Datanote: US Personal Income & Spending/ Trade, February

In one line: Core prices back on track; real after-tax income growth slowing sharply

- The February core PCE deflator rose by 0.3%, in line with the consensus
- Real personal spending rose by 0.4%, well above the consensus, 0.1%.
- Personal incomes increased by 0.3%, a bit below the consensus +0.4%.

- The advance goods trade deficit widened further to $91.8B, from $90.5B, above the consensus, $90.0B.

The 0.26% increase in the core PCE deflator is a bit less than the 0.30% we expected, based on the CPI and PPI data, but the undershoot is almost exactly offset by upward revisions to the December and January data. Rounding has nudged up the one-decimal January number to 0.5%, but the three-decimal is only 0.452%. Viewed in isolation, the February number is a relief after the upside surprises in the past two months; core services prices ex-housing rose only 0.18%, the smallest increase since November. This follows a 0.66% leap in January, some 0.40pp of which was due to spikes in healthcare and financial services components. These always looked like outliers - due to seasonal issues and the lagged effect of soaring stock prices, respectively - and they duly contributed only 0.12pp to core services ex-housing in February. This is a much better indication of the underlying trend. Some other services components which saw outsized gains in January, including airline fares and lodging costs, were much better behaved in February.

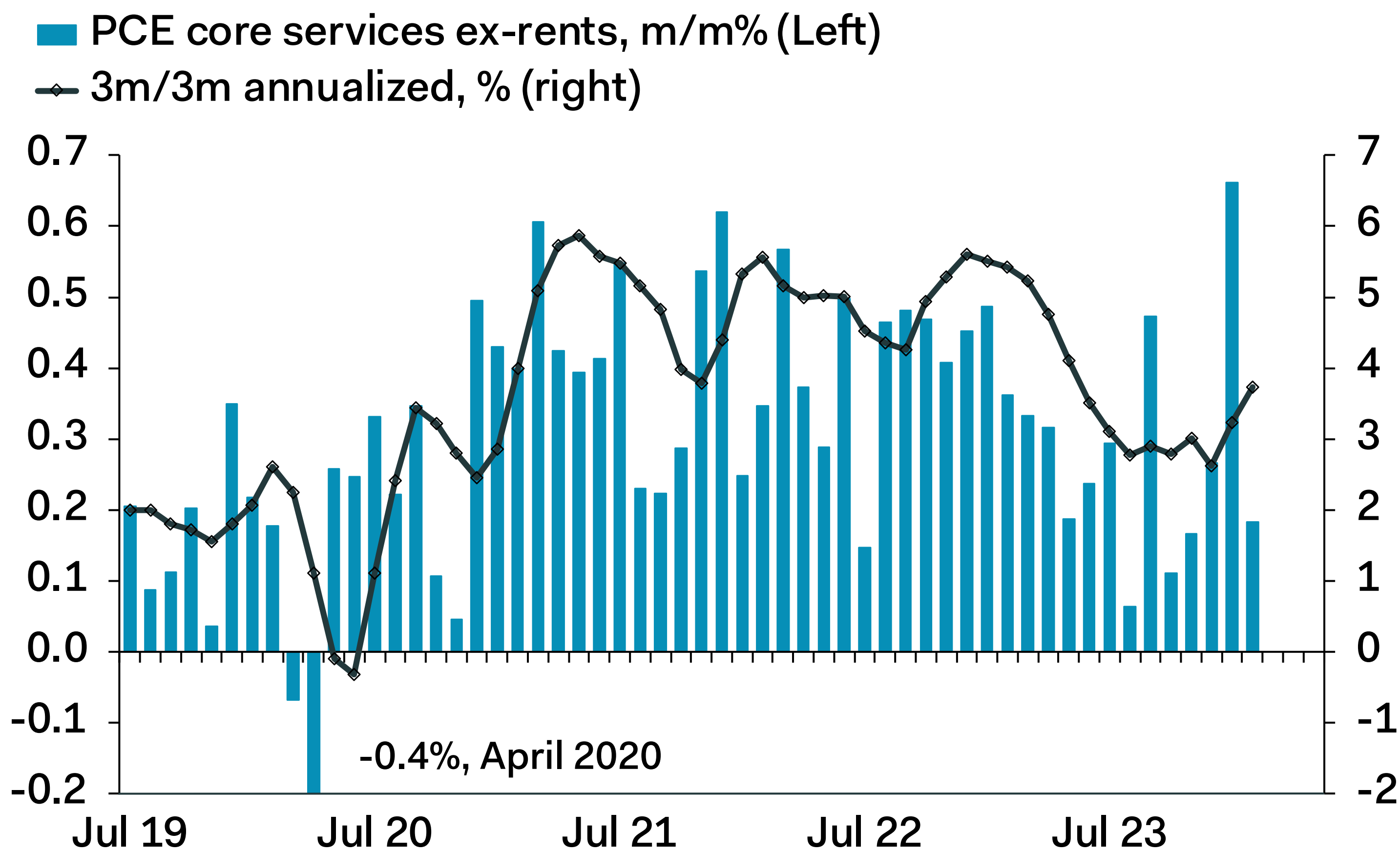
Core goods prices rose 0.3%, the biggest increase since May last year, but this followed three straight declines, and prices fell at a 1.7% annualized rate in the three months to February, compared to the previous three months. Higher prices for video/IT equipment lifted core goods prices in both Jan and Feb this year and in 2023, so some of the recent increase, at least, likely is a seasonal issue; the trend is downwards. The jump in Feb this year accounted for about half the increase in all core goods prices. Elsewhere, clothing prices reversed their January decline, but the trend here is about flat. We see no reason to worry about core goods inflation.

