

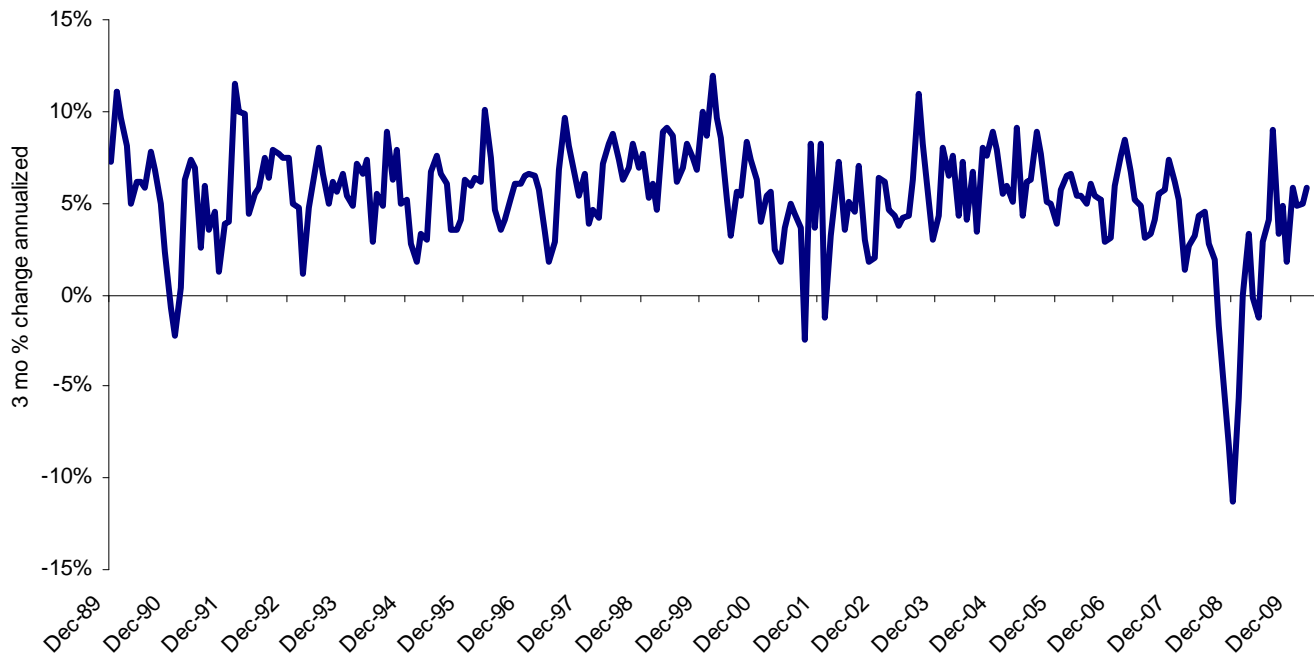
May 3, 2010

# Spending Rises, ISM Shows Strength, Wages and Savings Still Weak

The ISM purchasing managers' report rose again in April, while March consumption data strengthened. The ISM report showed strong hiring, but also strong upward pressure on prices. Construction spending in March was stronger than expected.

- We expect the first quarter's 3.2% real GDP growth to be revised upward and the second quarter to be stronger than the first. We've been at 3.5% for Q1 and think the revision may top that. We'll stay at 4.5% expectation for Q2, with strong payroll gains likely.
- While wage growth and the personal savings rate are still weak, consumption growth is approaching the historical growth trend (though not the level). Consumption grew 0.6% in March and an upwardly revised 0.5% in February. The three-month annualized growth is 5.8% in nominal terms...

