ECONOMIC UPDATE

REGIONS

June 29, 2018

May Personal Income/Spending: Services Weigh Down May Consumer Spending

- Personal income rose by 0.4 percent in May, personal spending rose by 0.2 percent, and the saving rate rose to 3.2 percent.
- The PCE deflator rose by 0.2 percent and the core PCE deflator rose by 0.2 percent in May. Year-on-year, the PCE deflator was up by 2.3 percent and the core deflator was up by 2.0 percent.

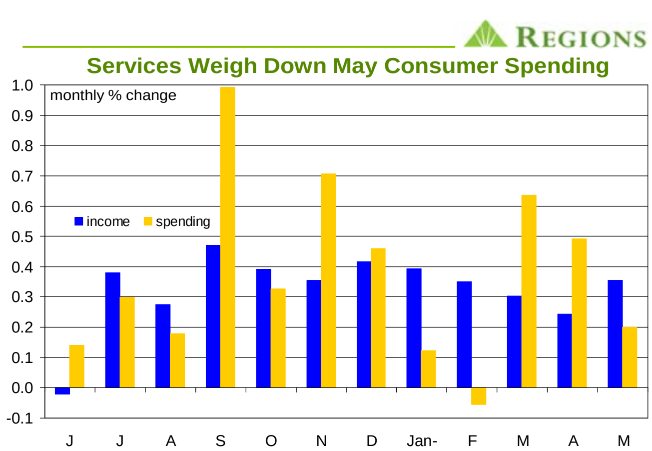
Total personal income rose by 0.4 percent in May, as we and the consensus expected, while total personal spending rose by 0.2 percent, falling short of the 0.4 percent increase we and the consensus expected. With income growth outpacing spending growth the personal saving rate edged higher and now stands at 3.2 percent. The PCE deflator, the FOMC's preferred gauge of inflation, rose by 0.2 percent as did the core PCE deflator, each in line with expectations. On a year-on-year basis, the PCE deflator is up 2.3 percent and the core PCE deflator up 2.0 percent, marking the fastest rates of PCE inflation since 2012 (March 2012 for headline PCE inflation and April 2012 for core PCE inflation). The FOMC has gone out of their way over recent months to stress their inflation target is symmetric, i.e., after a prolonged period of inflation falling short of their 2.0 percent target rate, the FOMC is willing to tolerate a period of inflation running ahead of that target rate. What remains unknown is how far and how long, i.e., how far above their target will the FOMC be willing to let inflation run and how long will they be willing to do so. While the May data will no doubt have their attention, we think it will be some time before the FOMC actually has to answer those questions.

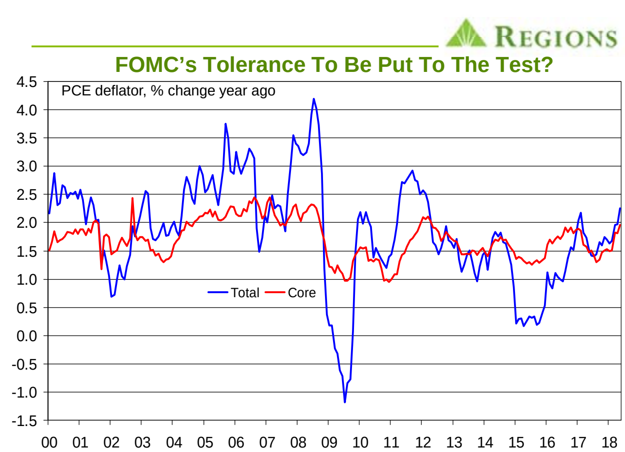
The 0.4 percent increase in May leaves total personal income up 4.0 percent year-on-year. Aggregate private sector wage and salary earnings rose by 0.3 percent in May, a slightly smaller gain than our forecast anticipated but which nonetheless leaves earnings up 5.3 percent year-on-year. Investment income was up 0.7 percent in May, which mainly reflects the 1.5 percent increase in dividend income as interest income was up a miniscule 0.1 percent. Rental income was up 0.5 percent, good for a 4.4 percent year-on-year increase, but growth in rental income has decelerated sharply over the past several months, a pattern we expect will persist in the months ahead. Disposable, or, after-tax, personal income was up 0.4 percent in May, leaving it up 4.0 percent year-on-year for a second consecutive month. That disposable personal income growth has picked up thus far this year mainly reflects the impact of the lower individual income tax rates incorporated into the 2017 tax bill.

Nominal personal spending rose by just 0.2 percent in May, while what was originally reported as a 0.6 percent increase in April was revised down to 0.5 percent. Spending on consumer durable goods rose by 0.1 percent in May while spending on nondurable consumer goods rose by 0.6 percent, but spending on services was basically flat, with an increase of just 0.08 percent. Sharply lower utilities outlays acted as a drag on services spending in May, as was the case with spending on recreational services. These declines are not overly concerning as they say little about the underlying state of consumer spending, particularly the drop in utilities outlays. Still, the middling increase in nominal spending left real spending flat in May; real spending on goods rose by 0.3 percent while real spending on services fell by 0.2 percent. Even with total real spending unchanged in May, growth in real consumer spending in Q2 will easily top the middling growth seen in Q1.

Core goods prices were up a modest 0.1 percent in May, but on a year-on-year basis were lower for a 66th consecutive month (this matches the persistent weakness in core goods prices seen in the CPI data). Core goods prices will be interesting to watch over coming months; a stronger U.S. dollar could be a source of further downward pressure, but this could be countered should the net effect of tariffs, whether on inputs to production or on finished consumer goods, lead to higher retail prices. Core services prices were up 0.3 percent in May, leaving them up 2.7 percent year-on-year. Though rent growth is decelerating, it is nonetheless contributing to core services inflation, as is accelerating growth in health care costs. Additionally, service providers have more latitude to pass on higher labor costs, which will be another support for core services inflation over coming months.

Firm income growth will continue to underpin growth in consumer spending over coming months. At this point, the bigger questions revolve around the path of inflation. Thus far, the pick-up in inflation is in line with what the FOMC had anticipated in 2018, but core goods prices will be the wild card in the deck over coming months.





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