UNITED STATES

Falling incomes do not overly affect real consumption

HIGHLIGHTS

- Consumer spending rose 0.2% in current dollars in January, after gaining 0.1% in December.
- Personal income fell 3.6%. This is a result of the payroll tax increase ordered by the fiscal cliff agreement and the pullback following the special dividends and bonuses paid out in December. Personal disposable income fell 4.0%, and the savings rate went from 6.4% to 2.4%.
- The consumption expenditure deflator remained stable in January, but rose 0.1% if we exclude food and energy. The annual change in the consumption expenditure deflator went from 1.4% to 1.2%, while the annual change in the core deflator went from 1.4% to 1.3%.
- Real consumption rose 0.1%, as it did in December. Spending on durable goods dropped 0.8%, but spending on non-durable goods and services rose 0.3%. Real disposable income pulled back 4.0%.

COMMENTS

Although it was widely predictable, disposable income fell further than expected. In December, incomes were inflated by the special dividends and bonuses given out in anticipation of the tax increases that could have resulted from the full fiscal cliff. The pullback is now being felt. What’s more, the 2 percentage point increase in the payroll tax paid by employees takes an additional US$114.1B bite from incomes. Without these events, personal disposable income would have gone up 0.3% in January, just as it would have in December.

The fact that consumption can grow despite these headwinds is quite remarkable. The drastic decrease by savings (inflated in December) helped consumer spending grow further. Households saved US$283.9B in January, down 64.3% from December and 36.6% compared with the average level recorded over the last six months. The savings rate fell to 2.4%, its lowest level since November 2007.

Implications: For now, the effects of the fiscal cliff aren’t too hard on consumption. However, a return to more healthy savings could limit consumption’s growth in the short term. Fortunately, the recent improvement by household confidence indexes suggests that this adjustment could be gradual.

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