U.S. CONSUMPTION CONTINUES TO GROW, INFLATION REMAINS MODEST

*U.S. current-dollar consumption increased by 0.3% m/m in October and real (inflation-adjusted) consumption increased by 0.1% m/m (consensus: 0%). Its eighth consecutive monthly increase (Chart 1). Positive fundamentals suggest that real consumption will continue to grow near 2.5% yr/yr through 2020, enough to sustain the economic expansion.

*Real disposable income growth inched down to 2.8% yr/yr from 3.3%, but it continues to outpace real consumption growth, as reflected in the personal saving rate which remains high at 7.8% (Charts 2 and 3). Despite elevated levels of confidence, consumers still appear to be cautious.

*The headline PCE price index - the Fed’s preferred measure of inflation – increased by 0.2% m/m in October, leaving its yr/yr change at 1.3% (consensus: 1.4%), and the core PCE price index increased by 0.1% m/m, lowering its yr/yr change to 1.6% from 1.7% (Chart 4). Given that nominal GDP growth has decelerated to 3.8%, a sustained pickup in core inflation is highly unlikely.

Consumption

Real consumption growth of nondurable goods (+0.2% m/m) and services (+0.2% m/m) picked up in October, while consumption of durable goods fell sharply (-0.8% m/m). Consumption of discretionary goods and services was mixed: motor vehicles and parts (-2.7% m/m), furnishings and durable household equipment (+0.5% m/m), recreational goods and vehicles (+0.7% m/m), jewelry and watches (-2.7% m/m), luggage and similar personal items (-0.1% m/m), clothing and footwear (+1.8% m/m), recreational items (+0.3% m/m), personal care products (0.0% m/m), recreation services (-0.3% m/m), food services (+0.4% m/m), and personal care services (+0.1% m/m).

Real average hourly earnings growth has accelerated over the last year and is lifting consumer purchasing power (Solid U.S. consumption to sustain the expansion, November 19, 2019). Moreover, other fundamentals are the most favorable they have been in this expansion and they are supportive of sustained, solid consumption growth: nonfarm payrolls have increased in every month for over nine years, by a cumulative 21.6 million; initial jobless claims are historically very low, reflecting low levels of job layoffs; low interest rates are reducing consumer credit costs and debt service burden; and the rate of personal saving is elevated, providing room for consumers to boost or smooth spending.

PCE prices

The underlying trend in core inflation continues to fall. The three-month annualized change in the core PCE price index declined to 1.0% from 1.5% and the six-month annualized change declined to 1.7% from 2.0 (Chart 5). Although the Fed is concerned that inflation that is persistently below its 2% target will reduce inflationary expectations and interest rates and narrow the Fed’s buffer from the effective (zero) lower bound, we emphasize that lower inflation lifts real wages and consumer purchasing power and is positive for economic performance.

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Chart 1: Real Personal Consumption (month-over-month, %)

Source: Bureau of Economic Analysis/Haver Analytics
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 2: Growth in Real Disposable Income and Real Personal Consumption (year-over-year, %)

Source: Bureau of Economic Analysis/Haver Analytics
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics
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Chart 3: Personal Saving Rate

Source: Bureau of Economic Analysis/Haver Analytics

Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 4: PCE Price Index - Headline and Core (year-over-year, %)

Source: Bureau of Economic Analysis/Haver Analytics

Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics
Chart 5: Core PCE Inflation - 3-mth and 6-mth annualized percent change

Source: Bureau of Economic Analysis/Haver Analytics

Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics
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