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Economic Indicator — August 30, 2024

Cooling Inflation in July Amid Sustained Consumer Spending

Summary

Spending still outpaced income in July, setting up for a decent Q3, and inflation continued to cool. With the 3-month annualized rate of core PCE inflation back *below* the Fed's 2.0% target, the case for "higher-for-longer" is not a compelling one.

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U.S. Personal Income & Spending: July 2024

	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24
Personal Income (MoM)	0.5	0.4	0.1	0.2	0.3	1.1	0.3	0.5	0.2	0.4	0.2	0.3
Personal Income (YoY)	4.9	4.8	4.3	4.4	4.5	4.6	4.3	4.3	4.4	4.4	4.4	4.5
Personal Income, Ex. Transfers (MoM)	0.6	0.5	0.1	0.3	0.3	0.7	0.1	0.5	0.2	0.4	0.2	0.3
Wages & Salaries Income (MoM)	0.6	0.5	-0.2	0.1	0.4	0.4	0.7	0.6	0.2	0.6	0.2	0.3
Personal Spending (MoM)	0.3	0.7	0.2	0.4	0.6	0.1	0.6	0.7	0.2	0.5	0.3	0.5
Personal Spending (YoY)	5.4	5.5	5.1	5.6	6.0	4.4	4.6	5.4	5.1	5.5	5.4	5.3
Durable Goods Spending (MoM)	-0.6	0.9	-1.0	0.2	1.1	-2.7	0.9	0.1	-0.8	1.5	-0.1	1.4
Nondurable Goods Spending (MoM)	1.4	0.7	-0.1	-0.3	0.2	-0.9	0.1	1.2	0.1	0.2	0.2	0.4
Services Spending (MoM)	0.1	0.7	0.5	0.7	0.6	0.9	0.7	0.6	0.5	0.5	0.4	0.4
Real Disposable Personal Income (MoM)	0.1	-0.1	0.0	0.2	0.2	0.1	-0.1	0.2	-0.1	0.3	0.1	0.1
Real Disposable Personal Income (YoY)	4.1	3.9	3.7	3.9	3.8	1.9	1.4	1.2	0.9	0.9	1.0	1.1
Real Personal Spending (MoM)	-0.1	0.4	0.2	0.4	0.5	-0.3	0.2	0.3	0.0	0.5	0.3	0.4
Real Personal Spending (YoY)	2.0	2.1	2.1	2.9	3.3	1.9	2.0	2.6	2.4	2.8	2.8	2.7
PCE Deflator (YoY)	3.3	3.4	2.9	2.7	2.6	2.5	2.5	2.7	2.7	2.6	2.5	2.5
Core PCE Deflator (YoY)	3.7	3.6	3.4	3.2	2.9	2.9	2.8	2.8	2.8	2.6	2.6	2.6
Personal Saving Rate (%)	4.5	3.9	3.8	3.7	3.6	4.0	3.7	3.5	3.5	3.3	3.1	2.9

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

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

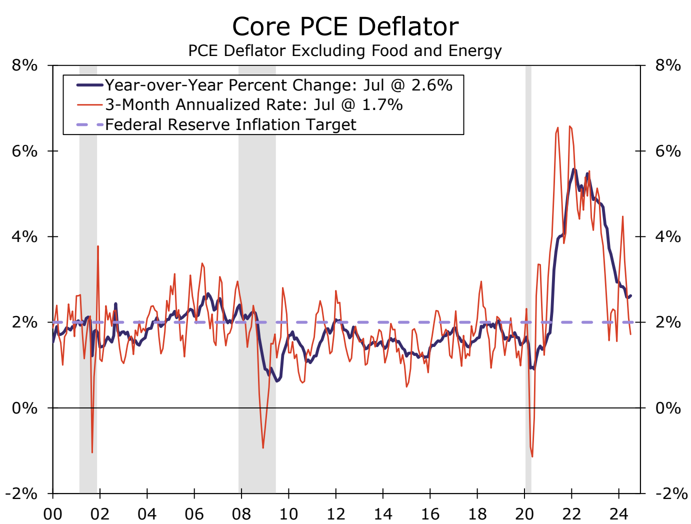
Argument for Restrictive Policy Looks Weaker

Yesterday's GDP report already showed that consumer spending was stronger in the second quarter than first reported; today's personal income and spending report reveals July data and shows that the third quarter is off to a compelling start.