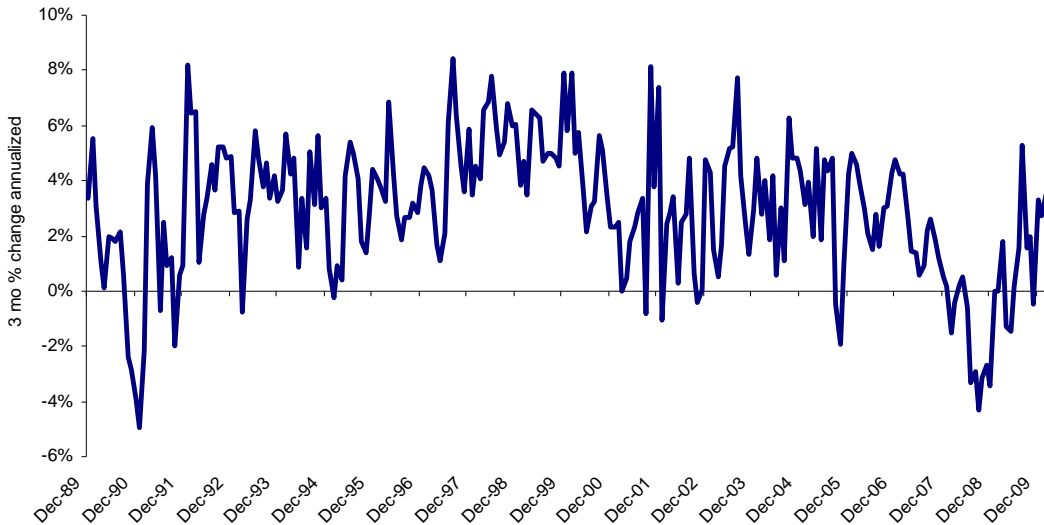
## Nominal PCE (3 mo % change annualized, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

...and 4.7% in real terms in the first three months of 2010.

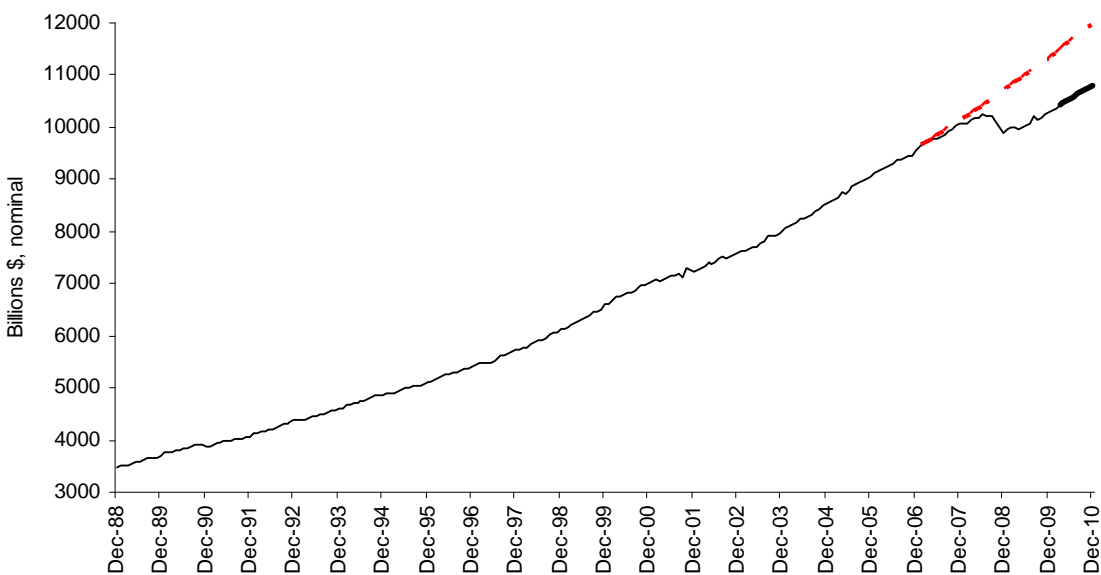
### Real PCE (3 mo % change annualized, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

- Personal consumption rose to \$10.43 trillion in March (nominal, annual rate), a new record. 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.

