Economic Indicator — March 29, 2024

Forget Resilience, Consumers Defiant in February Splurge

Summary

Nominal consumer spending shot up by the most in a year in February. Consumers are primarily deploying their outlays in the service sector and that is problematic because it is disrupting progress in bringing down service price inflation.

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U.S. Personal Income & Spending: February 2024

	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24
Personal Income (MoM)	0.5	0.2	0.3	0.2	0.3	0.5	0.4	0.2	0.4	0.3	1.0	0.3
Personal Income (YoY)	5.8	5.7	5.6	5.4	4.9	4.9	4.8	4.4	4.7	4.9	4.9	4.6
Personal Income, Ex. Transfers (MoM)	0.6	0.3	0.3	0.3	0.5	0.6	0.5	0.3	0.5	0.3	0.6	0.2
Wages & Salaries Income (MoM)	0.6	0.4	0.4	0.5	0.6	0.6	0.5	0.2	0.4	0.4	0.3	0.8
Personal Spending (MoM)	-0.1	0.4	0.2	0.4	0.6	0.3	0.7	0.2	0.4	0.6	0.2	0.8
Personal Spending (YoY)	6.3	6.1	5.9	5.3	5.9	5.4	5.5	5.1	5.6	6.0	4.5	4.9
Durable Goods Spending (MoM)	-1.6	0.8	0.9	-0.4	0.6	-0.6	0.9	-1.0	0.2	1.1	-2.5	1.4
Nondurable Goods Spending (MoM)	-1.0	0.9	-0.3	0.4	0.6	1.4	0.7	-0.1	-0.3	0.2	-0.9	0.1
Services Spending (MoM)	0.5	0.3	0.3	0.6	0.6	0.1	0.7	0.5	0.7	0.6	1.0	0.9
Real Disposable Personal Income (MoM)	0.4	0.2	0.3	-0.1	0.0	0.1	-0.1	0.2	0.4	0.2	0.0	-0.1
Real Disposable Personal Income (YoY)	4.4	4.5	5.0	5.3	4.4	4.1	3.9	3.8	4.2	4.2	2.1	1.7
Real Personal Spending (MoM)	-0.2	0.1	0.1	0.3	0.5	-0.1	0.4	0.2	0.4	0.5	-0.2	0.4
Real Personal Spending (YoY)	1.7	1.6	1.8	2.1	2.5	2.0	2.1	2.1	2.9	3.3	2.0	2.4
PCE Deflator (YoY)	4.4	4.4	4.0	3.2	3.3	3.3	3.4	2.9	2.7	2.6	2.4	2.5
Core PCE Deflator (YoY)	4.8	4.8	4.7	4.3	4.2	3.7	3.6	3.4	3.2	2.9	2.9	2.8
Personal Saving Rate (%)	5.2	5.2	5.3	4.8	4.4	4.5	3.9	4.0	4.0	3.9	4.1	3.6

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

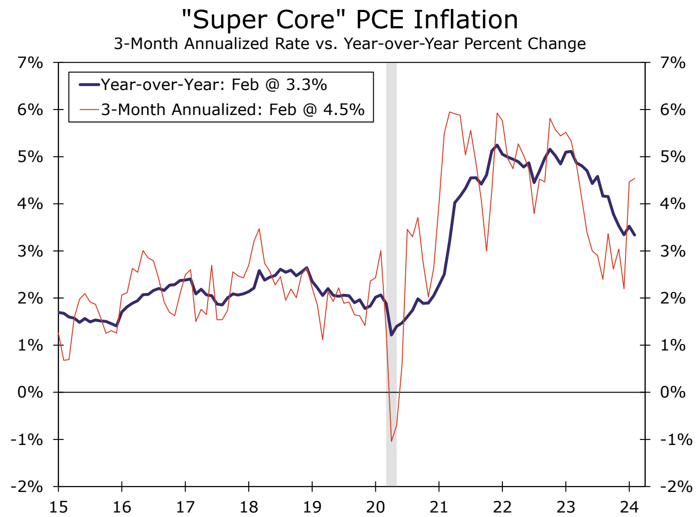
Source: U.S Department of Commerce and Wells Fargo Economics

Amid Spending Surge, Where's the Incentive to Lower Prices?

