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Economics Group

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Inflation Tame, Consumer Spending Soaring

The fact that income increased only 0.1% in July did not hold back the latest surge in consumer spending, as outlays increased 0.6% in July and the saving rate fell again, this time to its lowest rate all year.

Trade War Not Holding Back Spending So Far

Coming off a torrid pace of spending in the second quarter, U.S. consumers kept right on going into Q3, increasing spending another 0.6% in July. The latest spree was not held back by the fact that income barely moved (up just a tenth of a percent).

The saving rate hit 8.8% in February but has been trending lower ever since. Today's report confirms that consumers saved less to sustain spending as income growth has slowed. In fact, for some consumers, it is not just a matter of wages growing more slowly; some are actually starting to see smaller paychecks, as discussed subsequently.

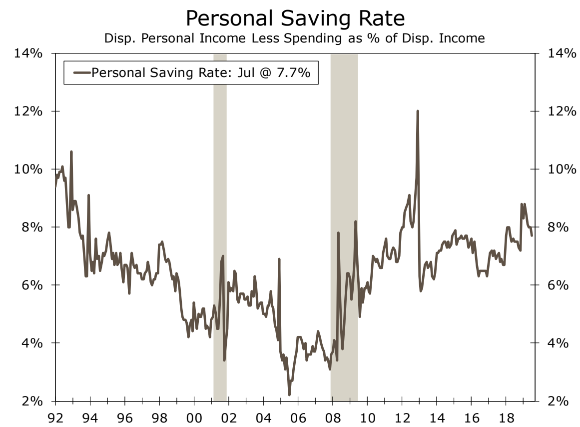
The manufacturing sector, which is more exposed to the trade war than most parts of the service sector, has been under a lot of stress in recent months. So far consumers have sidestepped the fallout despite evidence of a trend slowdown in the regional and national PMIs. Now we are seeing evidence of manufacturing troubles in personal incomes. Wages and salaries in the manufacturing sector fell in July, contributing to the smaller-than-expected increase in personal income.

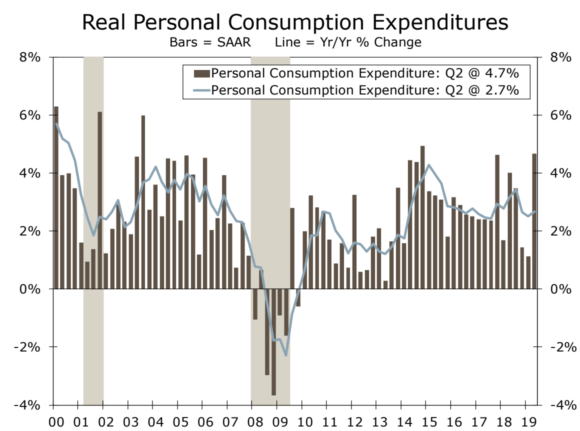
Earlier this week, upward revisions to the GDP report lifted the growth rate of consumer spending to a blistering 4.7% pace—the fastest since 2014. Before we get too carried away with hopes that the consumer is powering the economy through any potential slowdown, keep in mind that Q1 was the slowest pace of consumer spending growth since 2013. The strength in Q2 was at least partly a function of low base effects after a puzzlingly soft start to the year. So the question now perhaps is not whether the consumer can sustain the pace from Q2 but rather how much expenditure growth will slow. It is not on track to slow much. Barring a collapse in spending in August and September, Q3 will now likely have a three-handle on the pace of personal consumption.

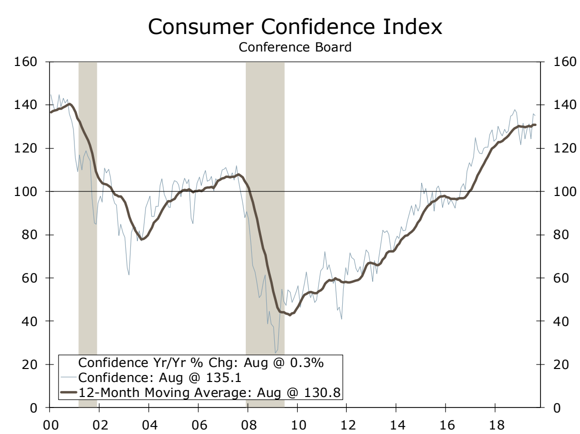
Earlier this week, we got an encouraging signal when the Conference Board's measure of consumer confidence fell much less than expected in August. The fact that the survey cutoff date was August 16 might mean that the measure is not fully capturing the volatile developments later in the month. Later this morning we will get a revised look at the University of Michigan's survey of consumer sentiment which might better capture consumers' moods in the second half of the month.

Third Base Coach is Telling the Fed to Keep Headed for Home

Both the headline and core rate of PCE inflation came in about as expected and enough below the Fed's 2.0% target rate to give the Fed the green light for another rate cut in September. In the context of soaring consumer spending, its not immediately clear that easier money is terribly needed at the moment. But perhaps, the more accommodative stance might offset any slumping in consumer confidence should the trade war escalate further.







Source: U.S. Department of Commerce, The Conference Board and Wells Fargo Securities

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