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Economic Indicator — April 28, 2023

Ongoing Pivot to Income as Main Driver of Spending

Summary

Consumer spending may not be quite as strong as it appears, but an underappreciated dynamic propping up the consumer is the tailwind from slowing inflation amid still elevated wage gains. The PCE deflator did not cool enough to stay the Fed's hand from another rate hike in May.

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U.S. Personal Income & Spending: March 2023

	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23
Personal Income (MoM)	0.2	0.5	0.5	0.8	0.6	0.5	0.9	0.4	0.3	0.6	0.3	0.3
Personal Income (YoY)	1.4	3.9	4.3	3.9	4.2	5.6	5.7	5.7	5.7	6.5	6.2	6.0
Personal Income, Ex. Transfers (MoM)	0.2	0.6	0.5	1.0	0.7	0.6	0.6	0.4	0.3	0.6	0.3	0.4
Wages & Salaries Income (MoM)	0.2	0.4	0.4	1.5	0.8	0.8	0.5	0.4	0.3	0.9	0.3	0.3
Personal Spending (MoM)	0.4	0.7	1.2	-0.1	0.7	0.6	0.7	-0.2	0.0	2.0	0.1	0.0
Personal Spending (YoY)	8.9	9.3	9.3	8.7	8.7	8.5	7.9	7.1	7.3	8.1	7.4	6.2
Personal Spending (% Change from Jan-20)	16.2	17.0	18.4	18.3	19.2	19.9	20.7	20.4	20.4	22.8	22.9	22.9
Durable Goods Spending (MoM)	1.2	-1.3	1.1	0.0	0.4	0.1	1.8	-3.2	-1.5	7.3	-1.5	-0.9
Nondurable Goods Spending (MoM)	-0.7	1.3	2.3	-1.2	-0.4	0.3	0.8	-0.5	-1.1	1.3	0.6	-0.4
Services Spending (MoM)	0.6	0.8	0.9	0.3	1.2	0.8	0.5	0.4	0.6	1.2	0.2	0.4
Real Disposable Personal Income (MoM)	-0.1	-0.1	-0.4	0.8	0.3	0.1	0.7	0.4	0.2	1.5	0.2	0.3
Real Disposable Personal Income (YoY)	-7.4	-4.8	-4.7	-4.6	-4.1	-2.6	-2.0	-1.4	-0.8	3.0	3.2	4.0
Real Personal Spending (MoM)	0.2	0.1	0.2	0.0	0.5	0.3	0.3	-0.4	-0.2	1.4	-0.2	0.0
Real Personal Spending (YoY)	2.4	2.6	2.1	2.2	2.3	2.1	1.7	1.4	1.9	2.6	2.2	1.9
PCE Deflator (YoY)	6.4	6.5	7.0	6.4	6.3	6.3	6.1	5.7	5.3	5.4	5.1	4.2
Core PCE Deflator (YoY)	5.0	4.9	5.0	4.7	4.9	5.2	5.1	4.8	4.6	4.7	4.7	4.6
Personal Saving Rate (%)	3.6	3.4	2.7	3.5	3.2	3.0	3.4	4.1	4.4	4.5	4.8	5.1
"Excess" Personal Savings (Trillions $)	1.65	1.56	1.46	1.38	1.29	1.19	1.10	1.02	0.95	0.87	0.80	0.74

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

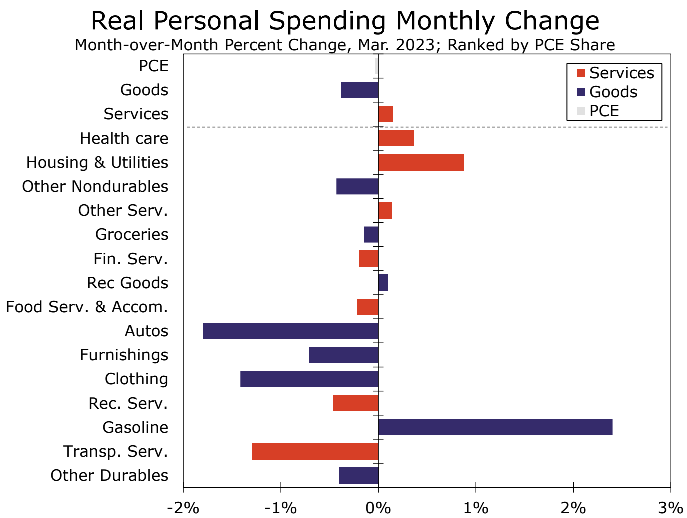
Source: U.S Department of Commerce and Wells Fargo Economics

Can't Stop Me Now?

