

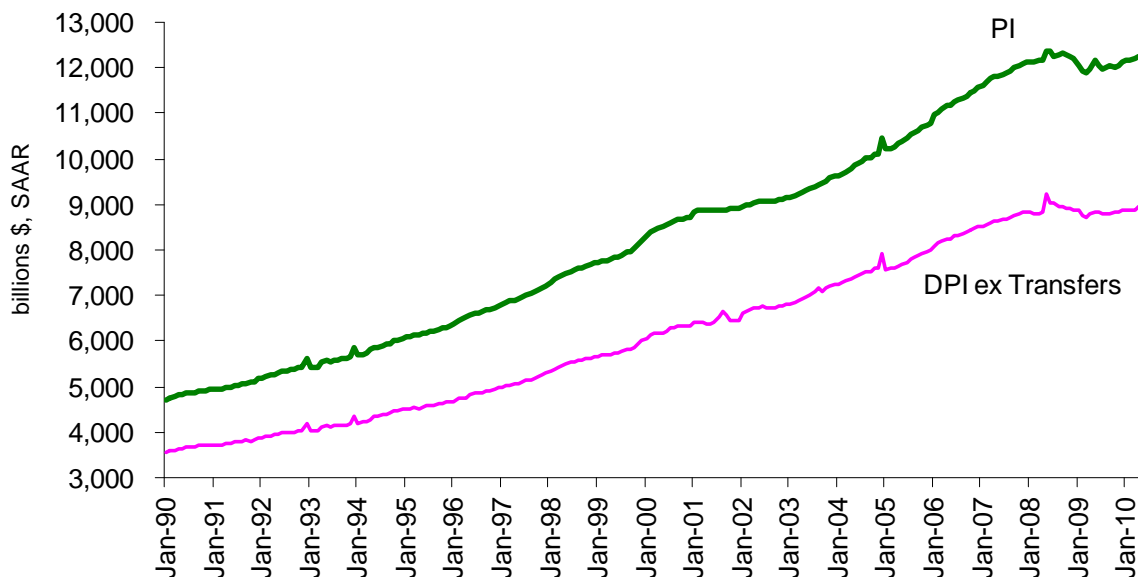
May 28, 2010

# Spending Flat, Income and Savings Still Dependent on Transfers

We expect strong job growth for May in next week's release. However, personal income growth remains a weak spot in the transition from recovery to expansion. A downward revision of the October-March personal income data further lowered the base of personal income, so the 0.4% April increase still leaves personal income disappointing, especially given the massive federal transfers propping it up. We think weakness in small-business hiring, optimism and access to credit is a key part of the problem.

- Personal income grew 0.4% to a \$12.27 trillion annual rate in April and is still stuck \$97 billion below the May 2008 peak (all data nominal terms). The March base was revised down to \$12.21 trillion from the pre-revision \$12.24 trillion based on newly available (weaker) data for private wages and salaries. The consensus estimate was a 0.4% increase to \$12.29 trillion.
- Disposable personal income excluding transfers is \$8.95 trillion, \$285.4 billion below its 2008 peak. The gap between the two measures is partly bridged by the rapid rise in federal debt, which provides transfer payments and promotes consumption.

