ECONOMIC UPDATE

REGIONS

March 1, 2018

January Personal Income/Spending: Tax Cuts Only Partially Reflected In The January Data

- Personal income rose by 0.4 percent in January, personal spending rose by 0.2 percent, and the saving rate rose to 3.2 percent.
- The PCE deflator rose by 0.4 percent and the core PCE deflator rose by 0.3 percent in January. Year-on-year, the PCE deflator was up by 1.7 percent and the core deflator was up by 1.5 percent.

Total personal income was up by 0.4 percent in January, matching our above-consensus forecast, while total personal spending was up by 0.2 percent, shy of our forecast of a 0.3 percent increase. With income growth outpacing spending growth, the personal saving rate rose to 3.2 percent. The PCE deflator, the FOMC's preferred gauge of inflation, rose by 0.4 percent with the core PCE deflator up 0.3 percent, matching our forecasts and yielding year-on-year changes of 1.7 percent and 1.5 percent, respectively.

Coming as it does late in the data release cycle, in any given month the monthly report on personal income and spending tends to attract little attention. Ahead of its release, however, the January report was eagerly (again, eagerly being a relative term here) awaited on several fronts – some saw it as an early read on whether, or to what extent, the tax bill enacted in late-2017 was impacting the economy, some awaited the read on the saving rate as a sign of whether we had a "saving crisis" on our hands, and others were anxiously awaiting the read on the PCE deflator, the last before the March FOMC meeting, for signs of an "inflation surge." Though any expectations that one month of data would answer any, let alone all, of those questions were unrealistically high, the January report does shed some light on the impact of the tax bill.

While our forecast for personal income growth was on the mark, we had expected private sector wage and salary earnings to be notably soft, reflecting the sharp decline in aggregate hours worked in January. At the same time, though, we expected bonus payments, including one-off payments made by firms in the wake of the tax bill, to jump. That the personal income data show private sector wage and salary earnings were up by 0.5 percent while supplemental payments came in shy of our expectations could simply be a reporting issue, as the composite for private sector labor earnings is in line with our forecast, even if we were off on the details. While we had expected another solid increase in interest income in January after a string of three months with better than 1.0 percent increases, interest income fell by 0.4 percent in January. As we expected, government sector earnings were up 0.6 percent reflecting annual cost of living increases that take effect in January. While a jump in January is common, the 1.3 percent increase in transfer payments was slightly larger than we anticipated.

January's increase leaves total personal income up 3.8 percent year-on-year, basically in the middle of the range that has prevailed over the past several months. More significantly, disposable personal income, i.e., after-tax personal income, jumped by 0.9 percent in January, good for a 4.0 percent year-on-year increase. This reflects some, but not all, of the impact of lower personal income tax rates – the lack of a uniform time frame for employers adjusting withholding schedules means the full effects of the tax cut won't be seen until the February/March data. As a side note, January's increase in disposable personal income is the largest monthly gain since December 2012 as income was being pulled forward in anticipation of higher tax rates taking effect in January 2013.

As we noted in our weekly *Economic Preview*, the monthly retail sales report is pretty much useless as a guide to consumer spending but it's all we have to go on in forming our expectations for the broader data on total consumer spending. This was the case with the January data, with today's report showing spending on nondurable consumer goods up 1.0 percent in January, much stronger than the retail sales data showing control retail sales were unchanged. Spending on consumer durables was down sharply in January, consistent with lower unit motor vehicle sales and a decline in sales at furniture stores.

The inflation data in today's report are roughly in line with and show the same kind of seasonal noise as the January CPI data, including the typical January spike in apparel prices. Aside from that, the data on the PCE deflator do not exactly offer evidence of inflation steadily moving towards the FOMC's 2.0 percent target, let alone justifying fears of an imminent "inflation surge." Still, while it is reasonable to expect inflation to move higher over coming months, the only relevant question is whether it does so faster than the FOMC is anticipating will be the case. At present, there is no evidence to support this contention.

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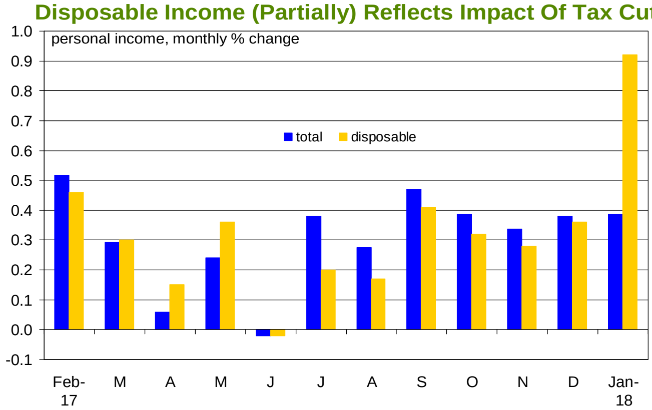
Disposable Income (Partially) Reflects Impact Of Tax Cut



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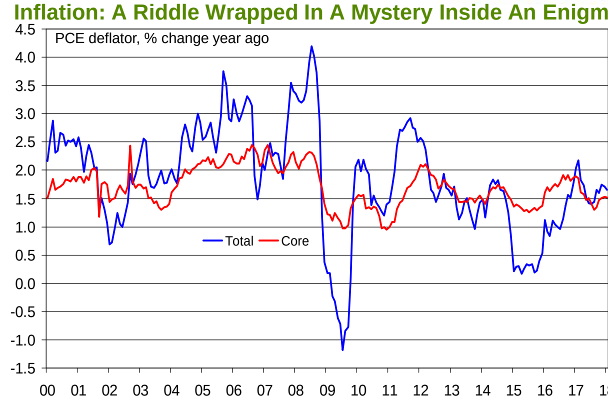
Inflation: A Riddle Wrapped In A Mystery Inside An Enigma



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