ECONOMIC UPDATE

REGIONS

June 26, 2020

May Personal Income/Spending: Challenging Path Ahead For Personal Income

- Personal income fell by 4.2 percent in May, personal spending rose by 8.2 percent, and the saving rate fell to 23.2 percent
- The PCE Deflator rose by 0.1 percent and the core PCE Deflator rose by 0.1 percent in May; on an over-the-year basis, the PCE Deflator was up by 0.5 percent and the core PCE Deflator was up by 1.0 percent

Total personal income fell by 4.2 percent in May, while total personal spending rose by 8.2 percent. The decline in personal income reflects a decline in transfer payments, which had surged in April, more than offsetting an increase in aggregate wage and salary earnings. The read on May consumer spending offers the first look at how consumer spending on services responded to the easing of restrictions on activity across the U.S., and while spending on services rose by 5.4 percent, this was a rather uninspired rebound and less than our forecast anticipated. With personal income having fallen and personal spending haven risen, the personal saving rate declined in May but, at 23.2 percent, remains considerably elevated.

That our forecast anticipated an increase in personal income in May simply reflected what we thought, even with a 90 percent increase, to be an understatement of transfer payments in April. That surge reflected the Economic Impact Payments (EIP) and the early rounds of the $600 per week in supplemental Unemployment Insurance (UI) benefits, each part of the CARES Act. The vast majority of the EIP was booked in April, which presaged a decline in "other" transfer payments in May, but we felt this would be offset by a larger increase in UI benefits than turned out to be the case. Either way, the broader point we've been making over the past two months remains the same – given the spike in transfer payments for Q2 as a whole, disposable personal income will rise in Q2 but is set to fall sharply in Q3, at least as things now stand.

The impact of transfer payments can be seen in our first chart below, which shows the monthly percentage changes in disposable (or, after-tax) personal income, total and excluding transfer payments. With total transfer payments having fallen by 17.2 percent in May, total disposable personal income fell by 4.9 percent. At the same time, however, private sector wage and salary earnings, easily the largest single component of total personal income, rose by 3.7 percent in May, pulling disposable personal income higher, with an increase of 1.5 percent. It is also worth noting that nonfarm proprietors' income, a proxy for small business profits, rose by 3.1 percent in May. While by no means filling the void left by a combined decline of more than 18 percent over March and April, the increase in May is consistent with small businesses starting to re-open over the course of the month.

Total consumer spending rose by 8.2 percent in May, falling short of our forecast of a 10.2 percent increase. Spending on goods rose by 14.1 percent, in line with our forecast, with spending on consumer durable goods jumping by 28.6 percent and spending on nondurable consumer goods rising by 7.7 percent. The rebound in spending on consumer durable goods reflects the healthy rebound in motor vehicle sales and a surge in spending on home furnishings and appliances. As we noted in our analysis of the report on May retail sales, however, even with hefty increases in May, the dollar volume of consumer spending on goods remains well below that of February, i.e., before the restrictions on economic activity that were imposed as part of the efforts to stem the spread of the COVID-19 virus.

Consumer spending on services rose by 5.4 percent in May. While we had anticipated a stronger increase, our broader point has been that any recovery in services spending would likely come at only a gradual pace. Aside from limitations on activity, consumer attitudes will play a large role in any rebound in spending on services, which is one reason the recent rise in positive tests for the COVID-19 virus bears watching. Given the outsized share of total consumer spending accounted for by spending on services (the numbers in the legend in our second chart below reflect the share accounted for by each component over the ten years prior to this Spring's shutdowns), consumer spending cannot be considered "back" until that can be said about spending on services.

The details of May personal income illustrate the challenges facing the economy in the months ahead. While the increase in labor earnings is encouraging, the pace of earnings growth will have to pick up sharply to offset what could be a steep decline in transfer payments by the end of July. This has implications not only for growth in consumer spending but also for the broader economy as well.

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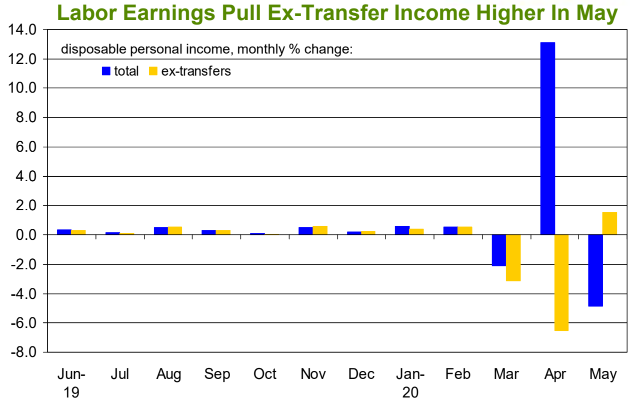
Labor Earnings Pull Ex-Transfer Income Higher In May



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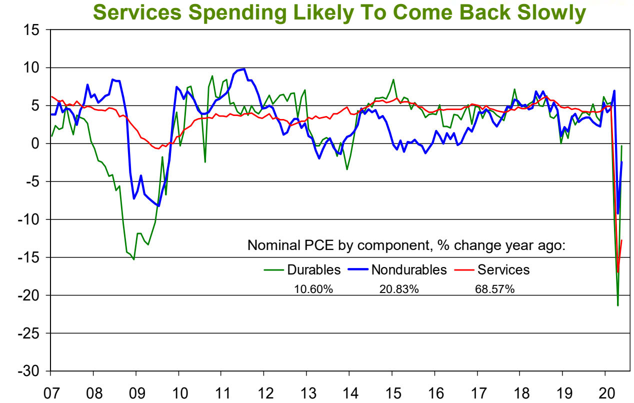
Services Spending Likely To Come Back Slowly



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