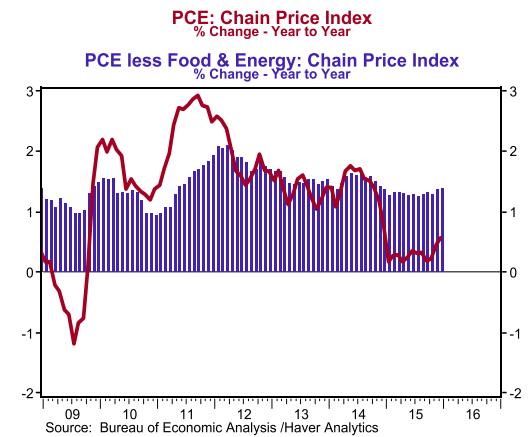
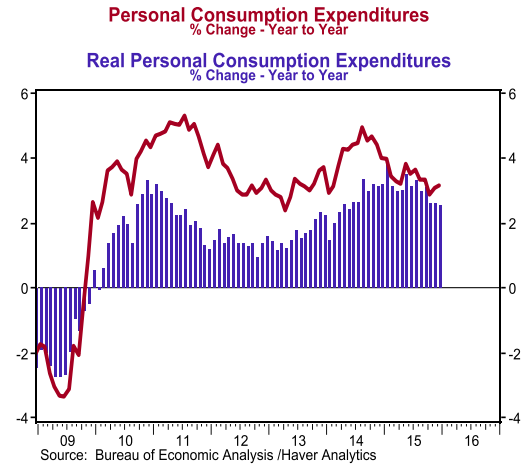


December Personal Income and Consumption

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

- Personal income increased 0.3% in December (0.2% including prior months' revisions). The consensus expected a gain of 0.2%. Personal consumption was unchanged in December (+0.1% including revisions to prior months). The consensus expected a gain of 0.1%. Personal income is up 4.2% in the past year, while spending is up 3.2%.
- Disposable personal income (income after taxes) increased 0.3% in December and is up 3.7% from a year ago. The gain in December was led by service-providing industries' wages and salaries, non-farm small business income, and Social Security.
- The overall PCE deflator (consumer prices) declined 0.1% in December but is up 0.6% versus a year ago. The "core" PCE deflator, which excludes food and energy, was unchanged in December and is up 1.4% in the past year.
- After adjusting for inflation, "real" consumption rose 0.1% in December and is up 2.6% from a year ago.



Implications: These are not recessionary numbers. Household spending cooled in December, but incomes continued to grow, meaning consumers are in a position to increase spending over the next few months. Personal income rose 0.3% in December, beating consensus expectations, and is up 4.2% in the past year. The increase in income was led by wages and salaries in private service-providing industries. Meanwhile, wages and salaries declined in private goods-producing companies as pay went back to normal in December after a large one-time bonus to unionized auto workers in November due to recent contract ratification. Although consumer spending was unchanged in December, it's up 3.2% in the past year. That increase is not due to an unsustainable credit binge. Instead, it reflects higher purchasing power by American workers. The main driver of the income gains in the past year has been overall private-sector wages and salaries, which are up 4.8% from a year ago. The only bad news in this report was the continued failure to make progress against government redistribution. Although unemployment compensation is hovering around the lowest levels since 2007, overall government transfers to persons were up 0.7% in December and are up 5.4% in the past year, largely driven by the Obamacare-related expansion of Medicaid. Before the Panic of 2008, government transfers – Medicare, Medicaid, Social Security, disability, welfare, food stamps, and unemployment comp – were roughly 14% of income. In early 2010, they peaked at 18.5%. Now they're around 17%, but not falling any further. Redistribution hurts growth because it shifts resources away from productive ventures and, among those getting the transfers, weakens the incentive to produce. This is why we have a Plow Horse economy, not a Race Horse economy. On the inflation front, the PCE deflator, the Fed's favorite measure, was down 0.1% in December. Although it's only up 0.6% from a year ago, it continues to be held down by falling energy prices. The "core" PCE deflator, which excludes food and energy, is up 1.4% from a year ago. That's also below the Fed's 2% inflation target, but we expect some acceleration in the coming year. As soon as energy prices stop falling, inflation is going to pick up. Together with continued employment gains, these data support the case for slow and steady rate hikes (think 0.25% at every other Fed meeting) in 2016.

Personal Income and Spending <i>All Data Seasonally Adjusted</i>	Dec-15	Nov-15	Oct-15	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % change
Personal Income	0.3%	0.3%	0.4%	3.7%	3.8%	4.2%
Disposable (After-Tax) Income	0.3%	0.2%	0.3%	3.3%	3.8%	3.7%
Personal Consumption Expenditures (PCE)	0.0%	0.5%	0.0%	2.0%	2.6%	3.2%
Durables	-0.9%	1.5%	-0.5%	0.3%	3.9%	3.5%
Nondurable Goods	-0.9%	0.3%	-0.1%	-2.5%	-2.3%	-0.1%
Services	0.4%	0.4%	0.1%	3.7%	4.0%	4.1%
PCE Prices	-0.1%	0.1%	0.1%	0.1%	0.1%	0.6%
"Core" PCE Prices (Ex Food and Energy)	0.0%	0.2%	0.0%	1.0%	1.2%	1.4%
Real PCE	0.1%	0.4%	0.0%	1.9%	2.5%	2.6%

Source: Bureau of Economic Analysis