April 30, 2018

ECONOMIC REPORT

Gus Faucher
Chief Economist

Stuart Hoffman
Senior Economic Advisor

William Adams
Senior Economist

Kurt Rankin
Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

SOLID GROWTH IN INCOME AND CONSUMER SPENDING IN MARCH; INFLATION DATA POINT TO JUNE FED RATE HIKE

SUMMARY

- After-tax income grew 0.3 percent in March, another solid gain.
- Consumer spending rose 0.4 percent over the month, the biggest increase since November. Consumer spending growth was soft in the first quarter.
- The Federal Reserve's preferred inflation measure was flat over the month, but inflation excluding food and energy was stronger.
- On a year-over-year basis, both overall and core inflation have accelerated in recent months, and are close to the FOMC's 2 percent goal.
- PNC does not expect the FOMC to raise the federal funds rate at its meeting this week. However, the inflation data support a fed funds rate hike at the FOMC's next meeting, in mid-June.

Nominal personal income rose 0.3 percent in March from February. Employee compensation rose 0.2 percent over the month, including a 0.2 percent increase in wages and salaries. There was a big 0.9 percent increase in dividend income, following a 1 percent increase in February, as businesses boosted dividends in early 2018 with reduced corporate taxation and to take advantage of lower personal income tax rates.

Personal disposable (after-tax) income also rose 0.3 percent in March. This followed an increase of 0.3 percent in February (revised down from 0.4 percent) and 0.9 percent in January (revised down from 1.0 percent). The big increase in after-tax income in January came from the cut to federal personal income taxes, which took effect at the beginning of the year. What matters for the calculation of personal disposable income is when the tax cut takes effect, and not necessarily when reduced tax withholdings start to show up in workers' paychecks.

Consumer spending rose 0.4 percent (nominal) in March, the biggest increase since December. Durable goods spending rose 0.8 percent as auto sales rebounded over the month. Seasonally-adjusted spending on nondurable goods fell 0.2 percent as gasoline prices rose by less than usual during the early spring. Services spending jumped 0.6 percent in March.

With spending up more than income, the saving rate fell to 3.1 percent in March from 3.3 percent in February. But with tax cuts boosting after-tax income this year, the saving rate is up from 2.4 percent at the end of 2017.

The personal consumption expenditures price index was unchanged in March from February as energy prices fell after seasonal adjustment, but the core index (excluding volatile food and energy prices) rose 0.2 percent. On a year-ago basis overall PCE inflation accelerated to 2.0 percent in March from 1.7 percent in February. Core PCE inflation was 1.9 percent in March year-over-year, up from 1.6 percent in February and 1.3 percent in August. The PCE price index is the Federal Reserve's preferred inflation measure.

After-tax income rose 0.2 percent in March adjusting for inflation, and real consumer spending rose 0.4 percent. Real after-tax income growth in the first two months of 2018 was revised slightly lower. Real consumer spending in January was revised higher from a 0.2 percent decline to a 0.1 percent decline, but February spending was revised lower, to a 0.2 percent decline from no change.

SOLID GROWTH IN INCOME AND CONSUMER SPENDING IN MARCH; INFLATION DATA POINT TO JUNE FED RATE HIKE

On a year-ago basis after-tax income, adjusted for inflation, was up 1.7 percent from one year earlier. Real consumer spending growth was 2.4 percent year-over-year in March (see Chart 1).

Personal income and spending growth in March were both solid. Consumer spending has been soft so far in 2018; adjusting for inflation it rose just 1.1 percent at an annual rate in the first quarter, the slowest pace in almost five years. But real after-tax income rose 3.4 percent annualized in the first quarter, from job growth, wage gains, and personal income tax cuts. Income growth should lead consumers to gradually boost their spending throughout 2018 and into 2019, although the need to increase saving and higher interest costs for big-ticket purchases will constrain growth somewhat.

Inflation is picking up on a year-ago basis as weak readings from the first half of 2017 drop out (see Chart 2). Overall PCE inflation hit the Federal Open Market Committee's 2 percent goal for the first time since February 2017, while core PCE inflation is as close to the FOMC goal as it has been since early 2017, and should reach it over the next few months.

