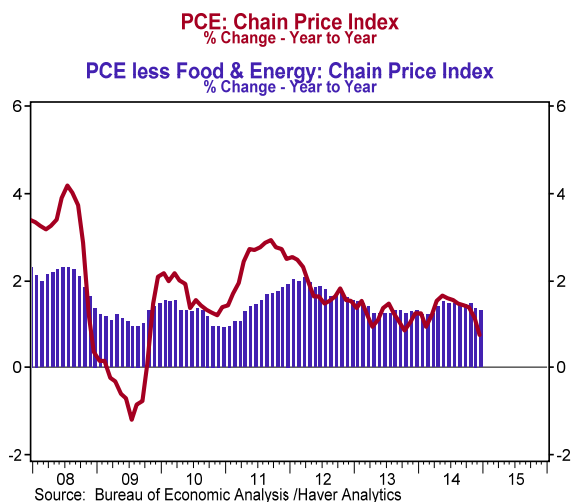
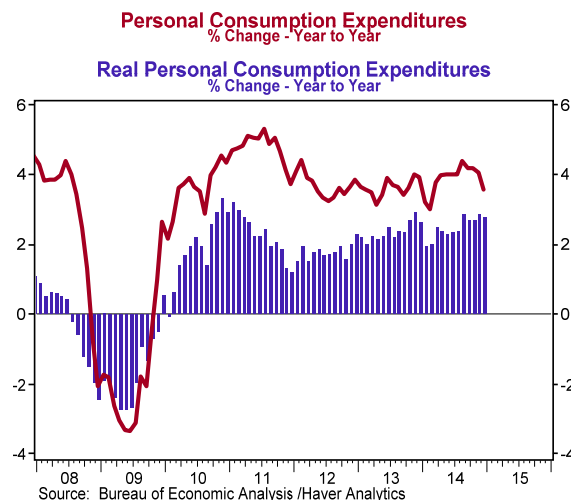


## December Personal Income and Consumption

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- Personal income increased 0.3% in December, coming in above the consensus expected 0.2%. Personal consumption declined 0.3% in December, coming in below the consensus expected -0.2%. Personal income is up 4.6% in the past year, while spending is up 3.6%.
- Disposable personal income (income after taxes) increased 0.3% in December and is up 4.5% from a year ago. The gain in December was led by social security and non-farm small business income.
- The overall PCE deflator (consumer prices) declined 0.2% in December but is up 0.7% versus a year ago. The “core” PCE deflator, which excludes food and energy, was unchanged in December and is up 1.3% in the past year.
- After adjusting for inflation, “real” consumption slipped 0.1% in December but is up 2.8% from a year ago.

**Implications:** Consumer spending took a breather in December, but consumer purchasing power keeps growing and we expect that trend to continue. As a result, consumer spending will rebound in the months ahead. Payrolls are up almost three million in the past year while the number of hours per worker is up as well. As a result, private-sector wages & salaries are up a robust 5.4% in the past year. Total income – which also includes rents, small business income, dividends, interest, and government transfer payments – increased 0.3% in December and is up 4.6% in the past year, which is faster than the 3.6% gain in consumer spending. That’s why consumers have enough income growth to keep on lifting their spending without getting into financial trouble. One part of the report we keep a close eye on is government redistribution. In the past year, government transfers to persons are up 5.6%, largely driven by Obamacare; Medicaid spending is up 14% versus a year ago. However, outside Medicaid, government transfers are up a more tepid 3.7% in the past year and unemployment compensation is at the lowest level since 2007. The bad news is that taken all together, government transfer payments – like Medicare, Medicaid, Social Security, disability, welfare, food stamps, and unemployment comp – don’t seem to be falling back to where they were prior to the Panic of 2008, when they were roughly 14% of income. In early 2010, they peaked at 18%. Now they are down to 17% but not falling any further. Redistribution hurts growth because it reallocates resources away from productive ventures. This is why we have a Plow Horse economy instead of a Race Horse economy. On the inflation front, the Federal Reserve’s favorite measure, the personal consumption price index, was down 0.2% in September and is up only 0.7% from a year ago. Given the drop in energy prices, expect one more monthly drop for January. But, with loose monetary policy, we expect inflation to rebound later this year. Keep in mind, though, that with tight bank lending standards and the energy production boom, the increase in inflation is going to be gradual.



Personal Income and Spending <i>All Data Seasonally Adjusted</i>	Dec-14	Nov-14	Oct-14	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % change
<b>Personal Income</b>	<b>0.3%</b>	0.3%	0.4%	4.0%	3.5%	4.6%
<b>Disposable (After-Tax) Income</b>	<b>0.3%</b>	0.3%	0.4%	3.6%	2.9%	4.5%
<b>Personal Consumption Expenditures (PCE)</b>	<b>-0.3%</b>	0.5%	0.3%	2.0%	3.1%	3.6%
<b>Durables</b>	<b>-1.2%</b>	1.8%	0.0%	2.4%	3.3%	6.5%
<b>Nondurable Goods</b>	<b>-1.3%</b>	-0.3%	0.1%	-5.5%	-2.7%	0.4%
<b>Services</b>	<b>0.1%</b>	0.5%	0.5%	4.6%	5.0%	4.2%
<b>PCE Prices</b>	<b>-0.2%</b>	-0.2%	0.0%	-1.5%	-0.5%	0.7%
<b>"Core" PCE Prices (Ex Food and Energy)</b>	<b>0.0%</b>	0.0%	0.2%	0.7%	0.9%	1.3%
<b>Real PCE</b>	<b>-0.1%</b>	0.7%	0.3%	3.5%	3.6%	2.8%

Source: Bureau of Economic Analysis