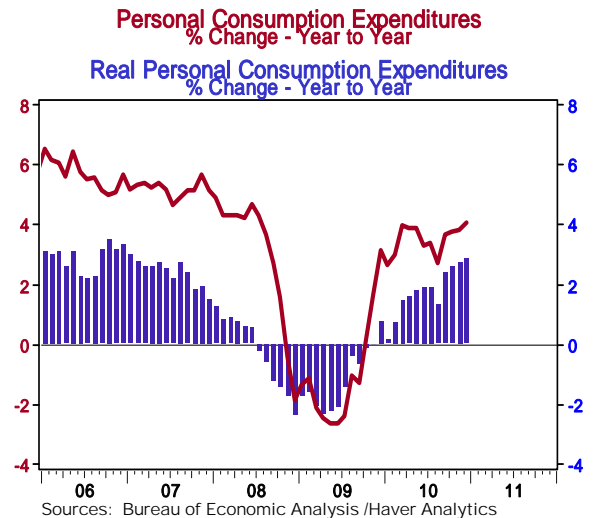


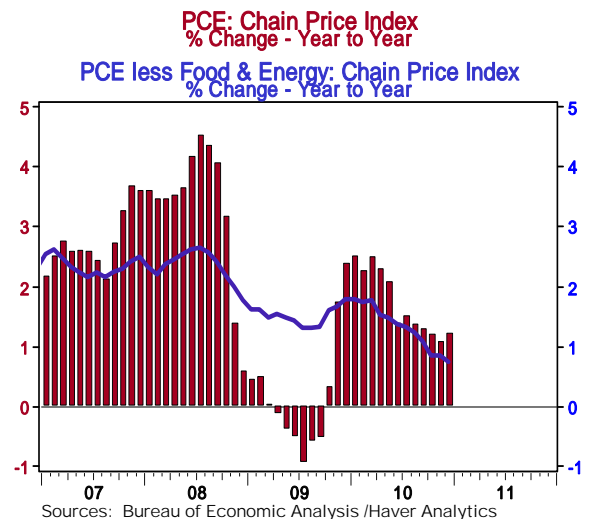
DECEMBER PERSONAL INCOME AND CONSUMPTION

Chief Economist – Brian S. Wesbury
Senior Economist – Robert Stein, CFA

- Personal income increased 0.4% in December, exactly as the consensus expected. Personal consumption increased 0.7%, beating the consensus expected gain of 0.5%. In the past six months, personal income is up at a 3.7% annual rate while spending is up at a 5.8% rate.
- Disposable personal income (income after taxes) was up 0.4% in December and is up at a 3.0% annual rate in the past six months. The rise in December was led by private-sector wages and salaries, interest, and dividends.
- The overall PCE deflator (consumer inflation) increased 0.3% in December and is up 1.2% versus a year ago. The “core” PCE deflator, which excludes food and energy, was unchanged in December and is up 0.7% since last year.
- After adjusting for inflation, “real” consumption was up 0.4% in December, is up at a 3.7% annual rate in the past six months, and at a 4.6% annual rate in the past three months.



Implications: Watch out above! Consumer spending accelerated into the end of 2010. “Real” (inflation-adjusted) consumer spending increased 0.4% in December and was up at a 4.6% annual rate in the last three months of the year. Why are consumers spending more? First, their incomes are rising. In the past year, real private-sector wages and salaries plus small business incomes are up 3.2%. Second, although consumers are still paying down debt, they’re doing so at a slower pace. Notice that this means spending can grow *faster* than income, not slower. Third, consumers’ financial obligations – their debt-related monthly payments plus other recurring charges like rent, car leases, and homeowners’ insurance – is now the lowest share of after-tax income since 1995. On the inflation front, consumption prices are up only 1.2% versus a year ago but seem to be accelerating, with prices up at a 2.0% annual rate in the past six months and a 2.4% rate in the past three months. Meanwhile, “core” inflation, which excludes food and energy, remains very subdued, up only 0.7% in the past year. Low core inflation is the excuse the Federal Reserve is using for quantitative easing. We think the Fed needs to focus more on overall inflation, not just the core. So do the Egyptians.



Personal Income and Spending <i>All Data Seasonally Adjusted</i>	Dec-10	Nov-10	Oct-10	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % change
Personal Income	0.4%	0.4%	0.5%	5.3%	3.7%	3.8%
Disposal (After-Tax) Income	0.4%	0.3%	0.4%	4.8%	3.0%	3.4%
Personal Consumption Expenditures (PCE)	0.7%	0.3%	0.7%	7.1%	5.8%	4.1%
Durables	0.7%	-0.4%	3.2%	14.8%	13.5%	8.3%
Nondurable Goods	1.5%	0.6%	1.0%	13.1%	12.1%	6.6%
Services	0.4%	0.4%	0.2%	3.9%	2.6%	2.6%
PCE Prices	0.3%	0.1%	0.2%	2.4%	2.0%	1.2%
"Core" PCE Prices (Ex Food and Energy)	0.0%	0.1%	0.0%	0.6%	0.4%	0.7%
Real PCE	0.4%	0.2%	0.5%	4.6%	3.7%	2.8%

Source: Bureau of Economic Analysis