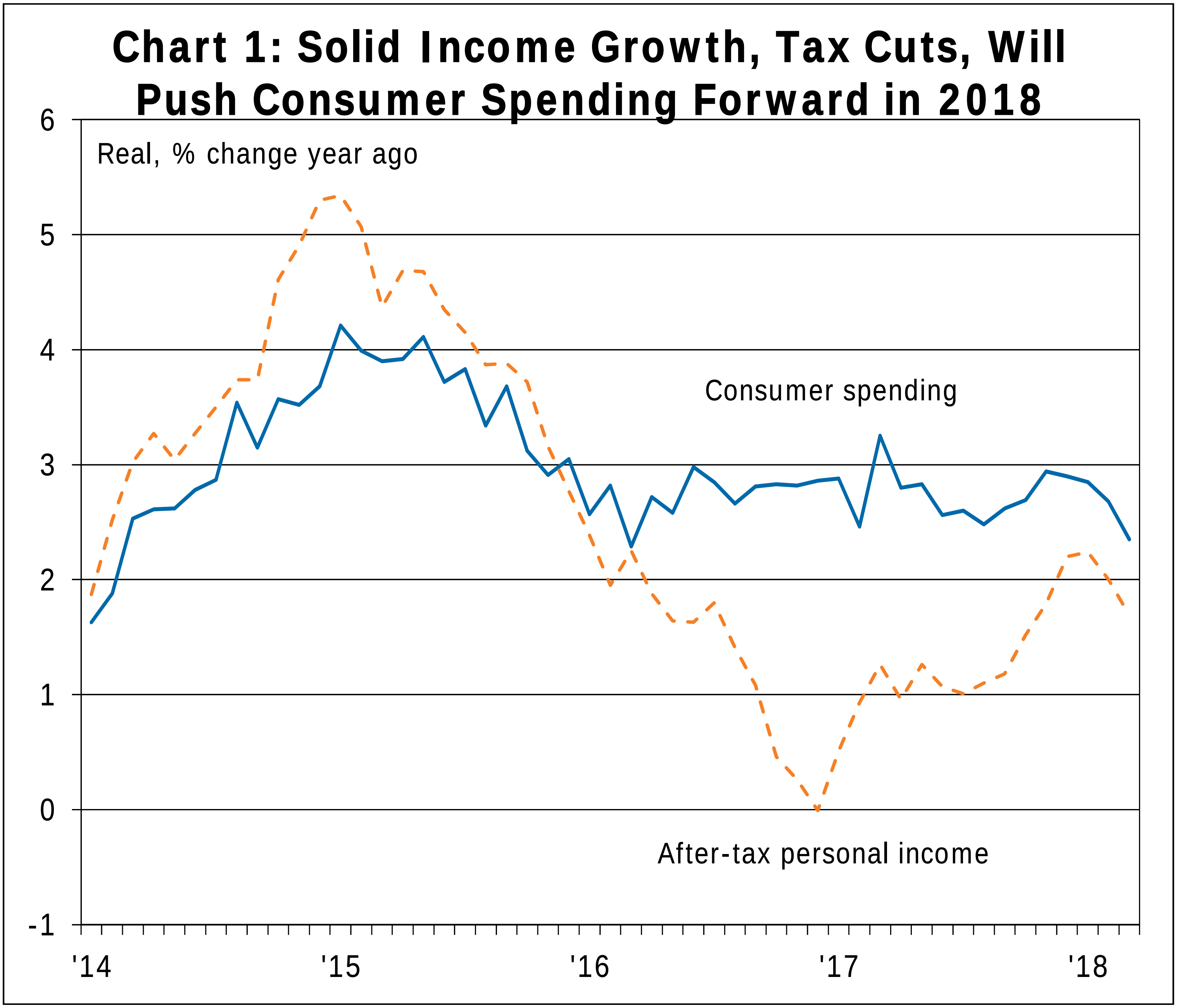

Chart source: Bureau of Economic Analysis

SOLID GROWTH IN INCOME AND CONSUMER SPENDING IN MARCH; INFLATION DATA POINT TO JUNE FED RATE HIKE

Solid income and consumer spending gains in March, along with accelerating inflation, support a gradual tightening in monetary policy in 2018. The FOMC will not raise the federal funds rate at its meeting this Tuesday and Wednesday. But the FOMC will almost surely raise the rate at its meeting after that, on June 12 and 13, by one-quarter of a percentage point to a range of 1.75 to 2.00 percent.