The days are getting longer and so is the wait for the Fed to lower interest rates. That is partly because consumer outlays have not been slowed by higher borrowing costs as evidenced by the 0.8% increase in nominal spending in February. That is the biggest jump in spending in over a year and a half. Even after adjusting for inflation, real consumer spending rose 0.4%.

Consumers had cut back on goods in January, but this category posted a 0.1% gain in February. Where consumers are really splurging is on outlays in the service sector where real spending jumped 0.6%. That is the biggest monthly jump in real services outlays since the wild summer of 2021 when consumers were still flush with pandemic-era savings and residual stimulus was still very much in play. Every category within services reported an increase in real spending. This is problematic for policymakers because as long as consumer keep splashing out in the service sector, the businesses that provide these services have no incentive to ease up on pricing.

The inflation rate for services less housing, or super-core inflation came in at 3.3% year-over-year, but the three-month annualized rate of 4.5% points to a problematic rise in service sector pricing (chart). While financial markets may take some comfort in the annual rate of the core PCE deflator coming in at 2.8% with a slightly smaller-than-expected monthly rise of 0.3% in February, service prices are no longer cooling as they were a few months ago.

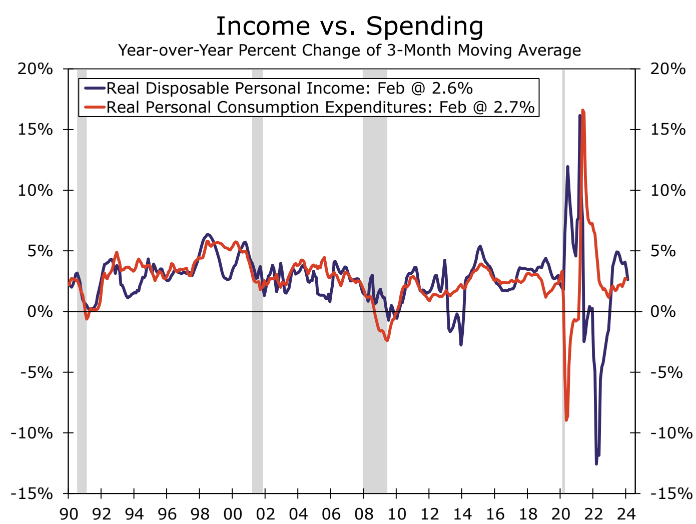


Source: U.S. Department of Commerce and Wells Fargo Economics

Despite Strong Wage Growth, Purchasing Power Is Fading

In addition to sticky services prices, strong wage growth will likely get the Fed's attention as well. After a blowout 1.0% gain in January, personal income rose 0.3% last month. Recall income was boosted by some one-off factors such as the cost of living adjustment to social security in January, and as such, we did not expect such strong growth to be sustained. But a 0.3% gain in February still marks a decent monthly gain, particularly after such a strong start to the year. Most of the strength was concentrated in wages & salaries, which shot up 0.8% in February, marking the largest one-month gain since January of last year. Rental income was also rather strong, up 1.6% in February after a 1.4% gain in January, and proprietors income bounced after two consecutive monthly declines. Elsewhere, the income details were more modest.

But when stripping out taxes paid and adjusting for inflation, households' purchasing power as measured by real disposable personal income slipped 0.1%. As seen in the nearby chart, real income and spending continue to converge. We expect the pace of real income to dictate the pace of consumption as the year progresses.



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

Modest Downside to Q1 Spending

Despite real spending coming in slightly better than anticipated in February, the recent data present some modest *downside* risk to Q1 real personal consumption expenditures (PCE). Thursday's third estimate of Q4-2023 real GDP growth revealed stronger spending at the end of last year. Real personal consumption expenditures (PCE) are now estimated to have risen at a 3.3% annualized rate, up from 3.0% previously. The higher base in Q4 positions for slower growth in Q1 than previously anticipated, yet a better outturn in February helps offset some weakness. All told, we still expect real PCE is tracking to rise close to our current forecast of a 2.4% annualized rate in Q1 though acknowledge there is some slight downside to that estimate.

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