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Spending Climbs Back in September as Disposable Income Stagnates

When adjusted for inflation, after-tax income has been flat for the last two months.

By Andrew Soergel | Economy Reporter Oct. 31, 2016

Consumer spending bounced back last month despite sluggish inflation-adjusted after-tax income gains, according to a new report from the Bureau of Economic Analysis.

Personal consumption expenditures ultimately climbed 0.5 percent in September for consumers' most active month of spending since June. The metric only ticked up 0.3 percent in July and had dropped 0.1 percent in August.

"With job and wage gains, household income continues to increase," Gus Faucher, deputy chief economist at The PNC Financial Services Group, wrote in a research note Monday. "This is supporting solid growth in consumer spending, which continues to lead the U.S. economic expansion."

Still, consumer spending growth overall cooled off in the third quarter, as was made evident by Friday's gross domestic product report for July, August and September. Though the economy as a whole expanded at a respectable 2.9 percent clip, consumption growth – which accounts for a relatively large share of overall economic improvement – eased from 4.3 percent to just 2.1 percent.

So much of the consumption data included in Monday's personal income report isn't exactly news. What is notable, however, is the sluggish pace of after-tax income gains seen over the last two months. Real disposable personal income was essentially flat in both August and September following five straight months of expansion.

All told, real disposable personal income has been flat for three of the first nine months in 2016, suggesting consumers still aren't consistently feeling income gains hit their pocketbooks.

But ermployee compensation has gained in every month since February, and supplements to wages and salaries – mostly job benefits – also have seen a steady run of growth. Employers are very clearly ramping up compensation as the labor market tightens and they have to compete more heavily for a limited supply of workers.

"No one should be concerned about the state of consumers. Wages are rising faster than inflation, which increases one's purchasing power. The value of household assets, such as stocks and real estate, has been climbing faster than debt levels**," Bernard Baumohl, chief global economist at The Economic Outlook Group,** wrote in a research note Friday. "Nor is job security particularly worrisome. Layoffs are at their lowest levels in nearly half a century."

Monday's report also offered a look at the Federal Reserve's preferred inflation-tracking metric. The price index associated with personal consumption expenditures was up 1.2 percent on the year. When volatile food and energy components were stripped away, inflation was up 1.7 percent. And looking strictly at the services sector, annual inflation gains hit 2.4 percent.

The Fed's long-term price inflation goal hovers at 2 percent, so September's figures point to an economy that could soon be due for higher interest rates – or the Fed's natural response to widespread inflation gains.

Fed officials repeatedly have indicated they don't want inflation to get out ahead of them, as they'd need to rapidly adjust their benchmark interest rate all at once in a move that could shock the domestic economy. So inflation numbers could quickly be approaching the point of being "close enough" for a rate hike.

The Federal Open Market Committee's second-to-last meeting of the year will kick off in Washington this week. Yet with such close proximity to a highly contentious presidential election, December is considered the most likely launch point for higher rates.

"With continued solid economic expansion … steady improvement in the labor market ... and inflation set to further accelerate, the Federal Open Market Committee is ready to raise the fed funds rate before the end of the year," Faucher said. "An increase at the FOMC's Dec. 13-14 meeting is likely."