ECONOMIC UPDATE

REGIONS

June 25, 2021

May Personal Income/Spending: Shifts In The Composition Of Spending Will Continue

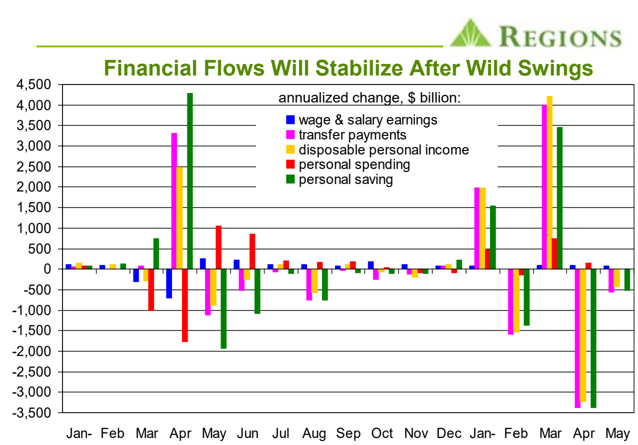
- Personal income fell by 2.0 percent in May, personal spending was unchanged, and the saving rate fell to 12.4 percent
- The PCE Deflator rose by 0.4 percent and the core PCE Deflator rose by 0.5 percent in May; on an over-the-year basis, the PCE Deflator is up 3.9 percent and the core PCE Deflator is up 3.4 percent

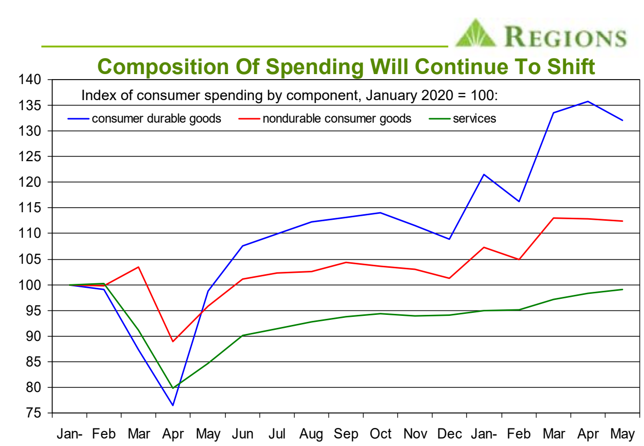
Total personal income fell by 2.0 percent in May, a touch lighter than the 2.1 percent decline our forecast anticipated and further below the 2.5 percent decline anticipated in the consensus forecast. Total personal spending was unchanged in May, as higher spending on services was neutralized by lower spending on goods. Though personal spending fell well short of the 0.9 percent increase we anticipated, the initial estimate of spending in April was revised meaningfully higher, as the initial estimate of consumer spending on goods was revised higher. With income falling while spending was unchanged, the personal saving rate fell from 14.5 percent in April to 12.4 percent in May. As measured by the PCE Deflator, inflation was a bit slower than anticipated in May, with the total PCE Deflator up by 0.4 percent and the core PCE Deflator up by 0.5 percent, which translate into year-on-year increases of 3.9 percent and 3.4 percent, respectively.

Total consumer spending on goods fell by 1.3 percent in May, with spending on consumer durables down by 2.8 percent, which in large measure reflects the sharp decline in motor vehicle sales as supply constraints continue to weigh on sales. Spending on services rose by 0.7 percent, which was a smaller increase than we expected, but given the relative weights – services account for roughly two-thirds of all consumer spending – the net result was that total consumer spending was unchanged. As we noted in our weekly *Economic Preview*, while we expected a jump in consumer spending on services in May, our question was the extent to which this would come at the expense of spending on goods. While the magnitude of the shift in the composition of consumer in May surprised us, keep in mind the degree to which spending on goods rose during the pandemic, supported by sizable fiscal transfers and the extent to which the services sector of the economy was either operating at only limited capacity or not at all. Given the upward revision to the April data, the cumulative increase in spending on goods was even more pronounced. We do think that the summer months will see larger increases in spending on services and a further retreat in spending on goods. This shift in the composition of spending will be important to keep in mind when interpreting the reported changes in total consumer spending in the months ahead.

The decline in personal income in May reflects the flows of the third round of Economic Impact Payments (EIP). Recall that, on an annualized basis, the third round of EIP added $4.044 trillion to transfer payments in March and another $688 billion in April, with the final $128.6 billion falling into May. These sharp swings in monthly payouts are what drove the 20.9 percent increase in total personal income in March and the subsequent declines in April (down 13.1 percent) and May (down 2.0 percent). As we've noted, the sharp swings in transfer payments have masked vigorous growth in private sector wage and salary earnings, easily the largest single component of personal income. After rising by 1.1 percent in both March and April, private sector wage and salary earnings rose by 0.8 percent in May, and while these increases may seem out of line with slower than anticipated job growth, keep in mind the extent to which average hourly earnings and aggregate private sector hours worked have risen over the past few months. It is also worth noting that unemployment insurance payouts have fallen sharply since January, reflecting people dropping off benefit rolls as they returned to work. Those declines will be more pronounced in the data for June and, to a much larger extent, July as the effects of states dropping out of the supplemental benefits program show up in the data. This will be a persistent drag on transfer payments and, in turn, growth in total personal income.

Another thing to watch for is the disposition the substantial pool of "excess saving" in the household sector, which our estimate puts at over $2.4 trillion as of May. While we use the term "excess saving" in the context of where saving would have been had saving and income trends not been altered by the pandemic, it could be that many households don't think of it as excess, but instead will opt to maintain higher levels of saving than they would have had had there been no pandemic. To the extent this is the case, there will be less of a boost to consumer spending from these funds than many of us have been anticipating.





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