WELLS FARGO

Economic Indicator — April 26, 2024

Spending Surges in Spite of Inflation

Consumers Rely on Income and Still Dip Into Savings to Fuel Spending

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Summary

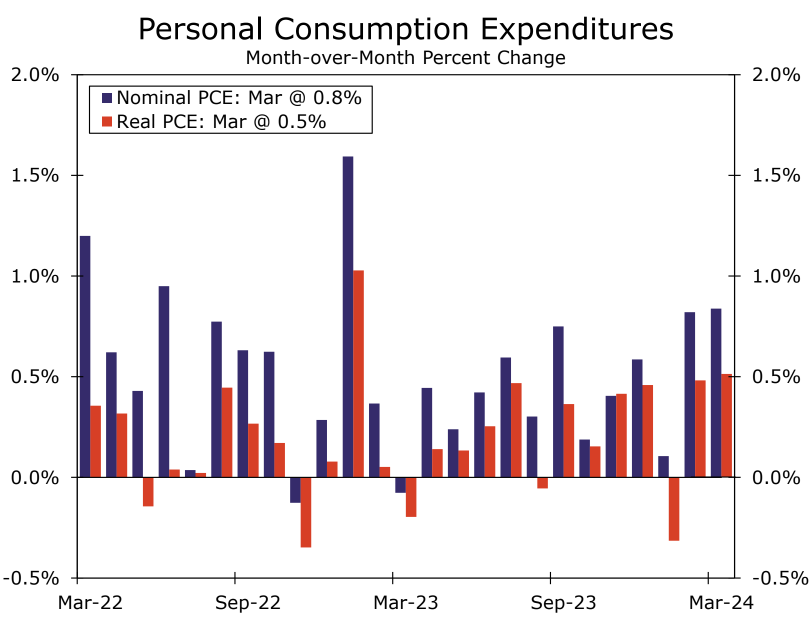
Despite real income growth being strong, real spending is stronger, forcing consumers to dip into savings. In the short run, that's problematic as it keeps pressure on inflation, particularly services prices. But the reach is not sustainable indefinitely amid mounting personal interest expense.

U.S. Personal Income & Spending: March 2024

	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24
Personal Income (MoM)	0.2	0.3	0.2	0.3	0.5	0.4	0.2	0.4	0.3	1.0	0.3	0.5
Personal Income (YoY)	5.7	5.6	5.4	4.9	4.9	4.8	4.4	4.7	4.9	4.9	4.7	4.7
Personal Income, Ex. Transfers (MoM)	0.3	0.3	0.3	0.5	0.6	0.5	0.3	0.5	0.3	0.7	0.2	0.6
Wages & Salaries Income (MoM)	0.4	0.4	0.5	0.6	0.6	0.5	0.2	0.4	0.4	0.4	0.7	0.7
Personal Spending (MoM)	0.4	0.2	0.4	0.6	0.3	0.7	0.2	0.4	0.6	0.1	0.8	0.8
Personal Spending (YoY)	6.1	5.9	5.3	5.9	5.4	5.5	5.1	5.6	6.0	4.4	4.9	5.8
Durable Goods Spending (MoM)	0.8	0.9	-0.4	0.6	-0.6	0.9	-1.0	0.2	1.1	-2.5	1.6	1.0
Nondurable Goods Spending (MoM)	0.9	-0.3	0.4	0.6	1.4	0.7	-0.1	-0.3	0.2	-0.9	0.4	1.5
Services Spending (MoM)	0.3	0.3	0.6	0.6	0.1	0.7	0.5	0.7	0.6	0.9	0.8	0.6
Real Disposable Personal Income (MoM)	0.2	0.3	-0.1	0.0	0.1	-0.1	0.2	0.4	0.2	0.0	-0.1	0.2
Real Disposable Personal Income (YoY)	4.5	5.0	5.3	4.4	4.1	3.9	3.8	4.2	4.2	2.1	1.7	1.4
Real Personal Spending (MoM)	0.1	0.1	0.3	0.5	-0.1	0.4	0.2	0.4	0.5	-0.3	0.5	0.5
Real Personal Spending (YoY)	1.6	1.8	2.1	2.5	2.0	2.1	2.1	2.9	3.3	1.9	2.3	3.1
PCE Deflator (YoY)	4.4	4.0	3.2	3.3	3.3	3.4	2.9	2.7	2.6	2.5	2.5	2.7
Core PCE Deflator (YoY)	4.8	4.7	4.3	4.2	3.7	3.6	3.4	3.2	2.9	2.9	2.8	2.8
Personal Saving Rate (%)	5.2	5.3	4.8	4.4	4.5	3.9	4.0	4.0	3.9	4.1	3.6	3.2

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

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



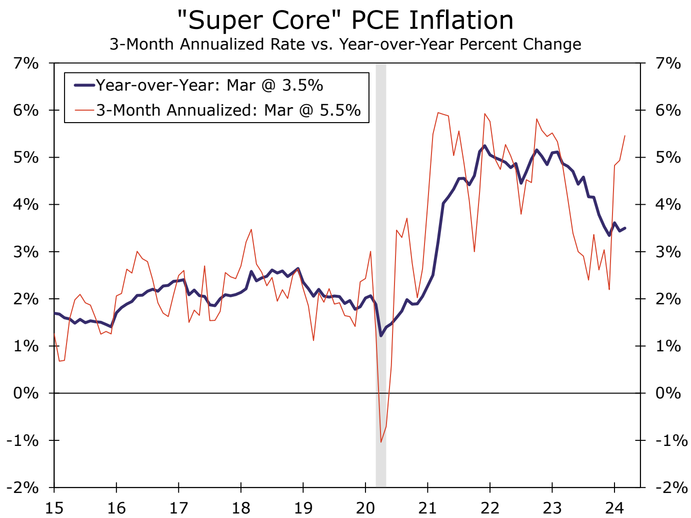
Source: U.S. Department of Commerce and Wells Fargo Economics

Should Old Acquaintance Be Forgot?