You can expect to read a good deal of analysis focussing on the 3.7% annualized increase in core services ex-housing in the three months to February, compared to the previous three months, the fastest increase on this basis since last May. But that makes sense only if you think that the January spike represents a shift in the trend, which we think is very unlikely. The six drivers of the surge in core inflation in 2021-to-22 - expanding margins, rapid wage gains, exploding rents, supply chain chaos, and pass-through from higher global food and energy prices - have all normalized or are in the process of normalizing, with no real signs of any reversal. That means the fundamental pressure on inflation is to the downside, but odd things can happen in individual months without changing the bigger picture. Our base case, then, is that the core PCE over the next few months will look much more like February than January. If we're right about that, and the labor market weakens anything like as much as is implied by the ongoing drop in small firms' hiring plans, the Fed will be easing in June.

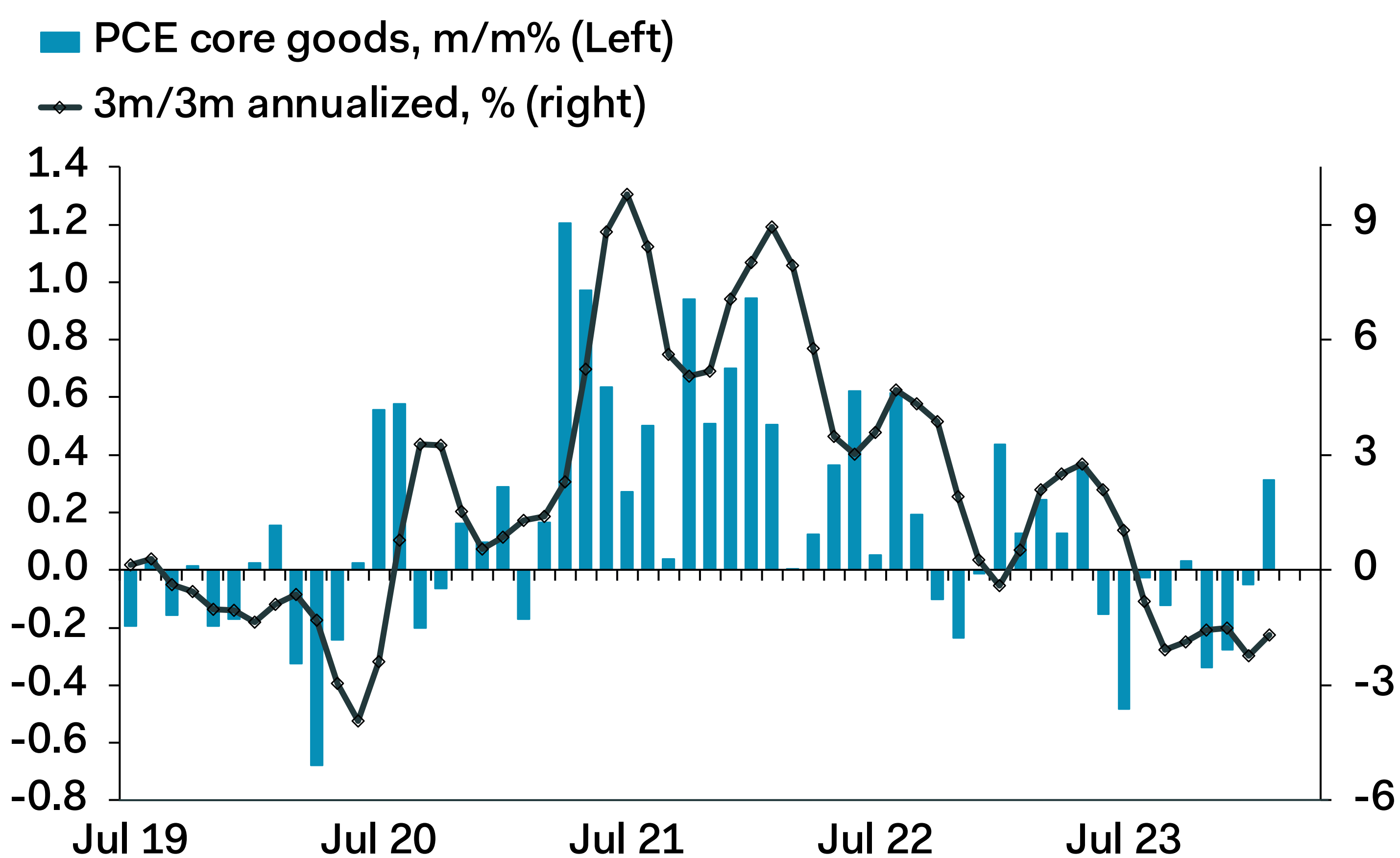
Consumers' spending looks in better shape than we had expected before this report; the 0.4% jump in real spending was much better than indicated by February's underwhelming retail sales data. Real spending on goods was soft, rising by just 0.1% after a 1.3% sharp fall in January, with the three-month-on-three-month annualized change dropping to just 0.5%. But this was more than offset by a solid 0.6% increase in real spending on services. Three-month-on-three-month annualized growth in services spending has now accelerated to 4.5%, the fastest rate since the post-COVID rebound in mid-to-late 2021. If total real consumption is flat in March, it would still rise by a little over 2% annualized in Q1, weaker than the 3.3% rate now estimated for Q4, but still solid. Expect upward revisions to GDP forecasts on the back of these numbers.

The modest 0.3% increase in personal incomes leaves overall income growth closer to the underlying trend, driven by wage growth, following January's 1.0% surge driven by one-time factors. The trend in real after-tax income growth is starting to look much weaker in the latest numbers, falling by 0.1% in February after flatlining in January. Assuming it recovers by 0.2% in March, real disposable incomes will growth by barely 1% annualized in Q1, too weak to sustain the recent strength of consumers' spending, now that excess savings appear to have dwindled significantly.

