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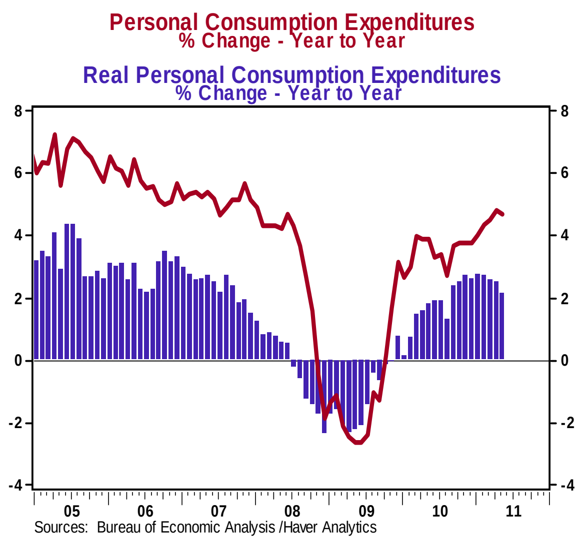
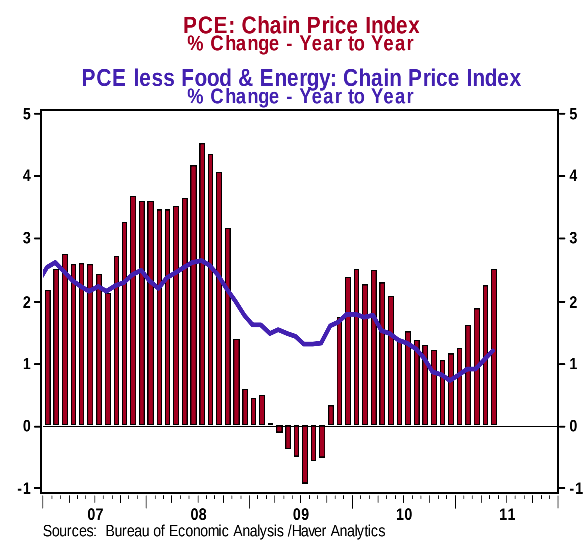
May Personal Income and Consumption

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Senior Economist
Andrew Hull – Economic Analyst
Strider Elass – Economic Analyst

- Personal income increased 0.3% in May, slightly less than the consensus expected. Personal consumption was unchanged, also slightly less than the consensus expected. In the past year, personal income is up 4.2% while spending is up 4.7%.
- Disposable personal income (income after taxes) was up 0.2% in May. Disposable income is up 3.1% versus a year ago. The gain in May was led by private-sector wages and salaries, which are up 3.6% from a year ago.
- The overall PCE deflator (consumer inflation) increased 0.2% in May and is up 2.5% versus a year ago. The "core" PCE deflator, which excludes food and energy, was up 0.3% in May and is up 1.2% since last year.
- After adjusting for inflation, "real" consumption dipped 0.1% in May but is up 2.1% versus a year ago.

Implications: Consumer spending got slammed by Japan in May, with purchases of durable goods like autos down 1.5% for the month. As a result, total consumer spending was unchanged for the month. With consumption prices up 0.2% in May – that was before the recent dip in oil prices – "real" (inflation-adjusted) consumer spending fell slightly. As we have said repeatedly, we believe these effects are temporary and will result in a forceful rebound in spending later this summer. Late this Friday (July 1), we expect automakers to report the start of the rebound, with sales bouncing up off the May low despite very skimpy manufacturer and dealer incentives in June. Longer term, consumer spending should strengthen. Consumer balance sheets are healthier and their financial obligations (monthly payments like mortgages, rent, car loans/leases, as well as other debt service), are the smallest share of disposable income since 1994. Meanwhile, the underlying trend in worker income continues in a favorable direction, with private-sector wages and salaries up at a 4.5% annual rate in the past six months. This is more than enough to outpace inflation and that gap should widen in the next few months due to the recent drop in oil prices. The problem for the Federal Reserve is that its favored measure of "core" inflation, which excludes food and energy, is accelerating, up only 1.2% versus a year ago but up at a 2.4% annual rate in the past three months. This is an economic problem that calls out for a tighter monetary policy, not the continuation of an overly loose policy.





Personal Income and Spending *All Data Seasonally Adjusted*	May-11	Apr-11	Mar-11	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % change
Personal Income	**0.3%**	0.3%	0.4%	4.1%	5.9%	4.2%
Disposal (After-Tax) Income	**0.2%**	0.2%	0.4%	3.7%	4.3%	3.1%
Personal Consumption Expenditures (PCE)	**0.0%**	0.3%	0.6%	3.7%	5.1%	4.7%
Durables	**-1.5%**	0.0%	-0.5%	-7.9%	2.9%	6.6%
Nondurable Goods	**-0.3%**	1.0%	1.1%	7.5%	10.7%	9.4%
Services	**0.4%**	0.1%	0.6%	4.4%	3.5%	2.8%
PCE Prices	**0.2%**	0.3%	0.4%	3.8%	3.9%	2.5%
"Core" PCE Prices (Ex Food and Energy)	**0.3%**	0.2%	0.2%	2.4%	1.9%	1.2%
Real PCE	**-0.1%**	-0.1%	0.2%	0.0%	1.1%	2.1%

Source: Bureau of Economic Analysis