PNC expects one further increase in the fed funds rate in 2018, at the FOMC's December meeting, for a total of three for the year. But three fed funds rate increases in the rest of 2018 (June, September, and December) are possible if the labor market tightens more than expected and inflation moves past 2 percent.

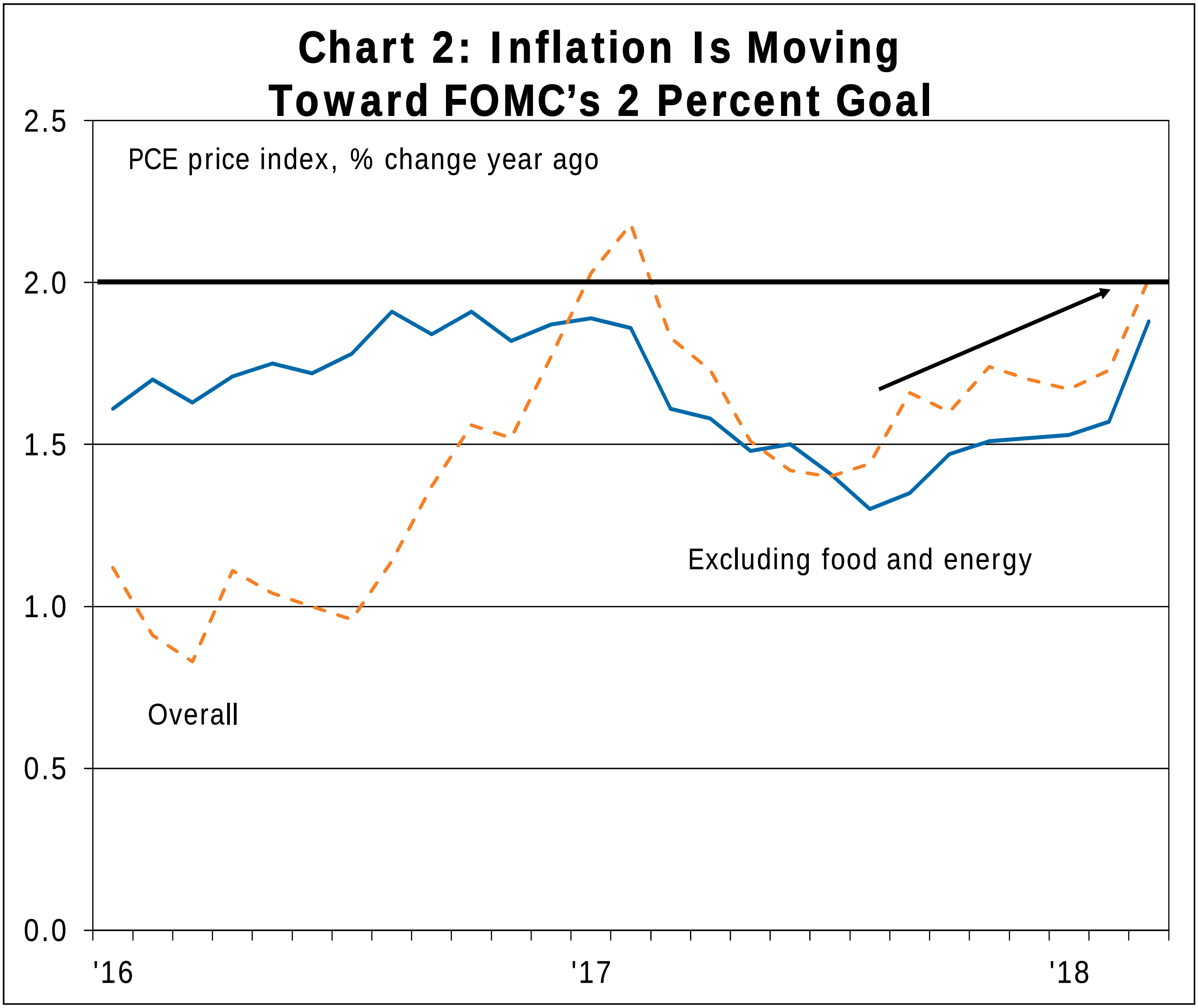

Chart source: Bureau of Economic Analysis

Visit http://www.pnc.com/economicreports to view the full listing of economic reports published by PNC's economists.