

Economic Indicator — May 26, 2023

## Strong Data Could Mean We're Not out of the Woods with Rate Hikes

### Summary

Consumer spending, core capital goods orders and inflation all picked up speed in April, making the Fed's task of getting inflation under control more difficult. While we recently pared our expected decline in consumer spending, there is still trouble ahead especially, if the labor market loses steam.

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#### U.S. Personal Income & Spending: April 2023

	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23
<b>Personal Income (MoM)</b>	0.5	0.5	0.8	0.6	0.5	0.6	0.2	0.2	0.6	0.3	0.3	0.4
<b>Personal Income (YoY)</b>	3.9	4.3	3.9	4.2	5.6	5.4	5.0	4.9	5.7	5.5	5.2	5.4
<b>Personal Income, Ex. Transfers (MoM)</b>	0.6	0.5	1.0	0.7	0.6	0.2	0.1	0.2	0.7	0.2	0.3	0.5
<b>Wages &amp; Salaries Income (MoM)</b>	0.4	0.4	1.5	0.8	0.8	-0.3	-0.1	0.0	0.9	0.2	0.3	0.5
<b>Personal Spending (MoM)</b>	0.7	1.2	-0.1	0.7	0.6	0.7	-0.2	0.0	1.9	0.1	0.1	0.8
<b>Personal Spending (YoY)</b>	9.3	9.3	8.7	8.7	8.5	7.9	7.1	7.3	8.1	7.5	6.2	6.7
<b>Personal Spending (% Change from Jan-20)</b>	17.0	18.4	18.3	19.2	19.9	20.7	20.4	22.7	22.7	22.9	23.0	24.0
<b>Durable Goods Spending (MoM)</b>	-1.3	1.1	0.0	0.4	0.1	1.8	-3.2	-1.5	7.2	-1.3	-1.2	1.6
<b>Nondurable Goods Spending (MoM)</b>	1.3	2.3	-1.2	-0.4	0.3	0.8	-0.5	-1.1	1.3	0.6	-0.5	0.8
<b>Services Spending (MoM)</b>	0.8	0.9	0.3	1.2	0.8	0.5	0.4	0.6	1.2	0.2	0.5	0.7
<b>Real Disposable Personal Income (MoM)</b>	-0.1	-0.4	0.8	0.3	0.1	0.3	0.1	0.1	1.6	0.2	0.2	0.0
<b>Real Disposable Personal Income (YoY)</b>	-4.8	-4.7	-4.6	-4.1	-2.6	-2.3	-2.0	-1.5	2.4	2.6	3.3	3.4
<b>Real Personal Spending (MoM)</b>	0.1	0.2	0.0	0.5	0.3	0.3	-0.4	-0.2	1.3	-0.2	0.0	0.5
<b>Real Personal Spending (YoY)</b>	2.6	2.1	2.2	2.3	2.1	1.7	1.4	1.9	2.6	2.3	2.0	2.3
<b>PCE Deflator (YoY)</b>	6.5	7.0	6.4	6.3	6.3	6.1	5.7	5.3	5.4	5.1	4.2	4.4
<b>Core PCE Deflator (YoY)</b>	4.9	5.0	4.7	4.9	5.2	5.1	4.8	4.6	4.7	4.7	4.6	4.7
<b>Personal Saving Rate (%)</b>	3.4	2.7	3.5	3.2	3.0	3.0	3.5	3.7	4.0	4.3	4.5	4.1
<b>"Excess" Personal Savings (Trillions \$)</b>	1.56	1.46	1.38	1.29	1.19	1.10	1.01	0.92	0.84	0.76	0.68	0.60

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

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

## Economic Resilience on Full Display in April

Today's durable goods and personal income & spending reports share a common theme of staying power. The consumer continues to deliver in a way that exceeds consensus expectations and defies predictions of a coming demise. While a simple trend extension makes a compelling case for the consumer to keep on rolling and allow the economy to achieve a soft landing, our analysis still suggests the fundamentals are deteriorating (more on that below). But there is no denying that the pace of spending revealed in today's data was stronger than expected, and the same can be said about robust core capital goods orders which may be benefiting to a degree from the sustained outlays on consumer goods. Taken together, the signal from today's data to policymakers at the Federal Reserve is that the fastest pace of rate hikes since the early 1980s has yet to sufficiently slow the economy to cool inflation. While our base case remains the FOMC holds the fed funds rate steady in June, the strong slate of data, with additional key readings on employment and inflation for May still to come, keeps the possibility of at least one more hike this cycle in play.

