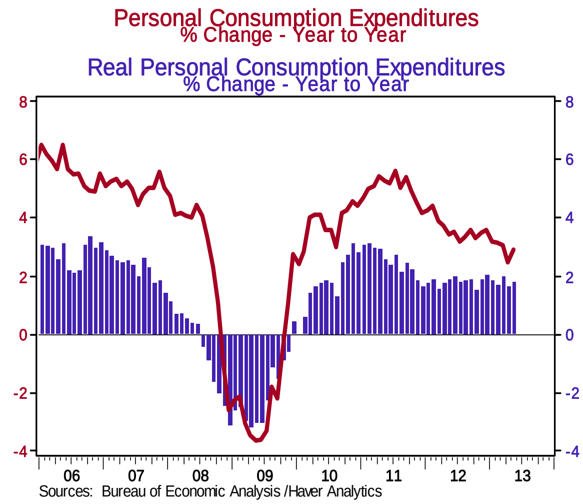
First Trust DATAWATCH

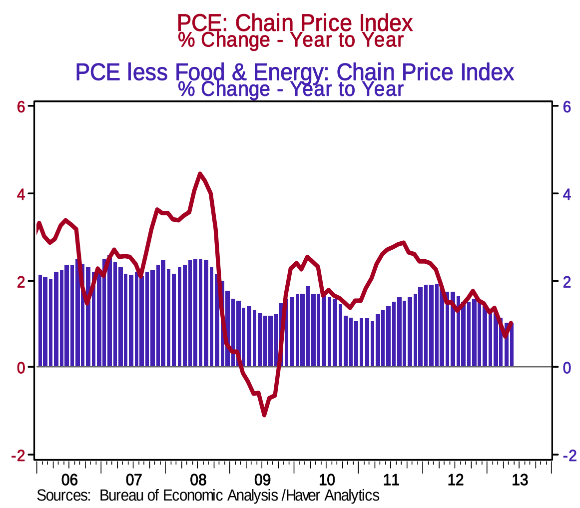
June 27, 2013 • 630.517.7756 • www.ftportfolios.com

May Personal Income and Consumption

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Economist

- Personal income increased 0.5% in May, beating the consensus expected gain of 0.2%. Personal consumption rose 0.3%, exactly as the consensus expected. In the past year, personal income is up 3.3% while spending is up 2.9%.
- Disposable personal income (income after taxes) increased 0.5% in May and is up 2.2% from a year ago. The gain in income was primarily driven by interest/dividends, private wages & salaries, and Social Security payments.
- The overall PCE deflator (consumer prices) rose 0.1% in May and is up 1.0% versus a year ago. The "core" PCE deflator, which excludes food and energy, was also up 0.1% in May and is up 1.1% in the past year.
- After adjusting for inflation, "real" consumption increased 0.2% in May and is up 1.8% from a year ago. If real spending is unchanged in June, it will be up at a 1.3% annual rate in Q2 versus the Q1 average.





Implications: Another month, another plow horse report on income and spending. Income grew a healthy 0.5% in May, was revised up for prior months, and is up 3.3% from a year ago. Adjusting for inflation, real income is up 2.3% from a year ago. These gains are *not* being artificially supported by government transfers; excluding transfers – such as Medicare, Medicaid, Social Security, and unemployment insurance – personal income is still up 2.3% from a year ago. Despite what some pundits are saying, there is still no evidence that the end of the payroll tax cut or federal spending sequester is hurting consumers. Real consumer spending is up 1.8% from a year ago; at the same time last year, real spending was up 1.9% over the prior year. Today's spending data included some downward revisions for prior months. As a result, real spending now looks like it will grow at a 1.5% annual rate in Q2, consistent with real GDP growth in the 2% - 2.5% range. We expect further gains in both income and spending over the remainder of the year. Job growth will continue and, as the jobless rate gradually declines, employers will be offering higher wages. Meanwhile, consumers' financial obligations are the smallest share of income since the early 1980s. (Financial obligations are money used to pay mortgages, rent, car loans/leases, as well as debt service on credit cards and other loans.) On the inflation front, the Federal Reserve's favorite measure of inflation, personal consumption prices, was up 0.1% in May, as were core consumption prices. Overall consumption prices are up only 1% in the past year while core prices, which exclude food and energy, are up only 1.1%. Both are clearly below the Fed's 2% target. However, we think these price measures have just bottomed and will be noticeably higher by year end. In other news this morning, new claims for unemployment insurance declined 9,000 last week to 346,000. Continuing claims ticked down to 2.97 million. These figures and other data are consistent with payroll growth of 170,000 in May, very close to the plow horse trend over the past couple of years.

Personal Income and Spending *All Data Seasonally Adjusted*	May-13	Apr-13	Mar-13	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % change
Personal Income	**0.5%**	0.1%	0.2%	3.6%	1.1%	3.3%
Disposable (After-Tax) Income	**0.5%**	0.1%	0.2%	2.9%	-0.8%	2.2%
Personal Consumption Expenditures (PCE)	**0.3%**	-0.3%	0.2%	0.3%	2.2%	2.9%
Durables	**0.9%**	-0.1%	-0.3%	2.0%	3.3%	6.7%
Nondurable Goods	**0.3%**	-1.6%	-0.6%	-7.5%	-0.8%	1.5%
Services	**0.1%**	0.0%	0.5%	2.9%	3.1%	2.7%
PCE Prices	**0.1%**	-0.3%	-0.1%	-1.2%	0.4%	1.0%
"Core" PCE Prices (Ex Food and Energy)	**0.1%**	0.0%	0.1%	0.7%	1.0%	1.1%
Real PCE	**0.2%**	-0.1%	0.3%	1.5%	1.9%	1.8%

Source: Bureau of Economic Analysis