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TD Economics

Data Release: Higher inflation cuts into purchasing power and real spending pulls back in January

- Personal income rose 0.4% in January, slightly above market expectations for 0.3%. Controlling for inflation and removing taxes, however, real disposable personal income fell 0.2%.

- Spending rose by 0.2% in nominal terms, below the consensus call for a 0.3% gain. In real terms, spending fell 0.3%, a larger decline than the median estimate for -0.1%. The decline in spending was widespread. Durable goods led the way, falling 0.8%. Services spending fell 0.2%, while non-durable goods spending was virtually flat (-0.04%).

- Consumer prices rose 0.4% in the month, pushing year-on-year inflation to 1.9% (from 1.6% in December). Core prices (ex food & energy) were up 0.3% month-on-month – the strongest gain in ten years – but year-on-year price growth held steady at 1.7%.

- The personal saving rate edged up to 5.5% in January from 5.4% in December.

Key Implication

- The downside of rising inflation is a decline in real purchasing power. This was the story in January. The turn-up in energy prices means that households are no longer seeing the purchasing power gains that they did over the past couple of years. This puts the onus for growth on stronger wage gains to drive increases in income and therefore spending. Fortunately, with the labor market continuing to tighten, this remains a good bet.

- It wasn't just energy prices that pushed higher in the month. The rise in core prices was also noteworthy. While core inflation is still below 2% on a year-on-year basis, the momentum is certainly in the upward direction. With economic slack continuing to diminish, it is likely to push toward the Fed's 2% by the end of this year.

- Market expectations have moved to increasingly expecting the Fed to lift interest rates at its next meeting in March given the hawkish rhetoric from many recent Fed spearkers. With the soft pace of real spending in this report, we would expect these odds to diminish somewhat. Nonetheless, the push higher in inflation means that every upcoming meeting will be in play.

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