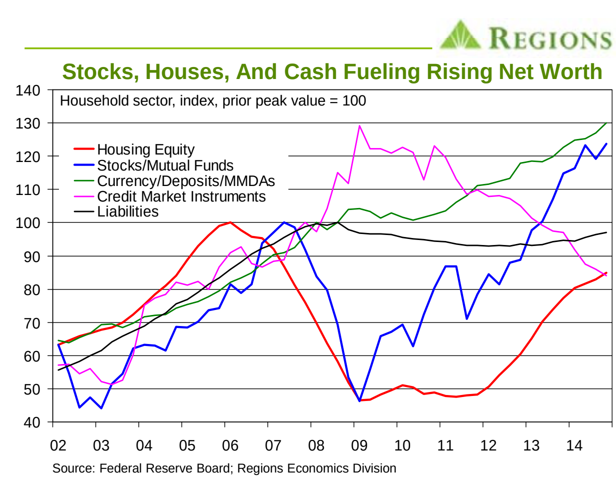
Total personal income grew 0.4 percent in February while total personal spending rose by a more modest 0.1 percent. The increase in spending fell short of expectations, ours included, primarily due to a smaller than anticipated increase in spending on household services. With income growth having outpaced spending growth, the personal saving rate rose to 5.8 percent, the highest since December 2012 (when the saving rate was boosted higher by a surge in disposable income motivated by pending tax changes). More broadly, consumers continue to sock away more savings even though accelerating growth in disposable personal income and lower retail gasoline prices have given them ample room to spend more. In short, after years of spending as if there were no tomorrow, consumers are now saving like there is a tomorrow. What is unclear, however, is how long this will remain the case.

Private sector wage and salary earnings rose 0.3 percent in February with government sector wage and salary earnings up 0.2 percent. As we have discussed frequently over recent months, gains in aggregate private sector earnings are being driven by growth in aggregate hours worked (i.e., the product of how many people are working and how many hours they are working) while growth in average hourly earnings (the third component of aggregate wage and salary earnings) remains somewhat range bound. Still, over the past eight months aggregate wage and salary earnings have grown at an average rate of 5.5 percent (year-over-year). Though the month-to-month changes can be bumpy, the broader point is growth has been trending higher, which in turn has put a firmer floor under growth in total personal income, as seen in the chart below. This is, thanks to what has been but meager headline inflation, translated into firmer growth in real disposable personal income.

Spending growth fell short of expectations in February thanks to a smaller than anticipated gain in spending on services. What in many parts of the U.S. was a record cold February was expected to bring a sizeable gain in utilities outlays, but with January's gain having been revised higher (up 7.3 percent) February's increase was a smaller 1.1 percent. Moreover, after accounting for price changes, real outlays on household utilities declined in February. Elsewhere, as was apparent in the February retail sales data, that harsh winter weather impacted consumer spending in other areas, thus it is likely at least some of February's build in savings was involuntary and to the extent this was the case it will be reversed in subsequent months.

That said, consumers have made a conscious choice to boost savings over the past several months, which we discussed in some detail in our March *Monthly Economic Outlook*. While there has been much discussion as to why what has been steadily rising household net worth has not generated much additional spending via the "wealth effect" this should not be a surprise when looking at the components of rising net worth. Direct stock ownership is more heavily concentrated than home ownership and, historically, has not generated very large wealth effects. While housing equity is rising, in the aggregate owners' equity is less than 55 percent of aggregate housing value and this is vastly overstating the equity position as roughly one-third of all homeowners have no mortgage debt. As such, those with mortgage debt have even less equity, in the aggregate, and a considerable number of mortgaged households are either underwater or only marginally above water so housing equity extraction is not supporting consumer spending. What is perhaps surprising is the extent to which increased holdings of cash and, to a far greater degree, simple saving deposits are accounting for higher shares of overall household assets. Indeed, saving deposits account for roughly 65 percent of total M2, so consumers are holding a considerable portion of wealth in a highly liquid form which, though having seemingly confounded analysts, is a perfectly rational reaction to what in recent years have been dramatic twists and turns in the economy, the labor market, and their own balance sheets. What we do not know is what will become of these savings once interest rates begin to rise and labor earnings grow at an even faster rate, providing it is growth in hourly earnings that drives faster growth in labor earnings.





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