



Economics Group

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Consumer Spending Activity Moderates in August

Personal income continued to edge higher in August but personal spending activity decelerated for the month. Real consumer spending fell on slightly higher inflation while July's personal spending was revised higher.

Personal Income Improves on Wage & Salary Growth

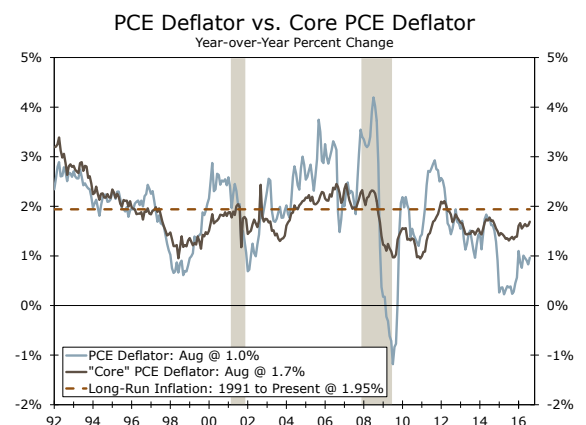
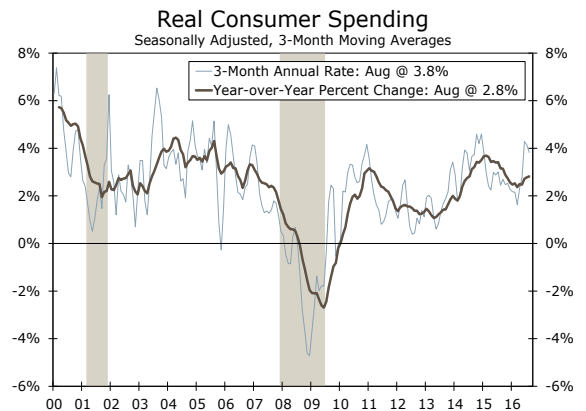
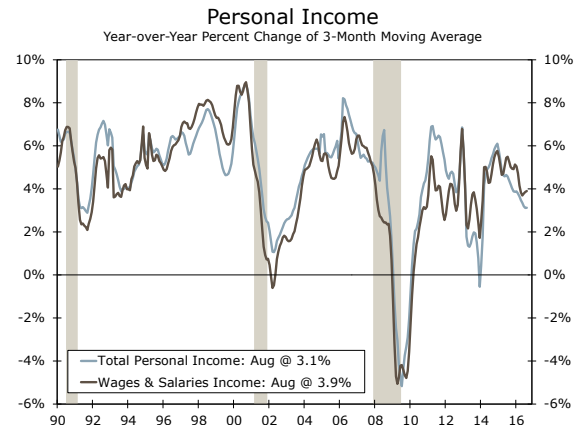
Personal income continued to march higher in August, rising 0.2 percent following July's 0.4 percent increase. One factor behind the slower pace of income growth was a downshift in wage and salary growth, which rose just 0.1 percent for the month following two months of strong 0.5 percent increases. After controlling for the effects of inflation and taxes, real disposable income growth came in at 0.1 percent, also a slight deceleration from the 0.3 percent pace observed in July. One measure we have been watching closely has been the saving rate. The saving rate remained elevated at 5.7 percent in August, suggesting not only more cautious consumers but also reflecting ongoing consumer deleveraging as documented in the Fed's household flow of funds data.

Real Spending Growth Shows Signs of Softening

Nominal consumer spending came in flat in August, the slowest pace of spending since March of this year. After controlling for the effects of inflation, real consumer spending fell 0.1 percent in August after a 0.3 percent increase in July. After accounting for this week's revisions to Q2 GDP and today's report, we expect consumer spending to downshift slightly in the third quarter. The three month annualized rate for real spending now stands at 3.8 percent for the current quarter compared to 4.3 percent at the end of Q2. As we have pointed out before, the only consistent major support to headline GDP growth in recent quarters has been consumer spending. While today's softer real spending is not overly concerning, should we continue to see flat or negative readings in the months ahead, we would become much more concerned about not only consumer spending but the outlook for GDP growth.

Consumer Price Growth Suggest December Fed Hike

The Fed's preferred measure of inflation, the personal consumption expenditure (PCE) deflator, rose 0.1 percent in August following a flat reading in July. Goods prices remained the weak link, falling 1.8 percent while services prices continued to march higher. Even with the continued decline in goods prices, the magnitude of the decline in goods prices has diminished over the last month. Core prices also continued to firm, climbing 0.2 percent for the month. The headline and core PCE deflators now stand at 1.0 and 1.7 percent respectively. In short, today's report suggests that inflation is now starting to move closer to the Fed's 2 percent target. By the end of this year we expect the headline PCE deflator to rise to 1.3 percent with the core measure coming in around its current level of 1.7 percent. We maintain our view that the next Fed rate hike will take place in December at which point it should be clear that the upward migration in inflation rates is not transitory.



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