Even after adjusting for the biggest monthly increase in PCE inflation since January, real consumer spending rose 0.5% in April which ties the second biggest monthly gain of the past year. But critically, income growth was only sufficient to match inflation: the nominal gain of 0.4% in personal income translates to a goose-egg (0.04% before rounding) after backing out the 0.4% increase in prices. This threatens to end what is now technically a 10-month run in which income outpaced inflation, but it is increasingly evident real income is losing a bit of momentum. It is not surprising then to see consumers tap the rainy day fund again as the saving rate fell for the first time in six months.

## How Much Longer Can Households Spend?

The sustainability of spending is the big question. Borrowing conditions are weakening amid higher rates and a tightening in lending standards. Excess saving is dwindling, but there remains some runway. The roughly \$600 billion in savings outstanding as of April implies seven months of spending power if households continue to spend it down at the average rate they have the past six months. But this is inherently an upper bound given we do not believe all of these funds are sitting idle and could have been used to purchase a home or invest in the stock market in recent years. Household checking and savings deposits provide a clearer view on liquidity but do so with a considerable lag. As of Q4, households had about \$13.3 billion in cash, and in performing a similar exercise, we estimate households have about six months of spending power before cash balances fall below trend. This positions the third and fourth quarters as potentially an important consumer turning point.

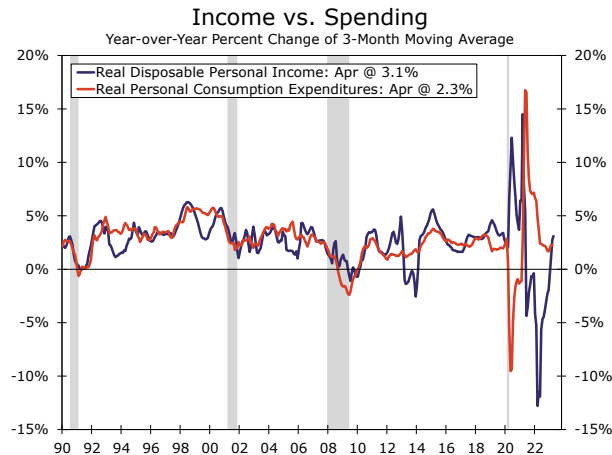
The biggest near-term upside in terms of purchasing power is income. Real disposable personal income has now risen for 10 straight months, and it's providing a notable tailwind to the consumer. For us, the big inflection point comes toward the end of the year. Borrowing will almost certainly be discouraged and the savings tank will be approaching E. Throw in a deterioration in the labor market, and it's not difficult to see how spending could turn quickly.

## Upside Surprise from Durable Goods Orders

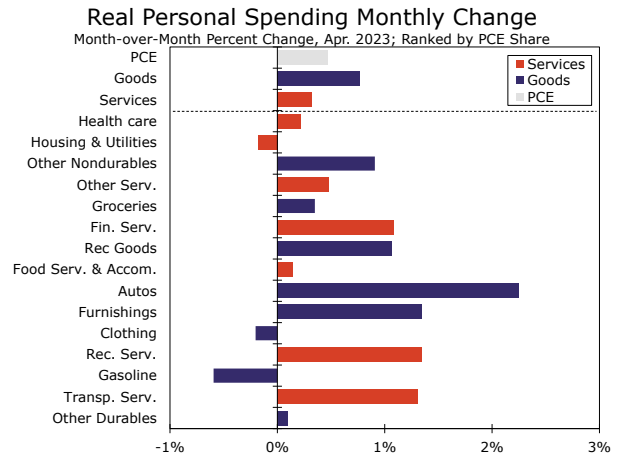
Separately reported data on durable goods also came in better than anticipated. Durable goods orders advanced 1.1%, despite the Bloomberg consensus expectation of 61 forecasters looking for a 1.0% drop. While total orders were lifted by a pop in defense orders specifically, stripping away some of the volatility suggests a still solid month of orders in April. Specifically, core capital goods (excluding defense & aircraft) rose 1.4%, marking the fastest monthly gain in over a year. This adds to other manufacturing data that demonstrate some stabilization after weakness at the end of last year.

