Economic Analysis

Personal Income and Spending Rise in February

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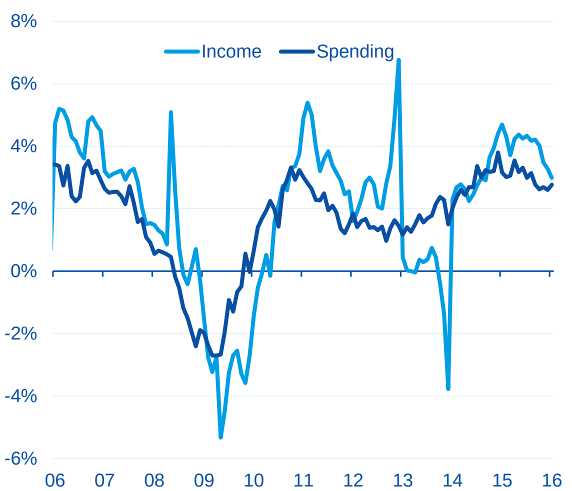
- **Consumer spending increased 0.1% MoM in February, driven by spending on services**
- **Core PCE inflation remained at 1.7%, which should be encouraging for the Fed**
- **Labor market strength should lead to stronger income and consumer gains going forward**

The latest personal income and outlays report by the BEA, while only showing modest increases in income and spending, was positive overall. Consumer spending in February increased 0.1% MoM (3.8% YoY), in line with consensus but somewhat disappointing considering the significant downward revision to January's data (from 0.5% to 0.1%). This brings personal consumption expenditures more in line with the latest readings on retail sales, both of which are now foreshadowing a slowdown in consumer spending for the first quarter. On a brighter note, real consumer spending increased 0.2% for the month, hitting 2.8% YoY (Chart 1). The gains were led by an increase in services spending, which continues to trend upward. Durable goods spending in February was flat, after declines in December and January, while nondurable goods spending decreased for the third month straight.

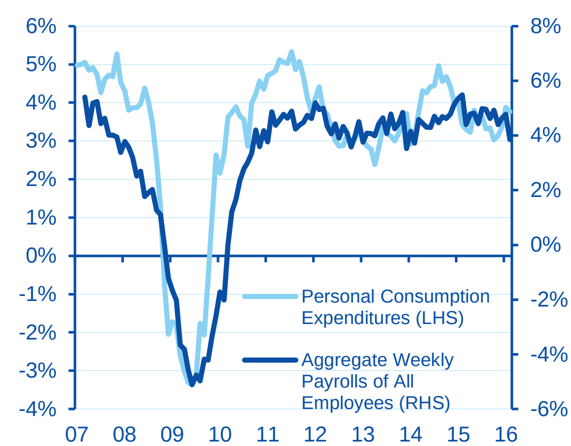
The slight YoY slowdown in nominal spending coincides with the slowdown in gains in aggregate payrolls (Chart 2). This, as well as the ongoing volatility and uncertainty in global financial markets that has characterized the beginning of this year, likely affected consumer confidence and thus spending, and pushed personal savings up. Personal savings increased 1.9% MoM (2.4% YoY), bringing the saving rate to 5.4%, the highest level since February 2015. We expect aggregate payrolls to recover as the labor market continues to tighten, positively affecting income and consumption.

Chart 1
Real Personal Income and Spending
YoY % Change



Source: Bureau of Economic Analysis and BBVA Research

Chart 2
Personal Spending and Aggregate Payrolls
YoY % Change



Source: Bureau of Economic Analysis and BBVA Research

Personal income continues to trend upward, but its growth is slower compared to 2014 and the first half of 2015. In February, nominal income increased 0.2% MoM (4.0% YoY), with real personal income up 0.3% (3.0% YoY). Gains in income were driven primarily by transfers, rental income, and receipts on assets. Compensation of employees fell 0.1% MoM, marking one of the few contractions since the beginning of 2011. The contraction comes after a relatively large increase in January (0.5% MoM) and remains 4.1% higher on a YoY basis. We expect the decrease in February to be transitory as the labor market continues to tighten.

Inflation remains low, but not as low as in 2015, as core PCE inflation held steady from January's rate at 1.7% YoY. This should provide encouragement to the Fed as it ponders future interest rate hikes, and as long as core inflation does not reverse tracks, we expect the next rate increase to come in June.

While February's personal spending and income report was not exceptional and included a large downward revision to spending in January, it shows that the upward movement in income and spending remains, despite some slowdown, and that inflation is definitely picking up. Add to this the positive employment data for February, and it looks like the outlook on the economy is not as bad as it might have seemed at the beginning of the year. Overall, we expect personal income to have a better showing next month, which together with the lower level of volatility and uncertainty in the economy should support stronger personal consumption.