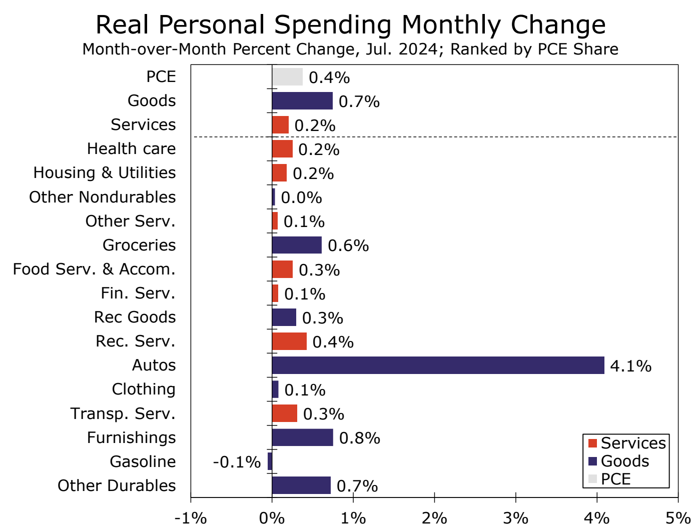
Today's report also offers affirmation that inflation is indeed on a cooling path with core PCE inflation at 2.6% (chart). For policymakers at the Federal Reserve, maintaining restrictive policy is becoming difficult to justify with the three-month annualized rate now back below target at 1.7%.

At the start of this month, financial markets were cast into a tailspin when July employment data came in much softer than expected. It is difficult to square that jobs market weakness with not only sustained consumer spending, but income gains that feel more like the sort you would see in a stronger labor market. Driven by a 0.3% increase in wages and salaries, overall compensation also rose 0.3%. Both measures are up 4.4% over the past 12-months. After accounting for inflation and taxes, real disposable personal income rose 0.1% in July and is up 1.1% over the past year. In plain English, paychecks are growing slightly faster than inflation and that is allowing consumers to spend—at least for now. A key concern is that if the jobs market gets worse amid a policy environment that remains too restrictive, income could slip. The wage gains are still encouraging for July, but we are skeptical pay will continue to rise at such a solid pace if there is further softening in jobs.

In the meantime, remarkably, income is still not keeping up with spending. In order to sustain the increased outlays, households have pared back saving to 2.9%. That is just the second time in 16 years that the savings rate has had a 2-handle.



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



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

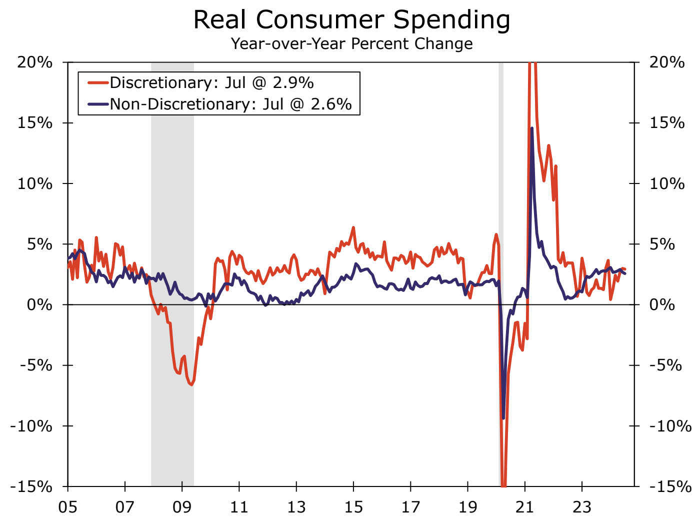
The retail sales report for July gave us a bit of a sneak preview of the spending action in today's broader and more comprehensive personal income and savings report. The big takeaway from both indicators is that auto sales accounted for much of the surge. The 4.1% real increase in spending on autos was far-and-away the biggest gainer (chart). Still, with only gasoline spending down (and only slightly) it is also fair to say that spending gains remained broadly based across other categories.

In a cycle that has seen a parade of examples in which consumers defy expectations, perhaps it is on us for not expecting the unexpected. But the composition of spending is not exactly reflective of the more cautious and choosy consumer so often discussed in corporate earning announcements. Discretionary spending is once-again outpacing non-discretionary outlays.

Groceries are expensive these days, no one is challenging that, but real spending at the grocery store was up 0.6% in July. Households were also splashing out on home furnishings, which rose more than any other category except autos.

A theme to watch the remaining month of the year is that personal income will continue to be of ever-increasing importance in terms of households' purchasing power. Pandemic-era support factors of excess liquidity and easy access to relatively-cheap credit are now a thing of the past. The gains in personal income rely on a tight labor market and to the extent that tightness turns to slack, it is difficult to imagine how consumers can continue to spend the way they have. Still, anyone paying attention these past four years has learned not to underestimate the uncanny capacity of U.S. consumers to find new ways to spend.

Spending growth in July combined with upward revisions to second quarter sets us up for some pretty decent growth in Q3 despite not yet having data for two out of three months. Even if consumer spending sputtered out in August and September, Q3 spending is still on track to come in comfortably north of 2%.



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

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