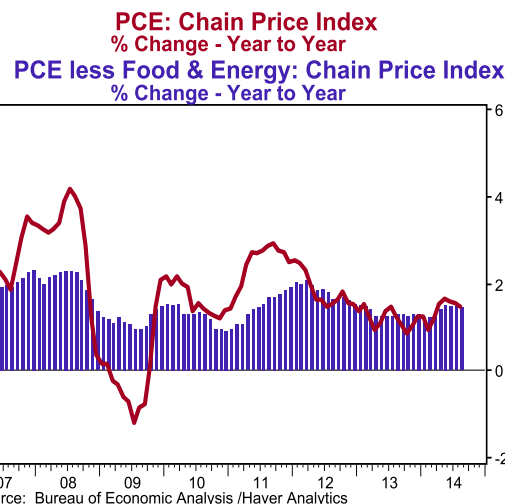
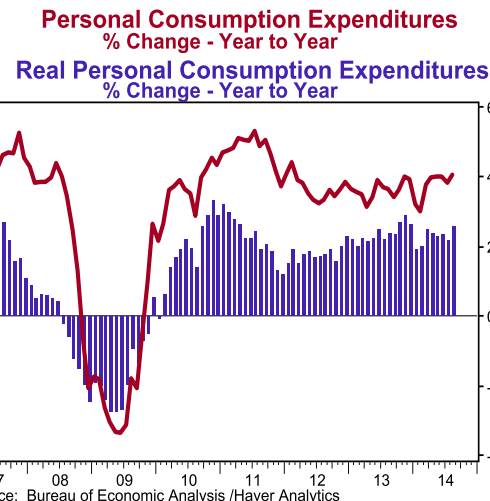


August Personal Income and Consumption

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

- Personal income increased 0.3% in August (+0.4% including revisions to prior months). The consensus expected a 0.3% gain. Personal consumption rose 0.5% in August (+0.7% including revisions to prior months), beating the consensus expected gain of 0.4%. Personal income is up 4.3% in the past year, while spending is up 4.1%.
- Disposable personal income (income after taxes) increased 0.3% in August and is up 4.2% from a year ago. The gain in August was led by wages & salaries in the private service sector, rent, and Medicaid, which offset a large decline in farm income.
- The overall PCE deflator (consumer prices) was unchanged in August but is up 1.5% versus a year ago. The “core” PCE deflator, which excludes food and energy, rose 0.1% in August and is also up 1.5% in the past year.
- After adjusting for inflation, “real” consumption rose 0.5% in August (+0.7% including revisions to prior months) and is up 2.6% from a year ago.

Implications: A solid report on consumer spending and income today. Consumption rose 0.5% in August and was revised up for prior months. This shouldn't be a surprise; payrolls are up about 2.5 million in the past year. Don't let anyone tell you this is all unsustainable. Total income – which also includes rents, small business income, dividends, interest, and government transfer payments – increased 0.3% in August, was revised up for prior months, and is up 4.3% from a year ago. This is slightly faster than the 4.1% increase in consumer spending in the past year. In other words, incomes lead spending and the US is not experiencing a credit-created increase in consumption. One overlooked part of this economic report is the massive growth in government redistribution. Medicaid, for example, is up 12.5% versus a year ago, largely due to Obamacare. Overall government transfer payments – like Medicare, Medicaid, Social Security, disability, welfare, food stamps, and unemployment compensation – are a very large share of income. Before the Panic of 2008, these transfers were roughly 14% of income. In early 2010, they peaked at 18%. Now they are 17%. Redistribution hurts growth because it reallocates scarce resources away from productive ventures. Keynesians try to say government spending is necessary to boost the economy in a recession, but this is certainly not the case anymore. Private sector jobs have expanded for 54 consecutive months and private-sector wages & salaries are up 5.8% from a year ago, which is faster than the 5.3% gain in government transfers. We expect both income and spending to accelerate in the year ahead as jobs and wages continue to grow. In addition, consumers' financial obligations are hovering at 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, the personal consumption price index, was unchanged in August and is up only 1.5% from a year ago. Given loose monetary policy, by the middle of next year, the Fed is going to struggle to keep inflation down at 2%. That's part of the reason we expect short-term rates to move up in the first half of 2015.



Personal Income and Spending <i>All Data Seasonally Adjusted</i>	Aug-14	Jul-14	Jun-14	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % change
Personal Income	0.3%	0.2%	0.5%	4.2%	5.3%	4.3%
Disposable (After-Tax) Income	0.3%	0.2%	0.5%	3.9%	5.4%	4.2%
Personal Consumption Expenditures (PCE)	0.5%	0.0%	0.5%	4.0%	4.6%	4.1%
Durables	1.8%	0.0%	0.5%	9.7%	12.7%	5.7%
Nondurable Goods	-0.2%	0.0%	1.2%	3.8%	3.5%	3.0%
Services	0.5%	0.0%	0.3%	3.1%	3.7%	4.2%
PCE Prices	0.0%	0.1%	0.2%	1.1%	1.8%	1.5%
"Core" PCE Prices (Ex Food and Energy)	0.1%	0.1%	0.2%	1.3%	1.7%	1.5%
Real PCE	0.5%	-0.1%	0.3%	2.9%	2.8%	2.6%

Source: Bureau of Economic Analysis