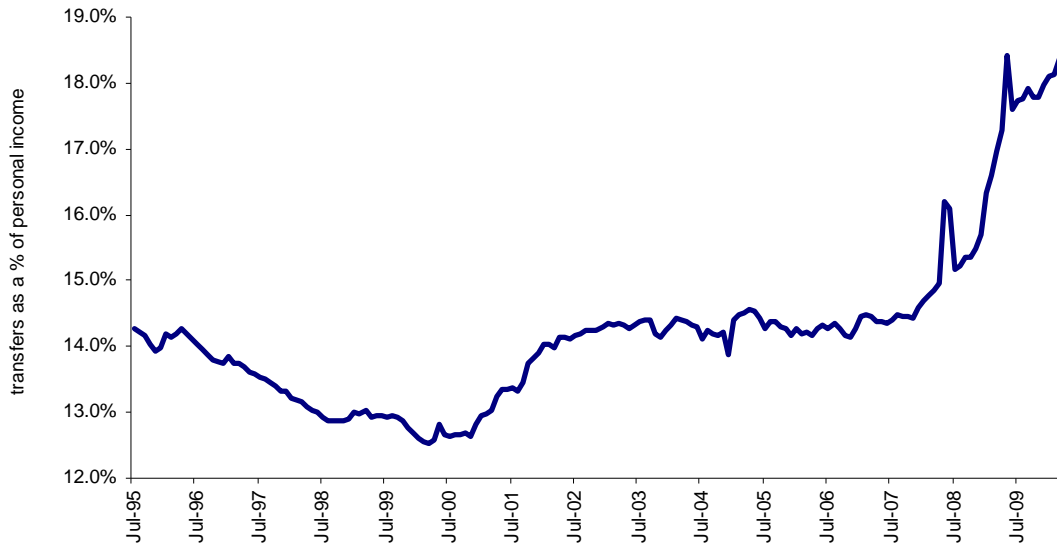
## Personal Income and DPI (last obs. April 2010)



Source: Bureau of Economic Analysis; Encima Global

- In April, transfers supplied \$2.24 trillion or 18.2% of total personal income.

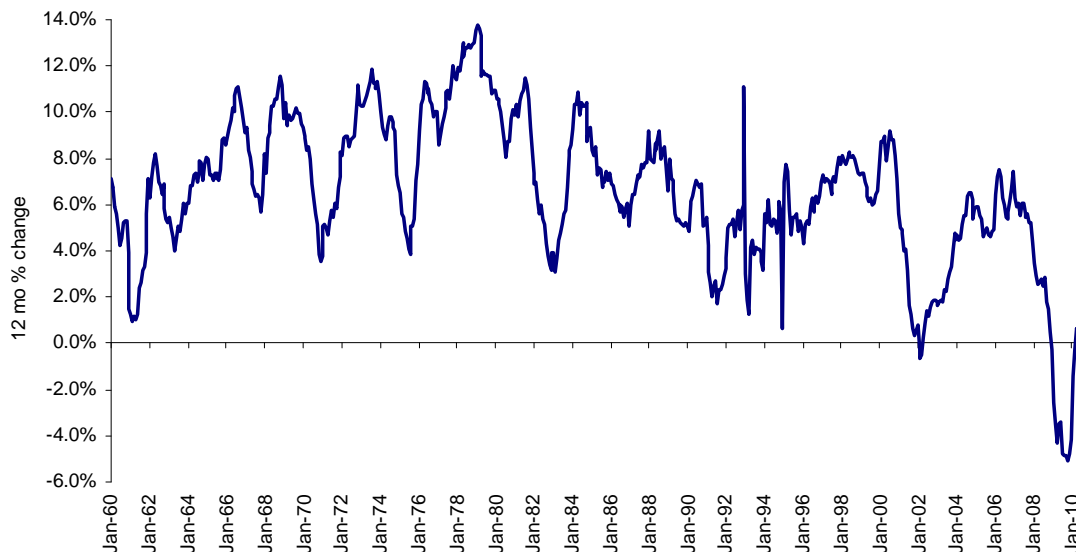
### Transfers as a percentage of Personal Income (last obs. April 2010)



Source: Bureau of Economic Analysis; Encima Global

- Income from wages and salaries (which don't include transfer payments) rose 0.4% in March to \$6.33 trillion. On a year over year basis, wage and salary income is now up 0.4%, having suffered a much deeper decline than in previous recessions. The stabilization in the year-over-year data reflects an improving employment situation from a reduced base, consistent with our outlook for a moderate expansion from the economy's lower base.