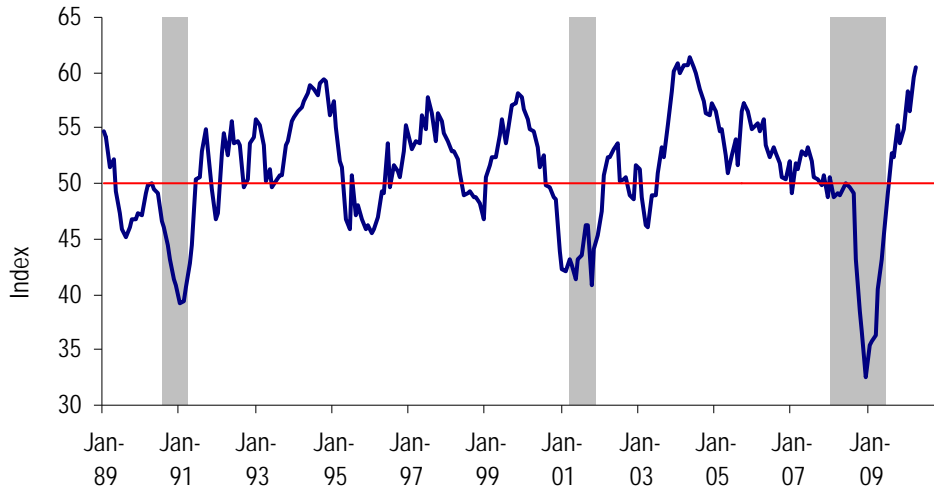
### Nominal PCE (last obs. March 2010, broad line projects through Dec 2010)



Source: Bureau of Economic Analysis; Encima Global

- The ISM manufacturing index rose to 60.4 in April and is approaching the high water marks of the 2003 rebound. It's consistent with our 4.5% real GDP growth expectation for the second quarter, with some risk to the high side.

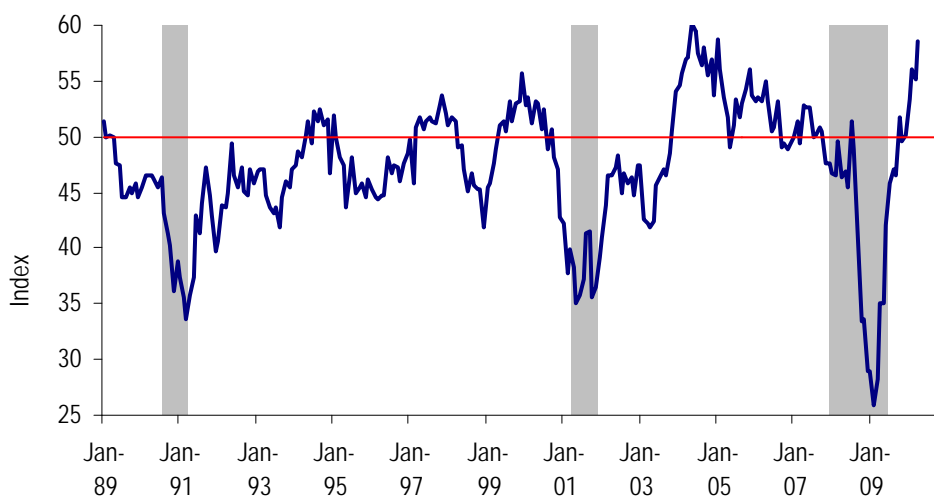
### ISM Manufacturing Index (last obs. April 2010)



Source: ISM; Encima Global

- The ISM manufacturing employment index is signaling strong growth in employment. We would expect Friday's employment report to show more private sector job growth for April in addition to the federal census hiring.