## How is Q2 Growth Shaping Up?

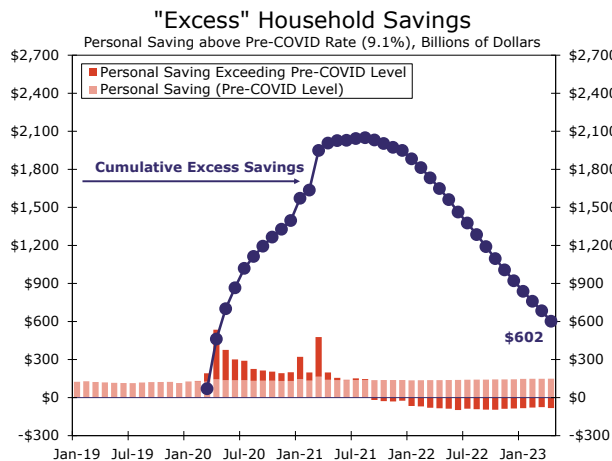
How do this morning's data shape growth in the second quarter? We learned [yesterday](#) that real GDP growth in Q1 was revised higher in the second estimate to show output rose at a 1.3% annualized clip at the start of the year. Our present forecast has growth expanding 1.9% in Q2. The real spending data suggest some upside risk to consumer spending in the second quarter, while the durables and advance trade data present some downside to equipment spending and net exports. For equipment spending, it is shipments rather than orders that feed into the BEA's calculation. Nondefense capital goods shipments slipped 1.8% in April and position the quarter for a weak start. The merchandise trade deficit widened to a six-month high amid a plunge in export growth, signaling a potential drag from net exports in Q2.



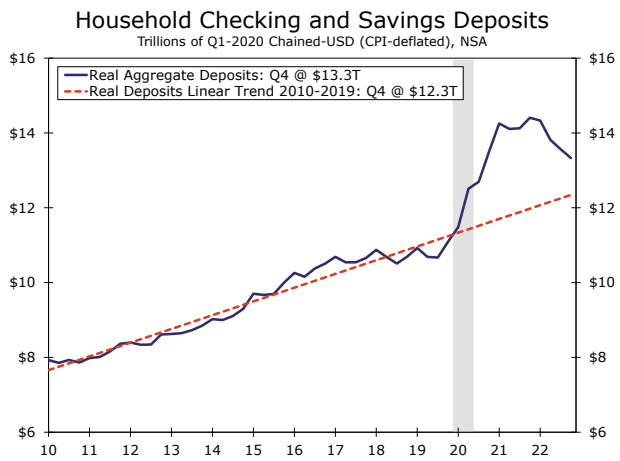
Source: U.S. Department of Commerce and Wells Fargo Economics



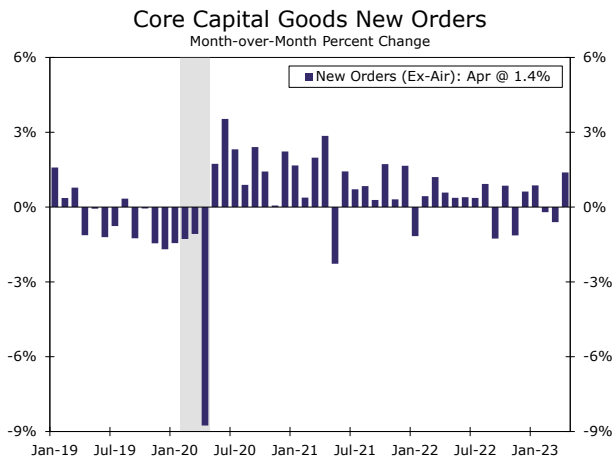
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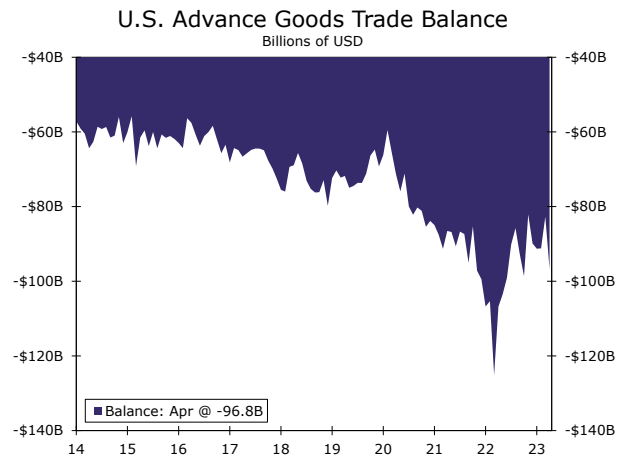
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