### Wages & Salaries (y/y change, last obs. April 2010)



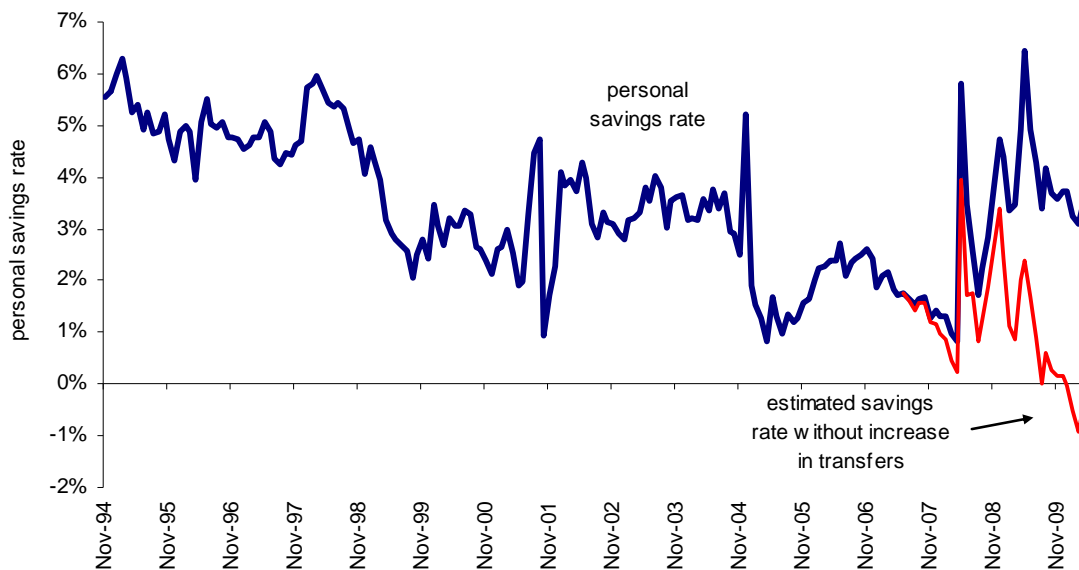
Source: Bureau of Economic Analysis; Encima Global

## Transfers Puff Up Personal Savings Rate; Consumption Linked to Jobs

The personal savings rate rose to 3.6% in April from 3.1% in March as personal income grew but not consumption. Without the increase in federal transfer payments since the end of 2007, however, we estimate the PSR in April would have been negative 0.3%.

- In effect, higher transfer payments are showing up as higher personal income and a higher personal savings rate at the expense of a rapidly growing national debt. It's a circular process – federal debt is growing enough to provide some household sector savings and some increase in consumption. On a combined basis, however, total U.S. borrowing and the dependence on debt is still growing.

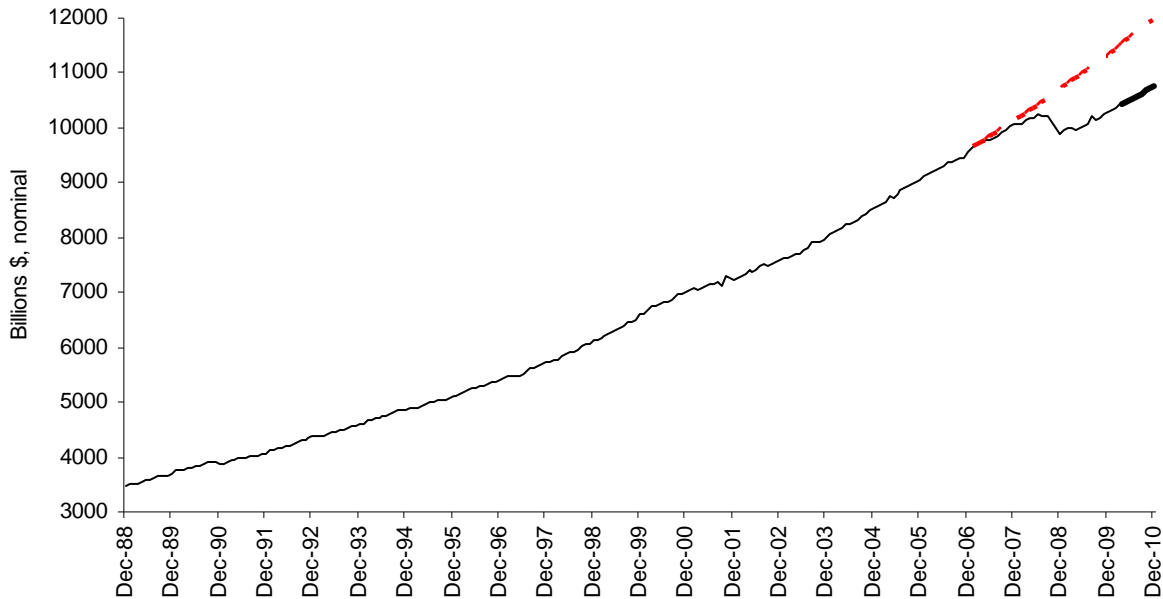
### Personal savings rate, excluding increase in transfers (last obs. April 2010)