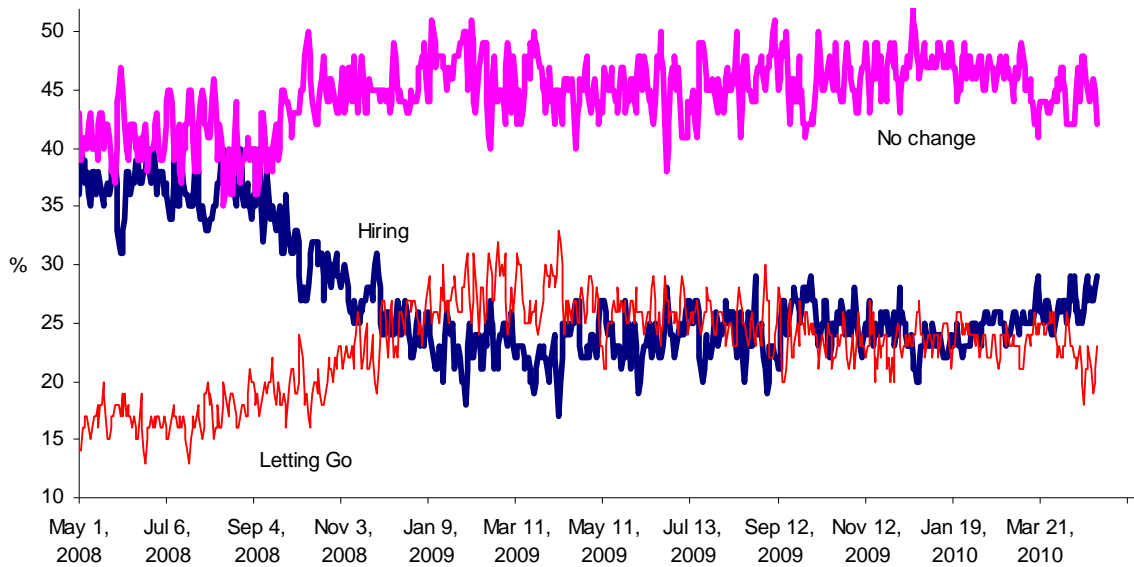
### ISM Manufacturing Employment Index (last obs. April 2010)



Source: ISM; Encima Global

- Gallup's daily jobs poll shows that hiring intentions have improved (far right-hand side) relative to perceptions that companies will let workers go. This ought to lead to a further decline in initial jobless claims in the coming weeks.

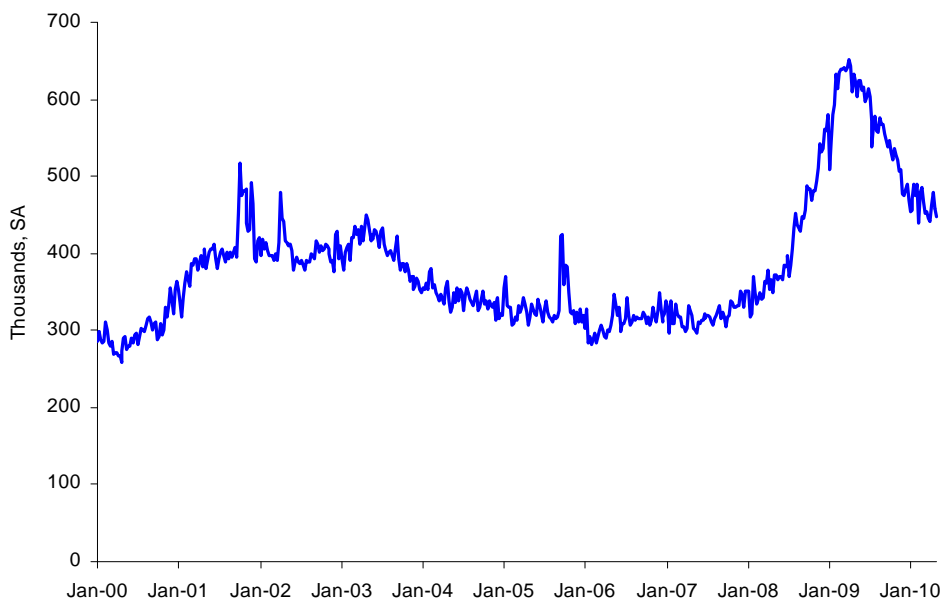
### Gallup Daily Jobs Poll (last obs. May 2, 2010)



Source: Gallup Poll; Encima Global

- Initial claims have remained high relative to previous recessions. We think they will head below 400,000 in coming weeks.

