ECONOMIC UPDATE

REGIONS

August 26, 2022

July Personal Income/Spending: Softer Gains Don't Really Change The Narrative

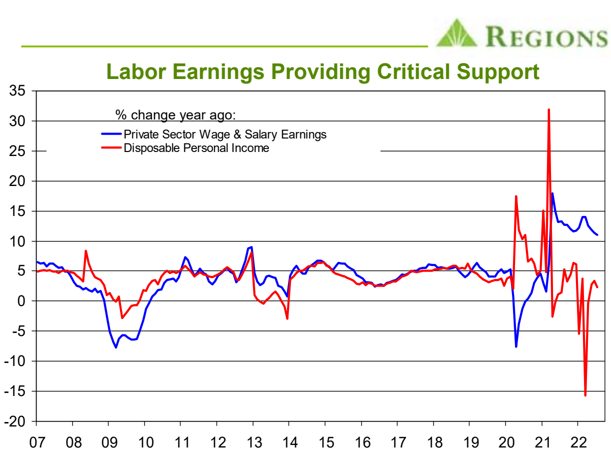
- Personal income rose by 0.2 percent in July, personal spending rose by 0.1 percent, and the saving rate was unchanged at 5.0 percent
- The PCE Deflator fell by 0.1 percent and the core PCE Deflator rose by 0.1 percent in July; on an over-the-year basis, the PCE Deflator is up 6.3 percent and the Core PCE Deflator is up 4.6 percent

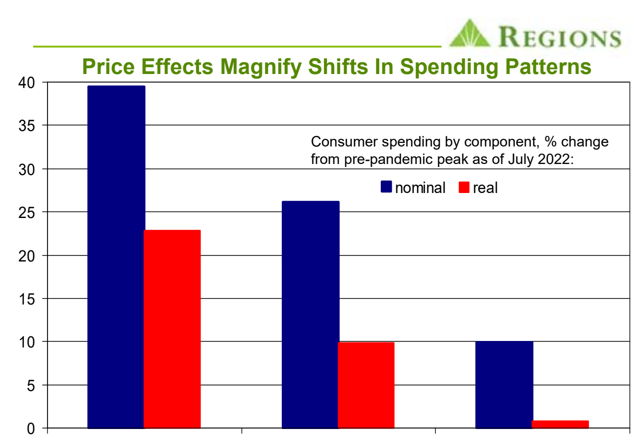
Total personal income rose by just 0.2 percent in July, well below the 0.7 percent increase we anticipated, while total personal spending was up by 0.1 percent, below what we and the consensus expected. The personal saving rate held steady at 5.0 percent in July. On the income side of the ledger, both proprietors' income and rental income reversed course, declining after some outsized advances, which offset another month of robust growth in labor earnings. On the spending side of the ledger, sharply lower gasoline prices dragged down nondurable goods while growth in services spending slowed. Health care, as accounted for in the GDP accounts, weighed on both income and spending in July. Out of all of these factors on both sides of the ledger, the two that we see as the most important are continued strength in labor earnings and the slowdown in services spending. The former comes as no surprise while health care and price effects largely account for the latter, though we still expect services spending to slow after the summer. The PCE Deflator was down by 0.1 percent in July while the core PCE Deflator was up 0.1 percent, each matching our below-consensus forecast, good for over-the-year increases of 6.3 percent and 4.6 percent, respectively.

Aggregate private sector wage and salary earnings rose by 0.8 percent in July, matching our forecast, leaving them up 11.0 percent year-on-year, the 16th consecutive double-digit year-on-year increase. Aggregate wage and salary earnings account for the number of people working, the number of hours they work, and what they earn for each hour worked, and this is by far the largest single component of personal income. This makes aggregate wage and salary earnings far more relevant than average hourly earnings as a guide to patterns in personal income and spending. After three straight monthly advances of at least 2.5 percent, rental income is reported to have fallen by 1.3 percent in July, whereas our forecast anticipated a more modest gain than those seen over the prior three months. Nonfarm proprietors' income, a proxy for small business profits, fell by 1.2 percent in July and, at this point, we're not sure what to make of this as the initial estimates and the revisions to this category have been all over the map over the past several months. While demand for services has been strong, smaller businesses don't necessarily have the same ability to pass higher input and labor costs along to customers that larger businesses do, and that fits with what now looks like a weaker trend in nonfarm proprietors' income, but a month ago that trend looked much stronger. In any event, farm income also dipped in July after a run of sizable gains.

Lower Medicare reimbursement rates and a dip in Provider Relief funding (a pandemic-era program) were drags on transfer payments in the July data. While these factors make personal income look weaker than is the case, they have no direct bearing on actual cash flows to households. Lower health care outlays weighed on consumer spending in July, but it is important to recall that in the GDP data health care spending reflects payments to service providers, regardless of who actually makes the payments – consumers, insurance providers, or governments. In many cases, providers are being squeezed by insurance reimbursement rates not budging despite the rapidly rising costs of providing care, and that turns up on both sides of the ledger. Again, the point here is that the accounting treatment of health care in the GDP data make July services spending look weaker than is actually the case.

Lower prices weighed on nominal consumer spending in July, most notably gasoline, air travel, and lodging. Spending on gasoline fell by 10.6 percent as prices plunged, and both air fares and lodging rates fell in July. Spending on new motor vehicles rose in July, in keeping with higher unit sales, but spending on used motor vehicles fell, in part reflecting lower used vehicle prices. Though home sales have fallen sharply, July saw strong gains in spending on furniture and appliances. Despite higher prices at both grocery stores and restaurants, food spending posted only a minimal gain in July; spending at restaurants was basically flat while grocery store sales were up only slightly. In any event, though the headline income and spending numbers were softer than expected, we'd caution against reading too much into that. Strong growth in labor earnings remains a key support in the face of elevated inflation, and we think there is still pent-up demand for services.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203

Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com