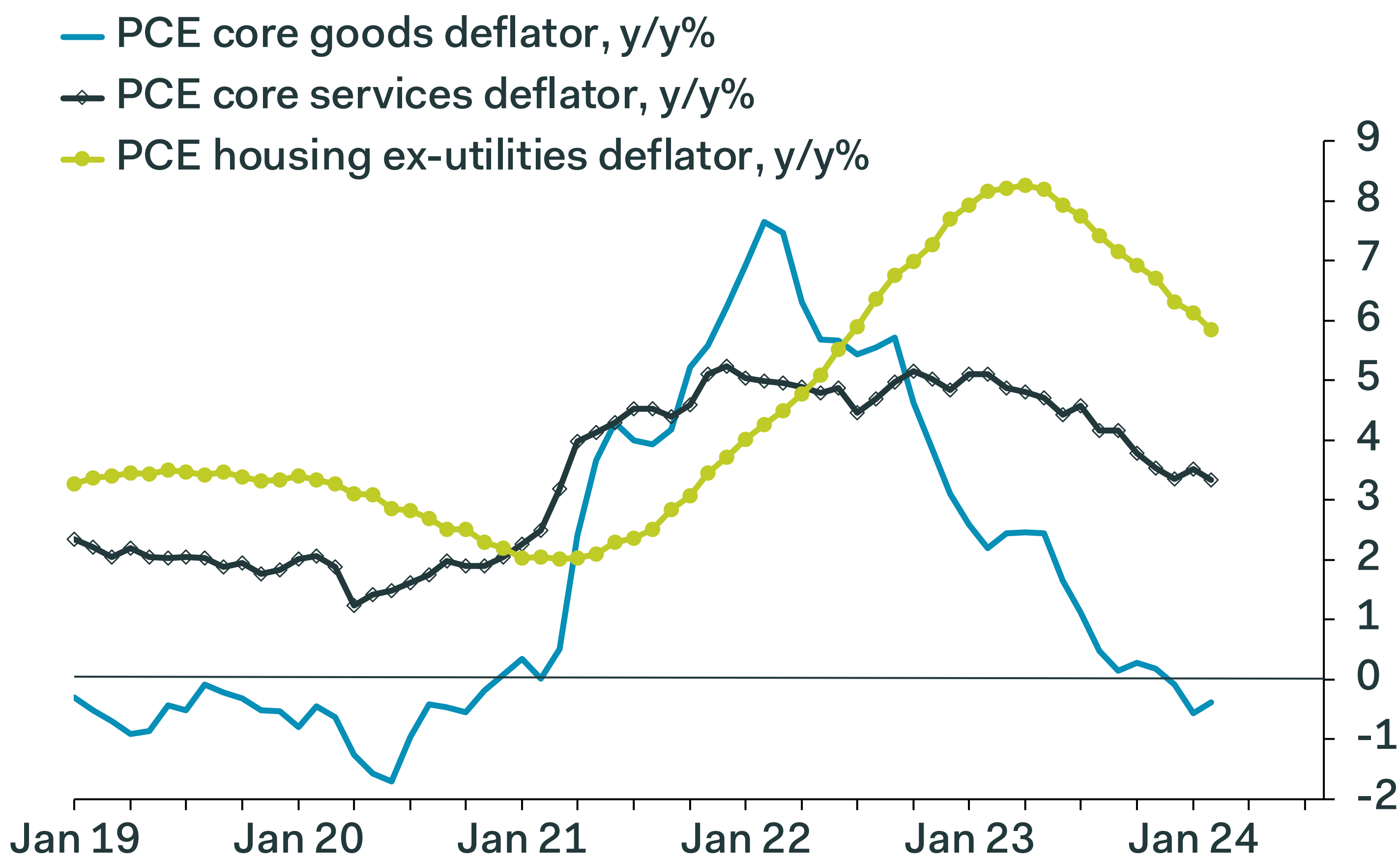
Elsewhere, the advance trade numbers show that the goods trade deficit widened further to $91.8B in February, as a solid increase in exports of food and industrial supplies more was more than offset by a bigger and broad-based rise in imports. That leaves the goods trade deficit at $91.1B on average in January and February, meaningfully larger than the $88B average in Q4. Plugging in some conservative assumptions for goods trade in March and presuming that services trade continues to evolve in line with its trends, net trade looks on course to subtract somewhere from 0.5-to-1.0 percentage points from overall GDP growth in Q1.