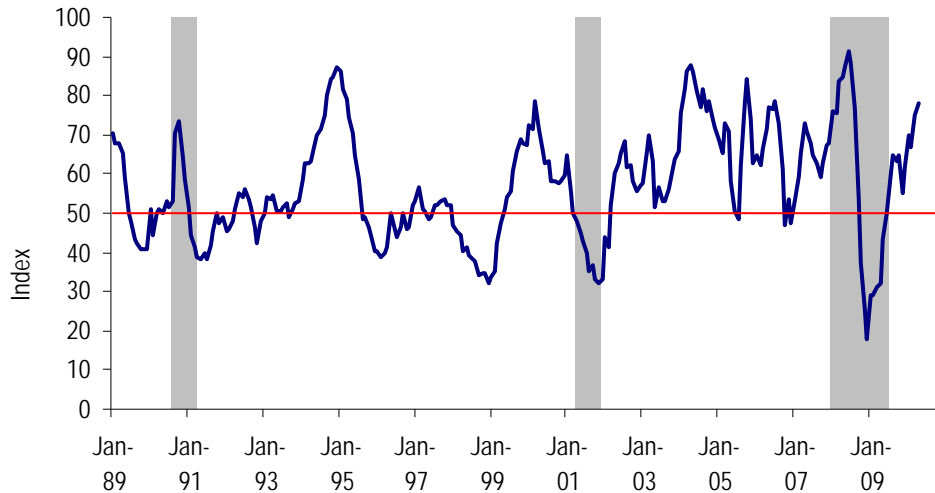
### Weekly Initial Jobless Claims (last obs. April 24, 2010)



Source: Bureau of Labor Statistics; Encima Global

- ISM prices paid index rose to 78 in April from 75 in March. Even though consumers haven't seen prices rise by much, manufacturers' prices are beginning to rise rapidly, reflecting the jump in commodity prices and the decade-long weakness in the dollar. We expect spot shortages as the recovery accelerates.

### ISM Manufacturing Prices Paid Index (last obs. April 2010)



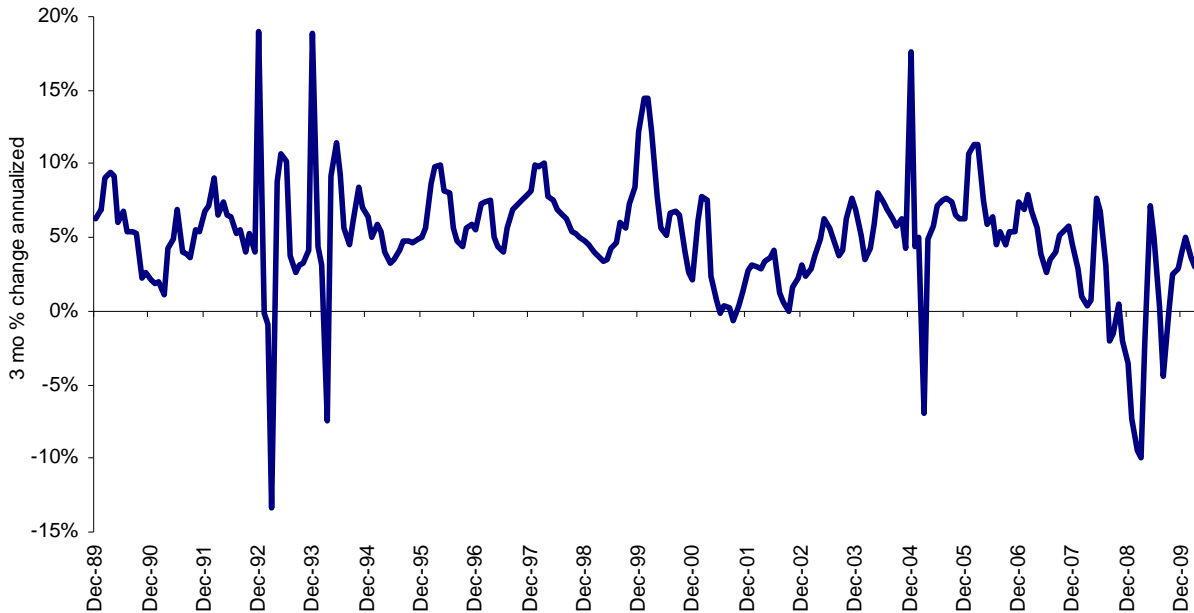
Source: ISM; Encima Global

### Personal Income Remains Weak

While consumption growth is approaching historical rates, growth in personal income is weaker. Without government transfers, personal income growth is still weak; even with large government transfers, it's only growing modestly.