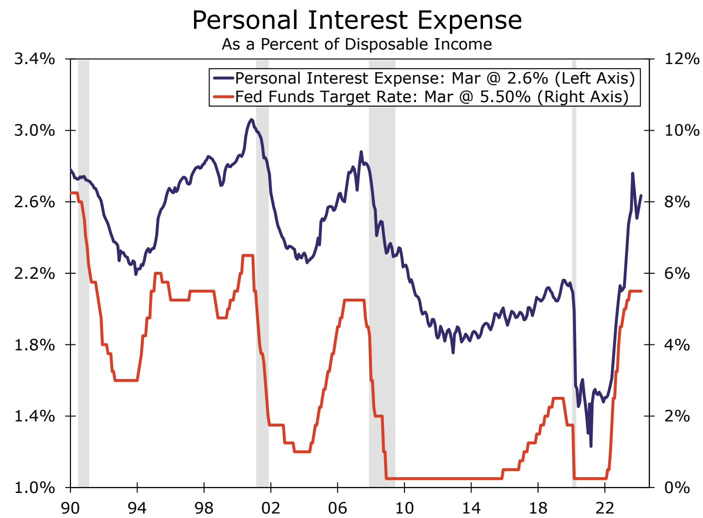
If January data were not brought to mind, consumer spending would look stronger and inflation would not look quite so daunting, Still, it is difficult to look at today's personal income and spending report and find indications of a consumer that is chastened by higher financing costs. Even as the path lower for inflation continues to be disrupted, paychecks outpaced price gains with personal income rising 0.5% in March.

Consumers have demonstrated in this cycle that they will continue to spend even when real income is down, but at times like these when real income can be a driver, spending is particularly robust. Nominal spending rose 0.8% for each of the past two months—a feat not surpassed since November 2021. On an inflation adjusted basis, real spending started the year on a dour note falling 0.3%, but since then it has risen 0.5% in back-to-back months.

We learned in yesterday's GDP report that goods spending contracted in the first quarter, but the weakness was mostly in durables, and we now know that weakness was concentrated in January. Real durables rose 0.9% in March after 1.4% in February.



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



Source: U.S. Department of Commerce, Federal Reserve Board and Wells Fargo Economics

Core Workout: Worries over Fresh Surge Overblown?

Yesterday's Q1 GDP release showed an acceleration in the quarterly rate of inflation—the core PCE deflator rose at a 3.7% annualized rate in Q1 after posting just a 2.0% sequential rate for each of the prior two quarters. At face value, that presents trouble for the Fed, but today's data offer some positive news. Upward revisions to January and February data reveal that much of the upside surprise in the annualized rate was due to more inflation in January and not a *significant* pickup late in the quarter. The monthly changes of core PCE in January and February were revised up to reveal a monthly pattern of 0.50%, 0.27% and 0.32% from January-March.

Still, core inflation picked up in March and that caused the annual rate to hold steady at 2.8%, but the composition of price gains is increasingly important in getting down to 2%. The "super core" measure of inflation, which focuses on services and strips housing from the estimates, rose at an annualized rate of 5.5% over the past three months. A quick glance at the nearby chart will fan hawkish views that the Fed is nowhere near ready to ease policy as the rate rivals its 2020-23 highs of around 6%. But here the concern over a fresh acceleration in inflation may be a bit overblown. Super core inflation was firm in March—it rose 0.4%, but the 0.7% gain in January was a major source of the jump in the annualized rate. If we simply match the monthly change in April, the three-month annualized rate will slip back to 4%—still above the roughly 2% pace of this component pre-pandemic but not quite as menacing as the recent three-month pace.

The question for the rates outlook is clouded by whether higher financing costs begin to bite and slow economic activity. There is evidence that financing costs are taking a toll on manufacturing and housing, but it has been difficult to spot the damage of financing costs to consumer outlays. Yet when we look at personal interest expense as a share of disposable income over the past 30 years, we find that peaks in the fed funds rate are associated with peaks in interest costs (chart). At 2.6% in March, personal interest costs comprise about as large a share of income as they have at any point since the start of the financial crisis. How long can spending defy gravity?

You don't get far in this business betting *against* the consumer, but earlier in this cycle we saw households dipping into savings to sustain spending when real income growth was flat or down. It is perhaps a symptom of the YOLO mentality of today's consumer that now consumers are reaching into savings even when real income growth is strong. The personal saving rate slid to 3.2% in March, the lowest since October 2022. Households continue to pull out all the stops to keep spending.

Strong economic growth and a sturdy consumer is not necessarily a problem for the Fed *unless* it causes sticky inflation, or worst case an acceleration. Price growth was firm in March. That suggests easing isn't around the corner, and it puts more emphasis on how inflation evolves into Q2 to determine the eventual start of Fed easing.

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