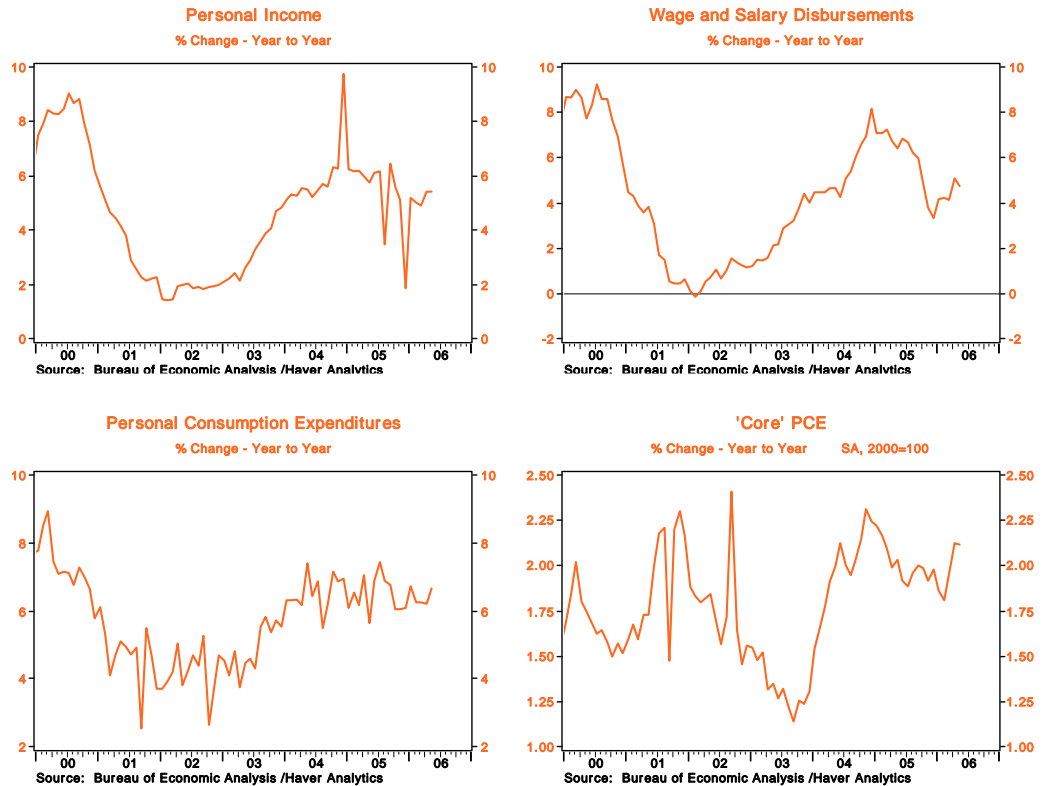


## MAY PERSONAL INCOME AND CONSUMPTION

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- Personal income increased 0.4% in May, after a 0.7% jump in April. Personal income is up 5.4% in the past year. Wages and salaries were flat last month, likely a bit of payback from the 0.8% gain in April. Wages and salaries are up 5.8% at an annual rate in the past six months and 4.8% in the past year – both higher than the growth rate of inflation.
- Personal consumption increased 0.4% last month versus a 0.7% gain in April. Consumption is up 6.7% in the past year.
- The PCE deflator increased 0.4% last month and is up 3.3% in the past year. The “core” PCE deflator increased 0.2% in May and is up 2.1% in the past year – above the Fed’s comfort zone.

**Implications:** Strong gains from non-farm proprietor’s income (small business) and interest and dividend payments pushed personal income up 0.4% in May. The surge in proprietor’s income (up 7.2% in the past year) is especially encouraging and suggests that the pro-growth tax cuts of 2003 continue to lift entrepreneurial activity. Nominal consumption was healthy in May, but a 0.4% gain in the PCE deflator accounted for nearly all of the gain. Over the past three months, consumption has increased 6.8% at an annual rate, while inflation (as measured by the PCE deflator) is up 5.0%. Real (or inflation adjusted) personal consumption is up just an annualized 1.7% thus far in Q2 versus a 5.1% annualized gain in Q1. In other words, the slowdown in the “real” economy during the past few months is partly due to accelerating inflation. Nominal growth remains near the 7% level, which suggests that a neutral fed funds rate is roughly 6.0%. As long as the Fed holds interest rates below neutral, the threat from rising inflation will remain. As a clear sign of these pressures, the “core” PCE deflator increased 0.2% in May, and is up 3.2% at an annual rate in the past three months – a level rarely seen in more than a decade. Following yesterday’s somewhat more dovish Fed statement, the dollar fell sharply, while gold and commodity prices surged. This suggests that inflationary pressures emanating from an accommodative Fed policy remain a concern.



Personal Income & Consumption <i>All data seasonally adjusted</i>	May-06	Apr-06	Mar-06	3-mo % ch. annualized	6-mo % ch. annualized	Yr over yr % ch.
Personal Income, current	0.4%	0.7%	0.4%	5.9%	5.9%	5.4%
less Personal Tax and Nontax Payments	0.5%	1.8%	0.8%	13.1%	17.3%	10.6%
equals Disposal Income	0.3%	0.6%	0.3%	5.0%	4.4%	4.7%
Wages and Salaries	0.0%	0.8%	0.4%	5.1%	5.8%	4.8%
Personal Consumption Expenditures (PCE)	0.4%	0.7%	0.5%	6.8%	6.9%	6.7%
Durables	-0.6%	0.3%	0.3%	0.2%	8.1%	3.1%
Nondurable Goods	0.7%	1.5%	0.5%	11.3%	9.4%	9.0%
Services	0.5%	0.4%	0.5%	5.8%	5.5%	6.2%
PCE Deflator	0.4%	0.5%	0.4%	5.0%	3.5%	3.3%
Savings Rate	-1.7%	-1.6%	-1.5%	-1.6%	-1.4%	0.0%

Source: Bureau of Economic Analysis

\*The 3 and 6 month changes in the Savings Rate are averages, the year-over-year percentage is the year-ago level

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