- Three-month annualized growth in personal income slowed to 3.0% in March, down from a 5.0% rate in the November-January period. It rose 0.3% in March from February to \$12.24 trillion (all dollar figures at annual rate).

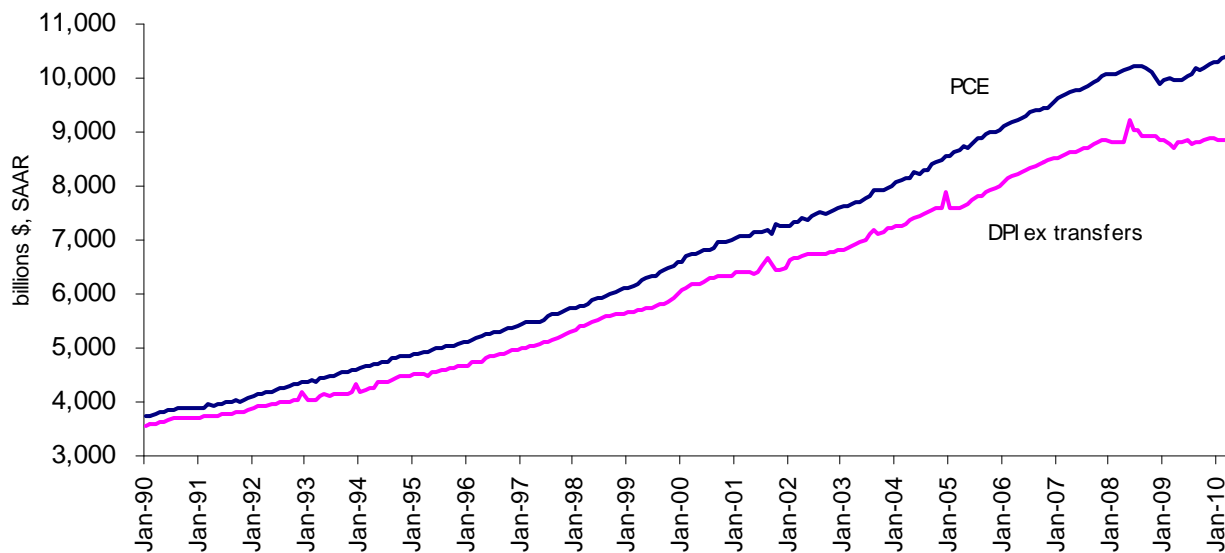
### Personal Income (3 mo % change annualized, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

- In contrast with consumption, personal income is still \$122.7 billion below its peak (in May 2008) even counting record federal transfers. At \$8.86 trillion, disposable personal income excluding transfers is \$373.2 billion below its peak. The widening gap is provided by the rapid rise in federal debt, which provides transfer payments and promotes consumption.

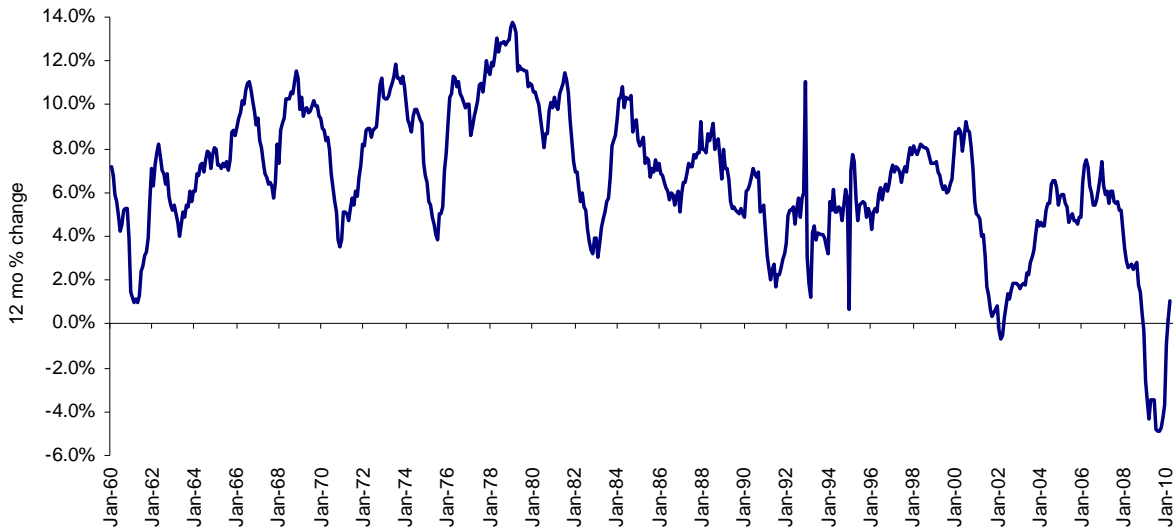
### Personal Consumption and DPI ex Transfers (\$ billions, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

