Economics

Economic Indicator — March 31, 2023

Revisionist Mystery: Buckle Up for a Blowout in Q1 PCE

Revision Puts PCE on Track for 4.5% Growth, but February's Slip More Telling

Summary

A revision to January lifted real spending enough to put PCE on track for an annualized growth rate of 4.5% in Q1. But a slowing in February may be more emblematic of the current state of the consumer. Meanwhile, PCE inflation is still hot enough to warrant another rate hike in May.

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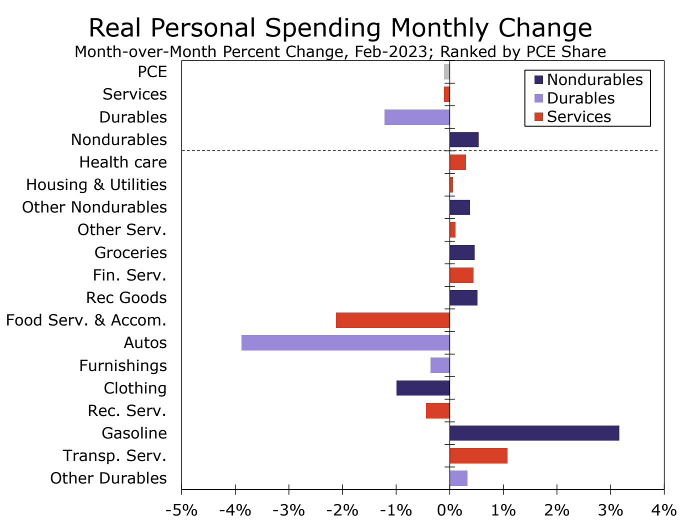
U.S. Personal Income & Spending: February 2023

	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
Personal Income (MoM)	0.5	0.2	0.5	0.5	0.8	0.6	0.5	0.9	0.4	0.3	0.6	0.3
Personal Income (YoY)	-12.1	1.4	3.9	4.3	3.9	4.2	5.6	5.7	5.7	5.7	6.4	6.2
Personal Income, Ex. Transfers (MoM)	0.6	0.2	0.6	0.5	1.0	0.7	0.6	0.6	0.4	0.3	0.7	0.3
Wages & Salaries Income (MoM)	0.5	0.2	0.4	0.4	1.5	0.8	0.8	0.5	0.4	0.3	0.9	0.3
Personal Spending (MoM)	1.2	0.4	0.7	1.2	-0.1	0.7	0.6	0.7	-0.2	0.0	2.0	0.2
Personal Spending (YoY)	9.2	8.9	9.3	9.3	8.7	8.7	8.5	7.9	7.1	7.3	8.2	7.6
Personal Spending (% Change from Jan-20)	15.8	16.2	17.0	18.4	18.3	19.2	19.9	20.7	20.4	20.4	22.9	23.1
Durable Goods Spending (MoM)	-0.6	1.2	-1.3	1.1	0.0	0.4	0.1	1.8	-3.2	-1.5	7.0	-1.4
Nondurable Goods Spending (MoM)	2.9	-0.7	1.3	2.3	-1.2	-0.4	0.3	0.8	-0.5	-1.1	1.7	0.9
Services Spending (MoM)	1.1	0.6	0.8	0.9	0.3	1.2	0.8	0.5	0.4	0.6	1.2	0.2
Real Disposable Personal Income (MoM)	-0.4	-0.1	-0.1	-0.4	0.8	0.3	0.1	0.7	0.4	0.2	1.5	0.2
Real Disposable Personal Income (YoY)	-21.6	-7.4	-4.8	-4.7	-4.6	-4.1	-2.6	-2.0	-1.4	-0.8	3.0	3.3
Real Personal Spending (MoM)	0.3	0.2	0.1	0.2	0.0	0.5	0.3	0.3	-0.4	-0.2	1.5	-0.1
Real Personal Spending (YoY)	2.3	2.4	2.6	2.1	2.2	2.3	2.1	1.7	1.4	1.9	2.7	2.5
PCE Deflator (YoY)	6.8	6.4	6.5	7.0	6.4	6.3	6.3	6.1	5.7	5.3	5.3	5.0
Core PCE Deflator (YoY)	5.4	5.0	4.9	5.0	4.7	4.9	5.2	5.1	4.8	4.6	4.7	4.6
Personal Saving Rate (%)	3.8	3.6	3.4	2.7	3.5	3.2	3.0	3.4	4.1	4.4	4.4	4.6
"Excess" Personal Savings (Trillions $)	1.73	1.65	1.56	1.46	1.38	1.29	1.19	1.10	1.02	0.95	0.87	0.80