Source: Bureau of Economic Analysis; Encima Global

- Personal consumption rose to \$10.424 trillion in April (nominal, annual rate). We think reasonably strong consumption growth will continue in 2010 as Washington sustains its transfer payments and the labor environment improves (with auto production, census hiring, and some stabilization for small businesses). However, current consumption growth isn't strong enough to recover the post-Lehman loss, leaving consumption still \$1 trillion below the pre-Lehman trend.

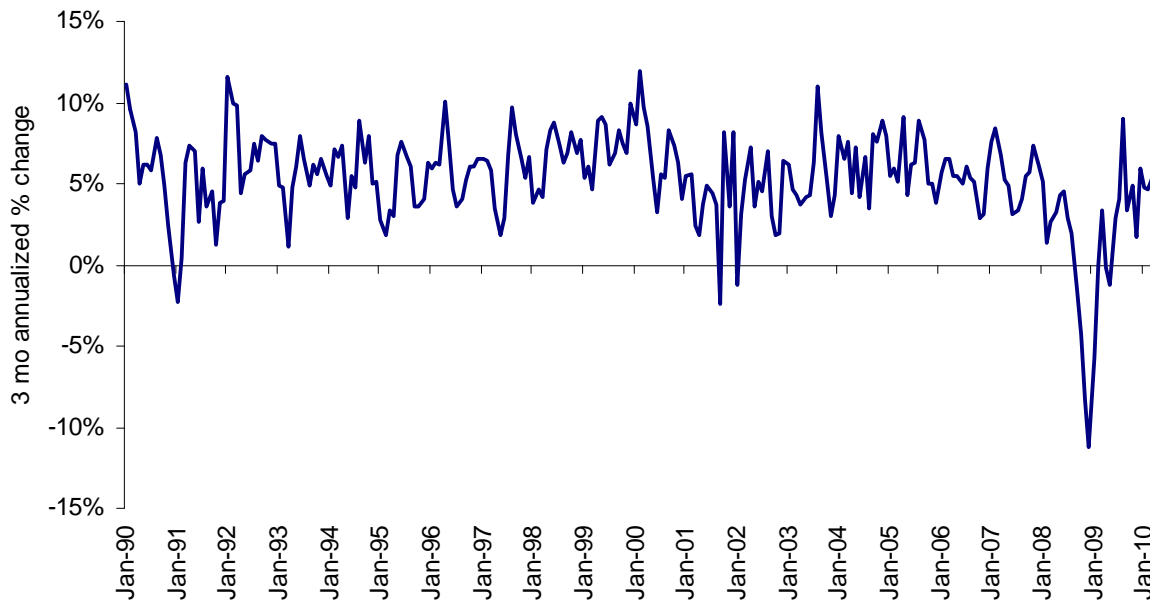
## Nominal PCE (last obs. April 2010, broad line projects through Dec 2010)



Source: Bureau of Economic Analysis; Encima Global

- Consumption was unchanged in April from March in nominal terms, versus 0.6% growth in March and 0.5% in February. Three-month annualized growth is 4.6% nominal...