- Income from wages and salaries (which don't include transfer payments) rose 0.2% in March to \$6.33 trillion. On a year over year basis, wage and salary income is now up 1.1%, 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 moderate growth from the economy's lower base.

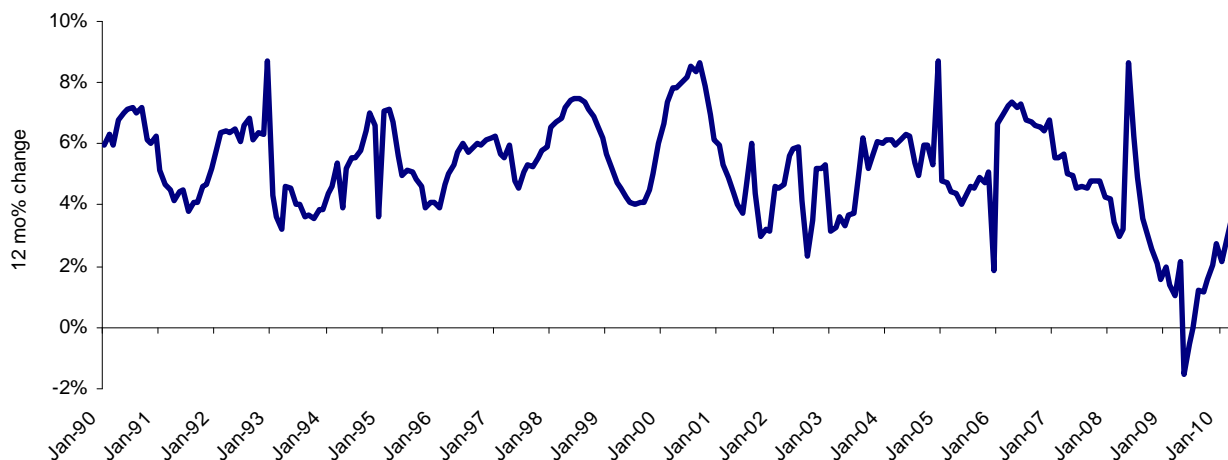
### Wages & Salaries (y/y change, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

- Disposable personal income (or personal income after taxes) rose 0.3% in March to \$11.09 trillion. On a year-over-year basis, DPI is up 3.4%. Excluding transfer payments, DPI was up 0.1%% in March from February and up 1.7% year-over-year.

