TD Economics

February 2, 2015

Data Release: A soft note to an otherwise decent year for spending

- Personal income rose by 0.3% M/M in December, above market expectations for 0.2%. Removing taxes and adjusting for inflation, real disposable income growth was 0.5%, the strongest gain in two years.
- Personal spending fell by -0.3% M/M in nominal terms, below the consensus forecast for a -0.2% drop. In real terms, consumer expenditures fell by a milder 0.1% M/M, albeit following a particularly robust 0.7% gain in November.
- In real terms, spending fell for both durable (-0.7% M/M) and non-durable goods (-0.1%), while spending on services was flat on the month. The drop in durable goods spending was partially a giveback from the strong 2.5% bounce in November, owing to particularly robust auto sales.
- With lower spending, the savings rate bounced back up to 4.9%, after hitting a 2014-low of 4.3% in November.
- Inflation as measured by the personal consumer expenditures (PCE) price deflator came in at 0.7% Y/Y, a steep drop from 1.2% in November, and below market expectations for 0.8%. Core PCE inflation (ex-food, ex-energy) decelerated modestly to 1.3% Y/Y from 1.4% in November, on par with the consensus forecast.

Key Implications

- This is a disappointing report on the surface. While the quarter as a whole was the best one for consumer spending in over eight years, the decline in December implies less momentum heading into 2015. That being said, this is the second year in a row with a strong November print, followed by a weak December. This may simply suggest that consumers are bringing forward traditional holiday spending one month early.
- There were reasons for cheer in this report. A robust gain in real personal disposable income and a sharp upswing in the savings rate suggests that consumers have padded their bank accounts. Moreover, the drop in inflation due to falling consumer energy prices is raising the real purchasing power of consumers just as the labor market is pointing to accelerating income growth. The improvement in wage expectations is evident in both small business surveys and consumer confidence surveys.
- Even with a rising U.S. dollar and a sharp fall in oil prices – an input into so many other goods and services – core PCE inflation has held relatively steady. This gives support to the Federal Reserve's message of looking through the transitory impact of lower oil. At this point in time, the case for a September rate hike remains very much intact.

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