U.S. Flash

Personal Spending Grows While Income Falls Sharply

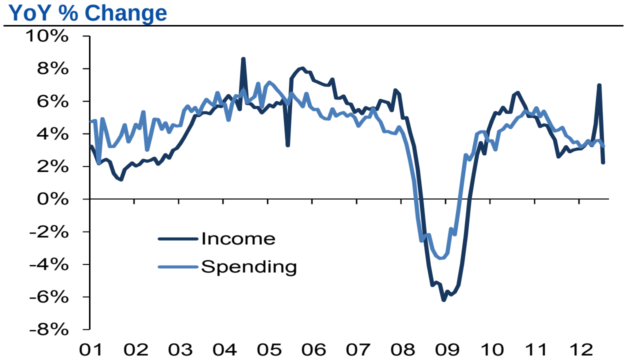
- **Personal consumption increased 0.2% in January on strong growth in services**
- **Incomes plummeted by 3.6% following December's unusual 2.6% gain**
- **PCE inflation decelerates to 1.2%, with core at 1.3%, holding well below the Fed's target**

The personal income and spending report for January sheds light on exactly how consumers tried to avoid the worst of Washington's tax and spending fears. Consumption rose by 0.2% as individuals did not adjust their spending habits much in reaction to the expiring payroll tax cut that hit in January. The downward revision for December's figure from 0.2% to 0.1% further attests to the impact of fiscal uncertainty prior to the deal on New Year's Day. The goods portion of consumption fell by 0.25% on lower durable goods consumption while the driver for spending came from the services sector, up 0.38%. In general, the fact that consumption held up in January was somewhat of a surprise, particularly considering the report's counterpart. The 3.6% decline in personal income, the most in 20 years, was a mixture of actions that took place in December and a less sanguine beginning to 2013. The most abrasive cut to income was the reset to a 2% higher payroll tax that emerged from a final hour deal in Washington, raising the rate back to the pre-Bush level and cutting into disposable personal income immediately in January. Companies were fearful that other taxes and rates might be changed for the new year so they doled out dividends to the tune of a 32% rise from November. Come January, that figure axiomatically had to decline and it did so by 34% as dividends returned to their regular schedules. The disposable income figure (income minus current taxes) shows the brunt of the damage: a decline of 3.9% due mostly to the payroll tax increase.

In other news, headline PCE inflation was flat in January while the core rate rose by 0.1% after a flat reading the month before. Year over year headline inflation was slowed to 1.2% after an upward revision to December's figure from 1.3% to 1.4%. Core PCE inflation also saw a slight downward tick to 1.3% YoY in January. This is good news for the Fed's current highly accommodative monetary policy stance and should keep the inflation hawks at bay for at least a bit longer.

Overall, this report is a rarity on the back of Washington's fiscal negotiations and does little to change the outlook for 2013 in terms of growth. Although the decline in income was more than anticipated, the circumstances point to a definite reduction in spending and the reasoning was outlined before the figures were even released. It therefore comes as neither a surprise nor a reason to sound alarm. The end of 2012 and early 2013 will be marred with economic data that holds little value save a political scorecard as spending cuts and public sector finances become cannon fodder for a myriad of impending budgetary debates.

Chart 1
Real Personal Income and Spending
YoY % Change



Source: Bureau of Economic Analysis & BBVA Research

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