ECONOMIC UPDATE

REGIONS

October 28, 2022

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September Personal Income & Spending; Q3 Employment Cost Index

- Personal income rose by 0.4 percent in September, personal spending rose by 0.6 percent, and the personal saving rate fell to 3.1 percent
- The Employment Cost Index rose by 1.2 percent in Q3, with wage costs up 1.3 percent and benefit costs up 1.0 percent

Personal Income/Spending: Total personal income rose by 0.4 percent in September, shy of the 0.5 percent increase we anticipated. Total personal spending rose by 0.6 percent, topping our above-consensus forecast of a 0.5 percent gain. With spending growth outpacing income growth, the personal saving rate fell to 3.1 percent. While the September data were incorporated into the BEA's initial estimate of Q3 GDP, the monthly data nonetheless merit attention, as the levels of income and spending in September set the base for the Q4 data. The PCE Deflator, the FOMC's preferred gauge of inflation rose by 0.3 percent, with the core PCE Deflator up 0.5 percent, each matching our forecast, yielding over-the-year increases of 6.2 percent and 5.1 percent, respectively.

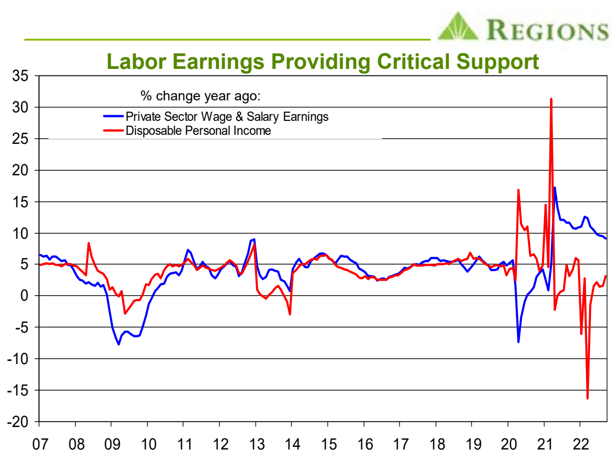
Nominal spending on goods rose by 0.3 percent in September, but with goods prices declining, dragged down by falling gasoline prices, real spending on goods was up by 0.4 percent. This was not, however, enough to offset the declines in real goods spending in the prior two months, hence the third straight quarterly decline in real spending on goods in Q3. In contrast, while nominal spending on services was up by 0.8 percent in September, continuing a run of hefty monthly advances, real services spending was up by just 0.3 percent as services price inflation continues to run hotter. The data from the PCE Deflator are in line with the data from the Consumer Price Index showing fading goods price inflation but accelerating services price inflation; with the latter carrying a heavier weight, that figures to keep upward pressure on core inflation.

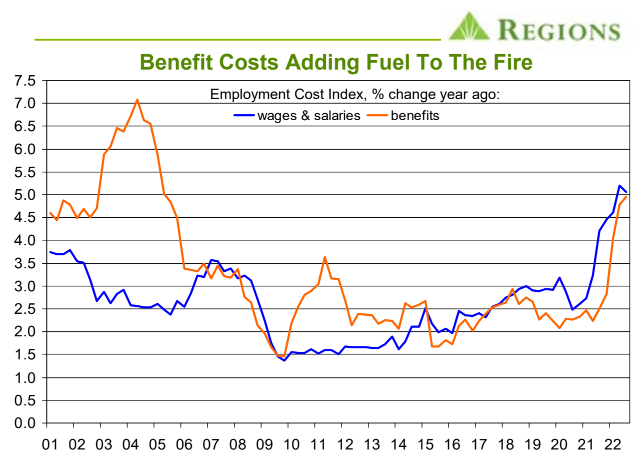
Private sector wage earnings remain the key driver of growth in personal income. Though over-the-year growth in aggregate private sector wage earnings is slowing, that is more a reflection of the year-ago comparisons getting harder, and growth continues to run ahead of inflation. After an oddly large increase in August, nonfarm proprietors' income, a proxy for small business profits, fell back into its middling trend in September, and this middling trend in part reflects small businesses having a tougher time in passing along higher input and wage costs than do large corporations. Though growth in after-tax income continues to lag inflation, consumers are drawing down savings and taking on credit card debt to help support spending, neither of which are indefinitely sustainable. This is one reason we expect slower growth in consumer spending over coming quarters.

Employment Cost Index: The Employment Cost Index (ECI) rose by 1.2 percent in Q3, a touch below our forecast of a 1.3 percent increase, with wage costs up by 1.3 percent and benefit costs up by 1.0 percent. On an over-the-year basis, the total ECI is up 5.0 percent, matching Q2's increase, with wage costs up 5.1 percent and benefit costs up 4.9 percent. While wage growth tends to be the main, if not sole, focus of discussions of labor market conditions, it is worth noting that growth in benefit costs has accelerated sharply over recent quarters, to the point that the over-the-year increase in Q3 is the largest such increase in benefit costs since Q2 2005. Moreover, with costs of providing and administering health insurance plans set to increase sharply in 2023, growth in benefit costs figures to accelerate further. As such, slower wage growth may not provide much relief to firms looking to manage total labor costs.

For those not familiar, the ECI is considered the most reliable gauge of trends in labor costs. One reason is that the ECI is measures changes in total labor costs, for both money wages and salaries and noncash fringe benefits (such as health insurance), and also includes employer-paid taxes such as Social Security and Medicare, making it a measure of total labor costs, which is what is most relevant to firms. Also, unlike the more widely followed measure of average hourly earnings found in the monthly employment reports, the ECI's measure of wage growth is not affected by shifts in the mix of employment across industry groups. The ECI measures changes in comp costs for the same jobs over time. The one drawback of the ECI is that it comes only at a quarterly frequency, making it a less timely gauge of changes in labor compensation costs.

For a FOMC looking for softening labor market conditions to ease wage growth pressures, the Q3 ECI data won't offer much encouragement. Despite a modest deceleration in wage growth, growth in total labor costs remained steady and continues to run well ahead of the pre-pandemic pace. Indeed, one common theme of Q3 corporate earnings releases has been continued upward pressure on wages, as labor supply remains no match for labor demand even with the latter having softened a bit of late. With the FOMC seeing wage growth as a primary source of inflation pressures in the broader economy, this is grounds for further increases in the Fed funds rate.





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