Three Key Observations Drawn From US Consumer Updates

United States, Personal Income / Consumption, % m/m, September:

Actual: 0.4 / 1.0

Consensus: 0.4 / 0.9

Scotia: 0.3 / 0.9

Prior: Unrevised from 0.2 / 0.1

United States, PCE / core PCE deflators, y/y % change, September:

Actual: 1.6 / 1.3

Consensus: 1.6 / 1.3

Scotia: 1.7 / 1.6

Prior: Unrevised from 1.4 / 1.3

- There are three key matters worth noting here in terms of inflation, the saving rate and income growth. **One is that despite hurricanes—that often result in higher scarcity-induced prices—core PCE inflation remained stuck at 1.3% y/y.** Like core CPI that was unchanged on the month at 1.7% y/y, the fact that core inflation did not firm may suggest that inflation ex-hurricane effects was even softer. Please see the updated chart comparing core PCE and core CPI and how the Fed's preferred measure continues to signal greater softness in a comparison of the two measures.
- Also note that **income growth was the fastest since February**. Each of total income, compensation, wages and salaries and disposable income grew by 0.4% m/m. That is encouraging but we'll need more months at this kind of trend pace to believe that income growth is sustainably firming.
- **Third, note that the saving rate fell a half point to 3.1%**. That's the lowest since December 2007. There is more going on here than hurricanes, however, in that the saving rate *climbed* when other storms like Katrina struck way back in 2005. Furthermore, this time around the saving rate has been on a downward trend for the past two years and hence well before the August-September hurricanes this time around. Indeed, the saving rate out of disposable income is now only half what it was a couple of years ago.
- Such a low level of the saving rate returns us to the pre-crisis era. It's possible that it goes lower yet, but the odds of going lower than it was during the peak of the housing and consumer boom are probably fairly modest. **This may question the durability of consumption gains should consumers focus upon rebuilding a depressed saving rate in the face of uncertainties over health care policy and unfunded social security obligations.** If the saving rate stabilizes or rebuilds in future, then faster sustained income growth will be required to continue to support a decent pace of consumption gains. Another possibility is that a sustained pace of wealth gains and wealth effects upon consumption that typically depress the narrow, conventional measure of the saving rate would be required to support consumption gains. As an aside, note that if the intent of perhaps reducing 401k contributions is not only to fund some of the tax cuts for wealthier individuals and companies, then the possible secondary intent of further reducing the saving rate by knocking back 401k contributions to boost short-term growth is a highly

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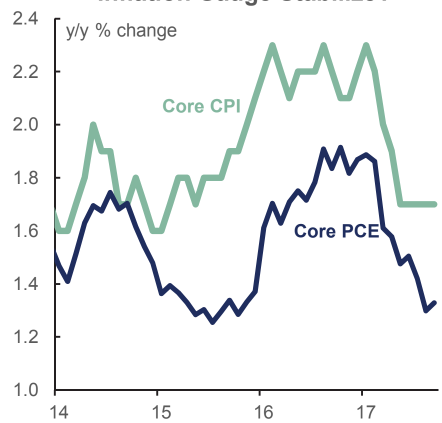
Will The Fed's Preferred Inflation Gauge Stabilize?



Sources: Scotiabank Economics, Bloomberg.

questionable tactic from the standpoint of the long-run health of household finances. Given the demographic challenges facing the US, now is arguably not the time to pursue policies that depress retirement savings.

- Most of the 1% rise in consumer spending came through a 0.6% rise in volumes with higher prices playing a relatively modest role. There is, however, very little incremental information offered by this update since we already knew the inferred monthly pattern for consumption based upon Friday's Q4 GDP figures and the first two-thirds of the quarter.