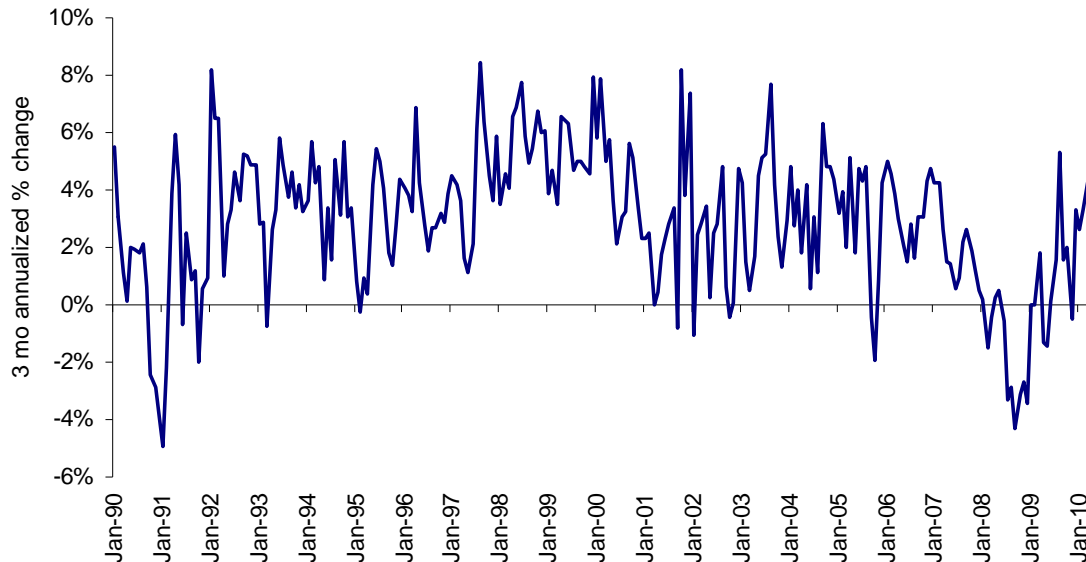
## Nominal PCE (3 mo % change annualized, last obs. April 2010)



Source: Bureau of Economic Analysis; Encima Global

...and 4.1% in real terms for the three months ending April 2010. The previous three months (January through March) were revised downward, partly explaining the lowered Q1 GDP figure reported yesterday.

