FEBRUARY PERSONAL INCOME AND CONSUMPTION

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Summary

The most interesting aspect of movements in personal income over the past few months has been the savings rate and behavior of personal outlays relative to personal income. Based on the February personal income figures I think the recession is over - at least for now, and as far as consumers are concerned. Most importantly:

- Consumer spending relative to income increased for February
  - for the second month running
  - after falling dramatically for Aug - Dec

Much of the report would seem to be mediocre news (personal income fell and by more than expected, prices increased, real spending fell) but I think the biggest news is that spending as a percent of income increased for the second month running.

Spending relative to income fell dramatically for August – December. (I.e. the "savings rate" increased dramatically. See http://www.closemountain.com/papers/macro_persinc_0903.pdf for a discussion with last month's data.) This was the biggest change in spending patterns in years, bringing the savings rate back to levels last seen in 1998. The changes were most likely the result of households adjusting to the bursting of the speculative bubble. The fall in spending meant the economy contracted dramatically. But it was, in an important way, good news because it signaled that households had completed some portion of the adjustment necessary to bring spending in line with income and historic norms, thus bringing the end of the current recession closer.

Now household spending relative to income has picked up, and for two months running (January and February). If this pattern continues it means the recession is effectively over. There will still be falls in personal income as the impact of layoffs is felt, but if spending relative to income has indeed stopped falling then the worst is over.

Details on Recent Movements in Spending and the Savings Rate

Economists commonly consider the "savings rate," which is the difference between current income and spending – the excess of income left after spending and taxes are accounted for. The definition is:

Savings Rate = (Disposable Personal Income – Personal Outlays) / Disp Pers Inc .

(This "savings rate" is not exactly the savings one usually thinks of, but rather a definition of the excess of income over spending in the aggregate economy. One could equally well talk of the "spending rate" – Outlays / Income – which is just one minus the savings rate.)

It is useful to decompose the rise in the savings rate in order to understand it a little more. To do so it is useful to consider savings as a percent of total personal income. Basically,

Disposable Personal Income = Personal Income – Personal Current Taxes
Savings = Disposable Personal Income – Personal Outlays

The standard definition of the savings rate is savings divided by Disposable Income:

Savings Rate (DPI) = (Disposable Personal Income – Personal Outlays) / Disp Pers Inc

= 1 – Personal Outlays / Disp Pers Inc

We can, however, define a savings rate divided by personal income that is only slightly different:

Savings Rate (PI) = (Personal Income – Personal Current Taxes – Personal Outlays) / Pers Inc

= 1 – Pers Curr Taxes / Pers Inc – Pers Out / Pers Inc

Since DPI and PI differ only by Pers Curr Taxes, which has monthly changes that are not large relative to the level of DPI and PI, the two measures will be very much the same. The advantage of the second is that we can decompose changes in that savings rate into changes due to taxes and that due to changes due to outlays (spending).

Table 1 shows both definitions of the savings rate, together with a decomposition for the personal income version. The savings rate jumped in May but that was due largely to the (temporary) tax rebates during summer 2008. The Savings Rate (PI) jumped by 4.3 percentage points, of which 3.3 were due to falling taxes and 1.0 due to falling spending. The savings rate fell in June through August as the effect of the tax rebates disappeared.

Starting in August spending relative to income (Personal Outlays divided by Personal Income) fell: from 87.2% in July to 84.4% in December, the lowest since 2001. (One can see the same by noting that Personal Outlays have fallen faster than Personal Income over this period.) For the change from April to December, the Savings Rate (PI) rose by 3.4 percentage points, of which 2.9 points were due to falling outlays relative to income and 0.5 points due to falling taxes relative to income. For January and February this was reversed with spending relative to income rising.

Table 1 – Savings Rate and Decomposition for April 2008 – January 2009

	Apr 08	May 08	Jun 08	Jul 08	Aug 08	'Sep 08	Oct 09	Nov 09	Dec 09	Jan 09	Feb 09
Sav Rate DPI	0.0%	4.8%	2.5%	1.7%	0.8%	1.4%	2.6%	3.0%	3.9%	4.4%	4.2%
Sav Rate PI	0.0%	4.3%	2.2%	1.5%	0.7%	1.2%	2.3%	2.7%	3.4%	4.0%	3.7%
PersOut/PI	87.3%	86.3%	86.6%	87.2%	86.8%	86.4%	85.3%	85.1%	84.4%	85.0%	85.4%
Tax/PI	12.7%	9.4%	11.1%	11.3%	12.5%	12.4%	12.4%	12.3%	12.2%	11.0%	10.9%
Ch due to PersOut	-0.3%	1.0%	-0.3%	-0.6%	0.4%	0.4%	1.0%	0.3%	0.7%	-0.6%	-0.3%
Ch due to Tax	0.1%	3.3%	-1.7%	-0.2%	-1.2%	0.0%	0.1%	0.1%	0.0%	1.2%	0.1%
%PI (simple rate)	0.0%	1.8%	0.1%	-0.8%	0.3%	0.1%	-0.1%	-0.5%	-0.3%	0.2%	-0.2%
%PersOut (simple)	0.4%	0.7%	0.5%	-0.1%	-0.2%	-0.4%	-1.3%	-0.8%	-1.1%	0.9%	0.2%