Notes: MoM = Month-over-Month Percent Change
YoY = Year-over-Year Percent Change

Source: U.S Department of Commerce and Wells Fargo Economics



Source: U.S. Department of Commerce and Wells Fargo Economics

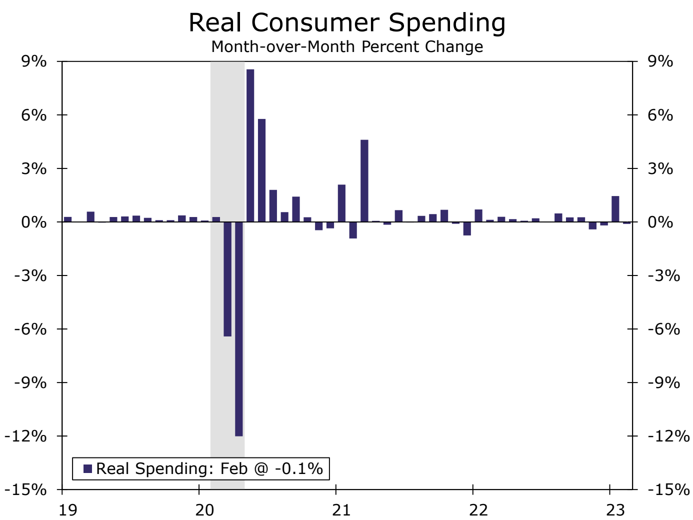
January's Gain Sets the Stage for Q1 PCE

The latest data on personal income and spending reflect the crosscurrents presently influencing the consumer and reveal the difficulty faced by everyone from policymakers to businesses as both struggle to divine how long consumers' staying power will last amid rate hikes and tighter credit.

Real personal consumer spending has now contracted in three out of the past four months and yet today's report will likely have many forecasters penciling in even stronger Q1 PCE growth. Why? Mostly because January's initially reported 1.1% increase in real spending was revised higher to a gain of 1.5%. That is an absurdly large monthly increase (chart). The pandemic shutdowns and stimulus checks injected some major volatility into the monthly changes in spending in recent years, but consider this: a 1.5% monthly increase in real spending is almost twice as strong as any monthly gain reported throughout the prior expansion between 2009-2020. If real spending is flat in March, real PCE would rise at an annualized pace of 4.5% in the first quarter.

So yes, in February we lost some spending momentum as real spending posted a scant 0.1% decline after the surge in January. Had it not been for a 3.9% real drop in the notoriously volatile motor vehicle category, real spending would have been positive (chart). In short, after a curiously strong January, the consumer is evidently losing momentum.

It bears noting that real services spending did notch its first monthly decline in 13 months, but the giveback in February was less than a sixth of January's gain. We may have some concerns about goods spending, but we are not concerned this is the beginning of a broader services retrenchment.



Source: U.S. Department of Commerece and Wells Fargo Economics

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It's ALL About the Income

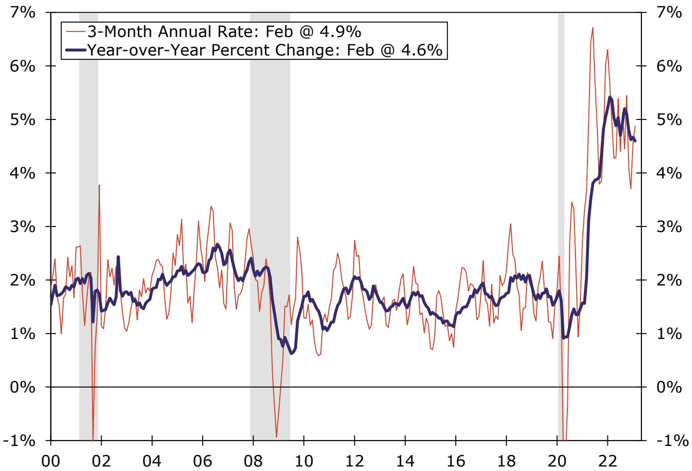
Income growth continued to be fairly favorable with personal income up 0.3% in February. A sturdy labor market amid slowing inflation is providing near-term support to households. Real disposable personal income, a more accurate depiction of households' purchasing power, was up for the eighth straight month, rising 0.2%. As seen in the nearby chart, the recent trend in real income has notably improved.

As we wrote in a recent note, income growth is the most important factor driving consumer spending capacity today. Savings are dwindling and households access to credit is diminishing. We estimate households have just under $800 billion in excess savings, but the capacity of excess savings to impact spending peaked in the middle part of 2021, and as the piggy bank has been emptied, it has played a smaller role in each subsequent month. Banks have already tightened their standards on consumer loans, and the recent angst in the banking sector may result in even firmer standards. It is income that is becoming the consequential driver of consumption. How long this lasts is key to the outlook, and it remains our baseline expectation that as financial conditions tighten and demand slows, firms more broadly will be forced to freeze hiring and eventually layoff workers amid decreased profitability.

Inflation Moderates, but Fed's Job Not Yet Done

Inflation is slowing, but only gradually. The core PCE deflator rose slightly less than expected, up just 0.3% in February, and inflation data for January were revised lower as well. This is a positive development, but a win can't yet be declared. The Fed has further work to do to get inflation back to its 2% target. The core PCE deflator is still running well-above target at a 4.9% annualized rate the past three months (chart). We'd summarize the inflation development as a step in the right direction, but we think the elevated readings keep the heat turned up on the Fed, and thus still expect the Fed to hike rates an additional 25 bps at its May monetary policy meeting.

Core PCE Deflator



Source: U.S. Department of Commerce and Wells Fargo Economics

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