### Real PCE (3 mo % change annualized, last obs. April 2010)

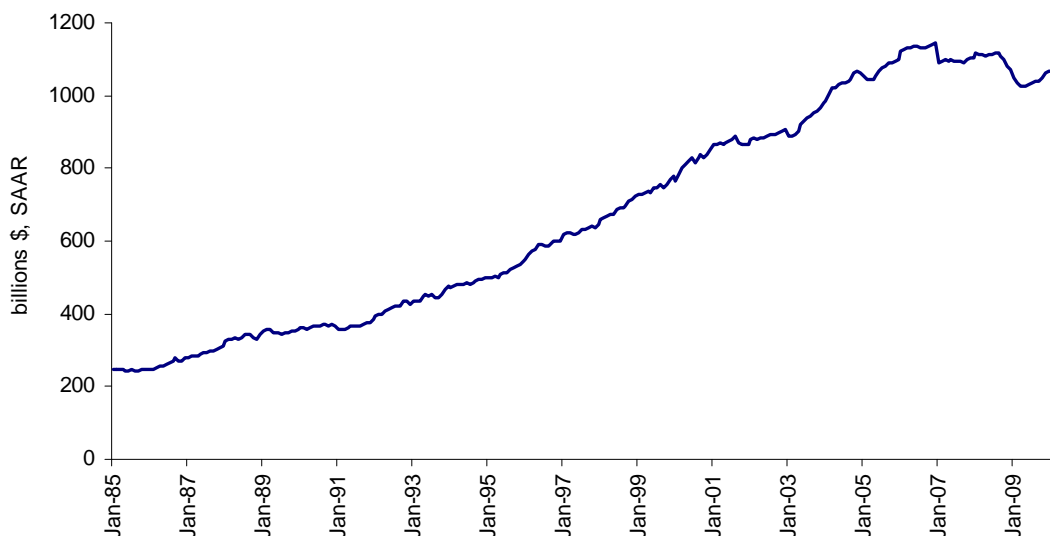


Source: Bureau of Economic Analysis; Encima Global

### Small Business Income Rises

- Proprietors' income rose \$13.6 billion or 1.3% to \$1.08 trillion in April from March. On a year over year basis, it's up 5.5% but it is still down 5.7% from the peak in December 2006.

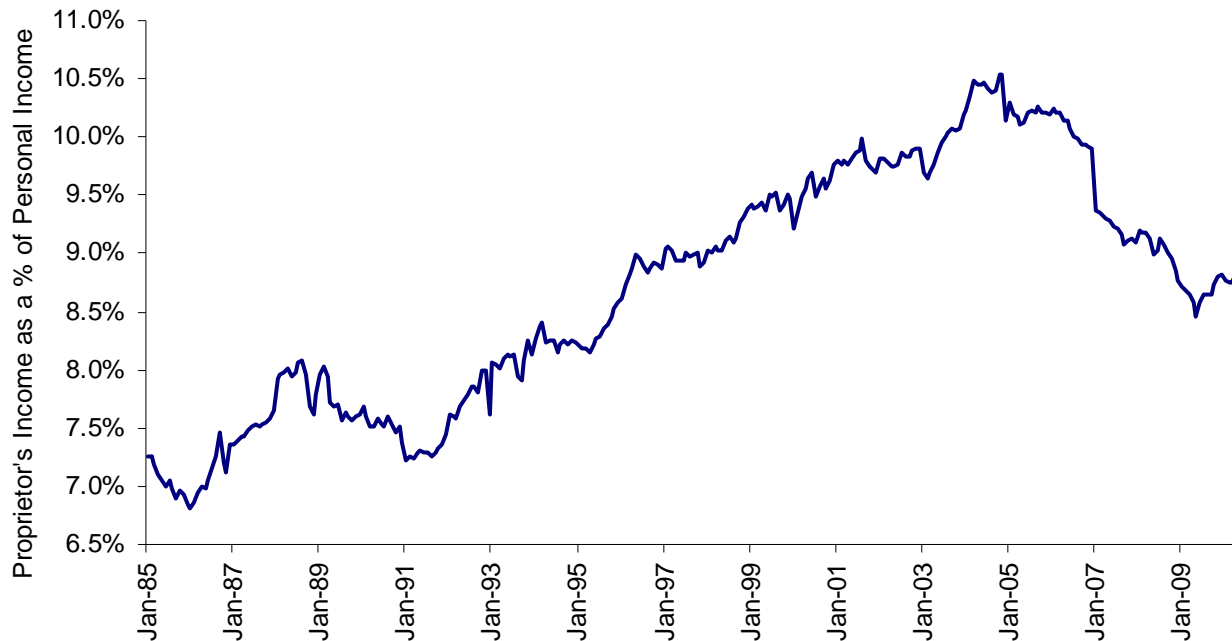
### Proprietors' Income with IVA and CCAdj (billions, last obs. April 2010)



Source: Bureau of Economic Analysis; Encima Global

- While governments, big corporations and especially banks are doing well, small businesses have lost a major part of their share in the economy. As a percentage of personal income, proprietors' income stood at 8.8% in April, about the same proportion as in the 1990s. It had peaked in November 2005 at 10.5%. With the economy less dynamic as the federal government expands into new businesses, we expect an sustained expansion, but not enough growth to rapidly lower unemployment.

### Proprietors' Income with IVA and CCAdj to Personal Income (last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

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