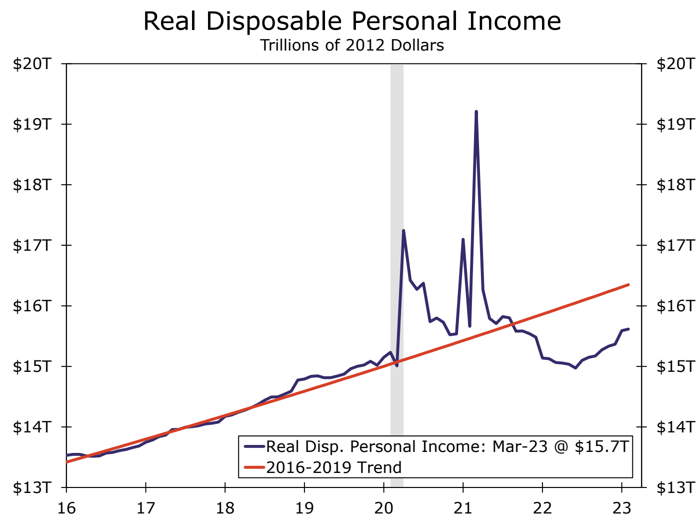
Personal spending notched another modest gain in March increasing by $8.2 billion in the month. On the face of it, it looks like the consumer cannot be stopped. Not by a pandemic, not by the highest inflation in 40 years nor the rate increases meant to tame that inflation, not even by market gyrations amid the first major bank failures since the financial crisis. This was also a theme that emerged from yesterday's Q1 GDP print, essentially that growth is being sustained by an ever-resilient consumer.

The staying power of the consumer was certainly a dynamic fully in play last year, but we think that is the wrong take-away from the GDP report as well as today's details on March spending in particular. Here's why: aside from a pop in January (which was admittedly the biggest surge in almost two years), it's been a downhill ride since November for consumer spending; especially after adjusting for inflation. Real consumer personal outlays actually fell, albeit very mildly in March. Still, factoring in today's print, real consumer spending has now contracted in four of the past five months.

So the 3.7% annualized growth rate for Q1 PCE is entirely due to January's surge. The spending details reveal that almost half of that month's increase was attributable to motor vehicle sales alone, perhaps reflecting some healing in supply chains. The composition of spending for March in particular is also reflective of a theme that informs our own forecast and that is the transition to services (chart). Outside of a price-related rise in gasoline sales, the top categories for spending last month were housing and utilities followed by healthcare spending. That is hardly the spending profile of a heedless consumer on a spending spree.



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



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

Running from my Kryptonite and I'll Keep Rising up

An underappreciated dynamic propping up the consumer is the tailwind that has come from slowing inflation amid still elevated wage gains. Real disposable personal income rose for the ninth straight month in March (chart), up 0.3%, and we learned yesterday this measure of income was up at an 8% annualized pace in the first quarter. This increase in purchasing power has allowed households to continue to spend even as excess savings has slowed and credit grows more expensive or challenging to come by.

As overall nominal income (+0.3%) outpaced spending (0.0%), the personal saving rate rose to 5.1% in March, which marks the highest rate in which consumers have saved at in a little over a year. The improvement in the saving rate in recent months is a positive development, though it somewhat reflects tax accounting. Households are still saving a lower share of income than they did pre-pandemic. There's some gas left in the tank to rely on excess savings, but that's becoming less and less of a driver of spending and households may grow less inclined to tap the rainy day fund as uncertainty grows.

The labor market remains exceptionally tight, though there are signs slack is beginning to materialize with job openings rolling over and layoff announcements surfacing. The outcome depends on the income. Job security and prospects matter much more for today's consumer than rising interest rates and persistent inflation. If we see further deterioration in labor, spending will likely come under pressure as the year progresses.

Inflation continues to slow. The core PCE deflator rose 0.3% in March, driving the annual change to 4.6%, the lowest in a year and a half. While the Fed will be pleased to see the pace of price growth is coming off the boil, inflation remains far too hot for the Fed's liking. Separately released data this morning on the Employment Cost Index also showed only modest improvement coming from labor cost pressure. We expect the FOMC will elect to hike the target range on the federal funds rate by an additional 25 bps at next week's meeting, lifting the range to 5.00%-5.25%. This is currently the last rate hike we forecast for the Fed this cycle, though rate changes remain highly uncertain and will depend on how inflation and labor market data progress from here.

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