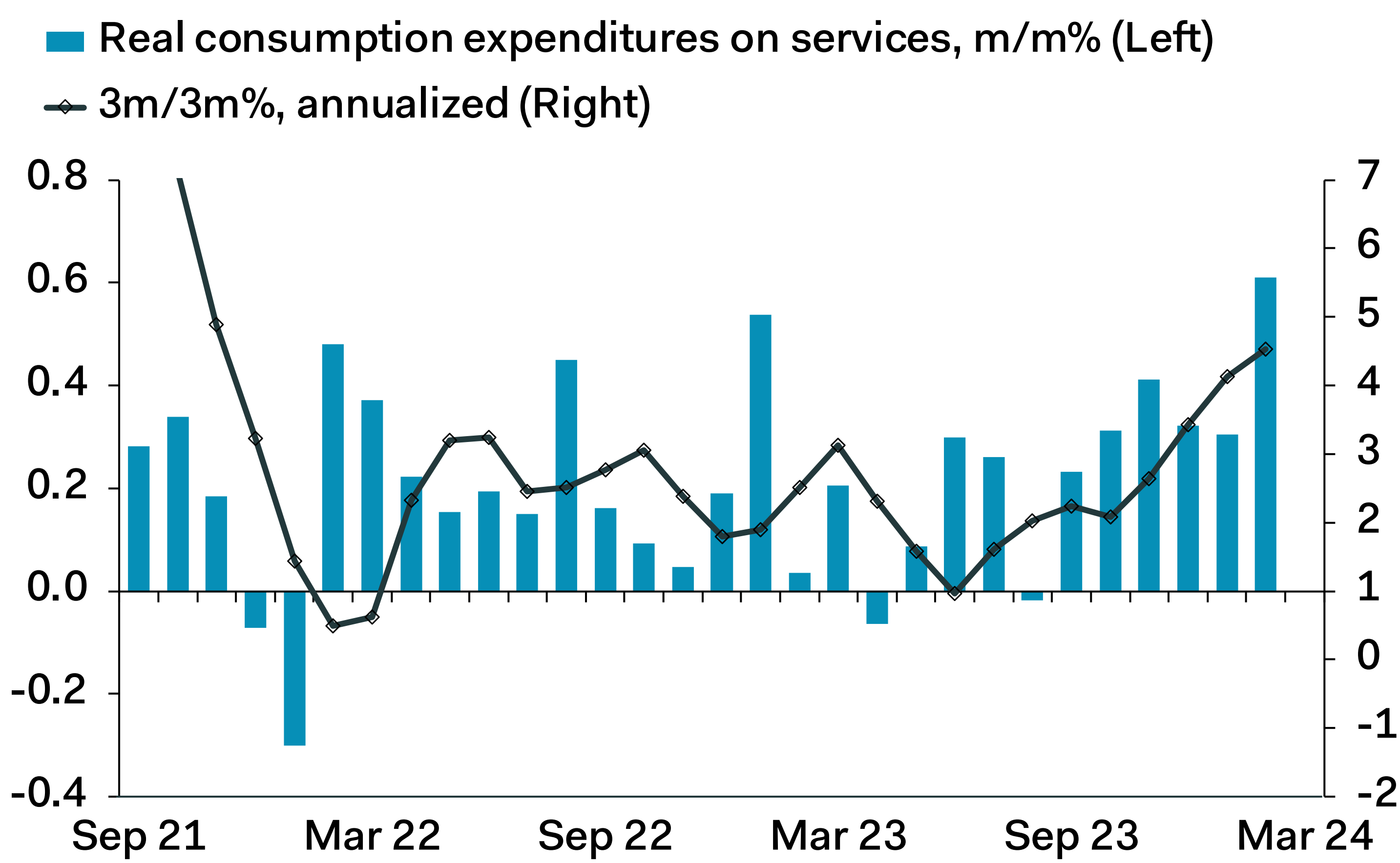


PCE core services ex-rents, m/m% (Left)
3m/3m annualized, % (right)
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
-0.1
-0.2
7
6
5
4
3
2
1
0
-1
-2
-0.4%, April 2020
Jul 19
Jul 20
Jul 21
Jul 22
Jul 23



PCE core goods, m/m% (Left)
3m/3m annualized, % (right)
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8
9
6
3
0
-3
-6
Jul 19
Jul 20
Jul 21
Jul 22
Jul 23


PCE core goods deflator, y/y%
PCE core services deflator, y/y%
PCE housing ex-utilities deflator, y/y%
9
8
7
6
5
4
3
2
1
0
-1
-2
Jan 19
Jan 20
Jan 21
Jan 22
Jan 23
Jan 24


Real consumption expenditures on services, m/m% (Left)
3m/3m%, annualized (Right)
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
7
6
5
4
3
2
1
0
-1
-2
Sep 21
Mar 22
Sep 22
Mar 23
Sep 23
Mar 24