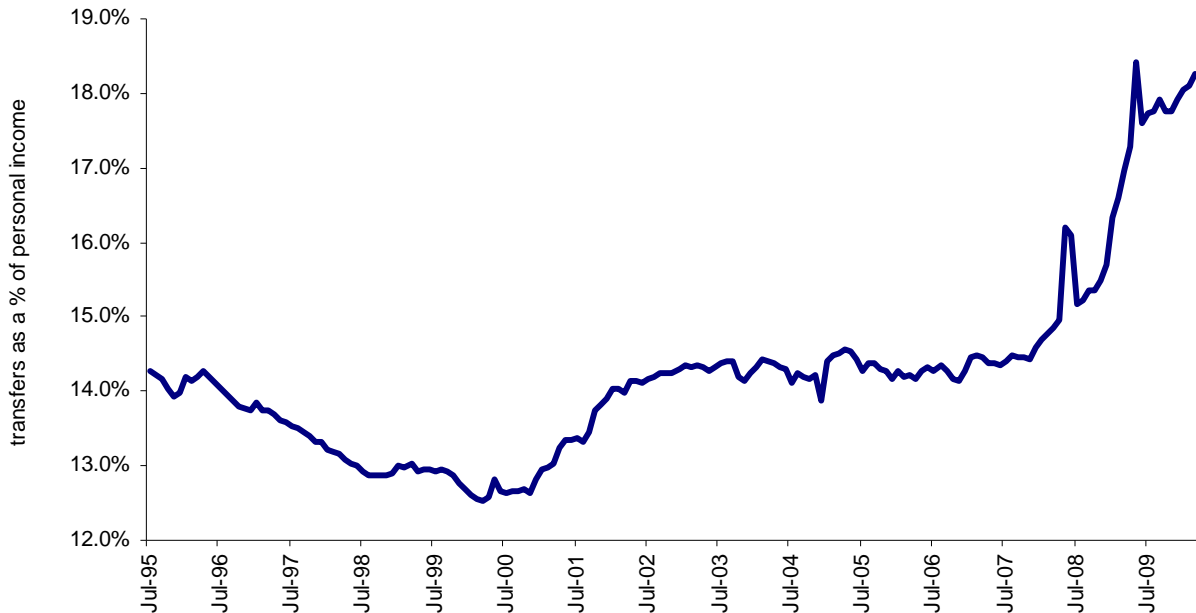
### Disposable Personal Income (y/y change, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

- Transfers rose to 18.3% of personal income, nearing the old high.

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



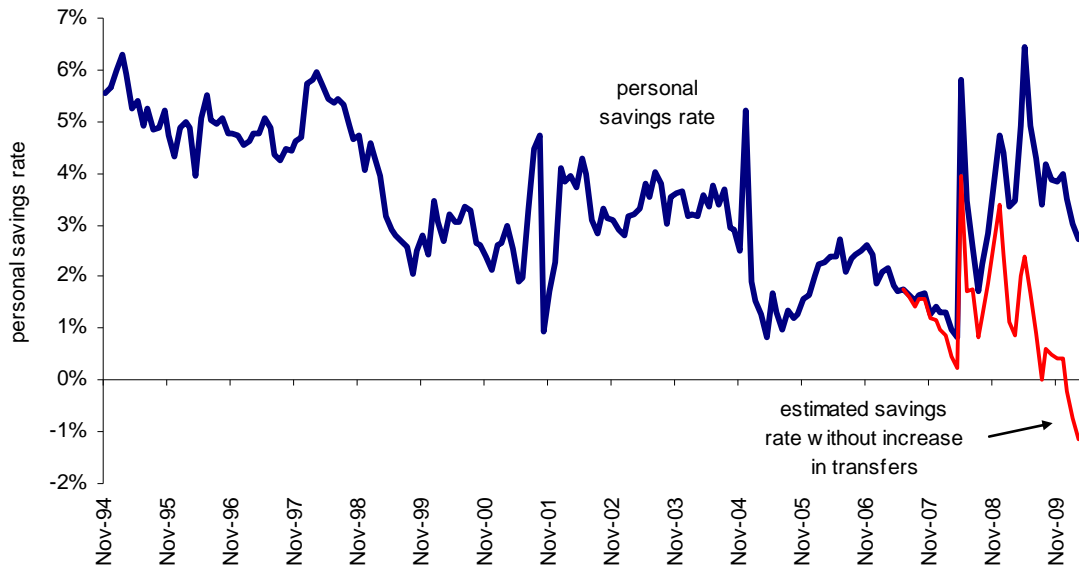
Source: Bureau of Economic Analysis; Encima Global

### Transfers Puff Up Personal Savings Rate, but Consumption Depends on Jobs

The personal savings rate weakened in March as consumption grew but not personal income. Excluding the expansion in transfer payments, personal savings fell deeper into negative territory. The large transfer payments are still holding up disposable income and the personal savings rate some, but at the expense of increased government borrowing. Though the personal savings rate remained positive due to the extra transfers, 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, total U.S. borrowing and the dependence on debt is still growing.

- The personal savings rate slowed to 2.7% in March from 3.0% in February. Without the increase in transfers since the end of 2007, we estimate the PSR would have been negative 1.2%. 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.

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

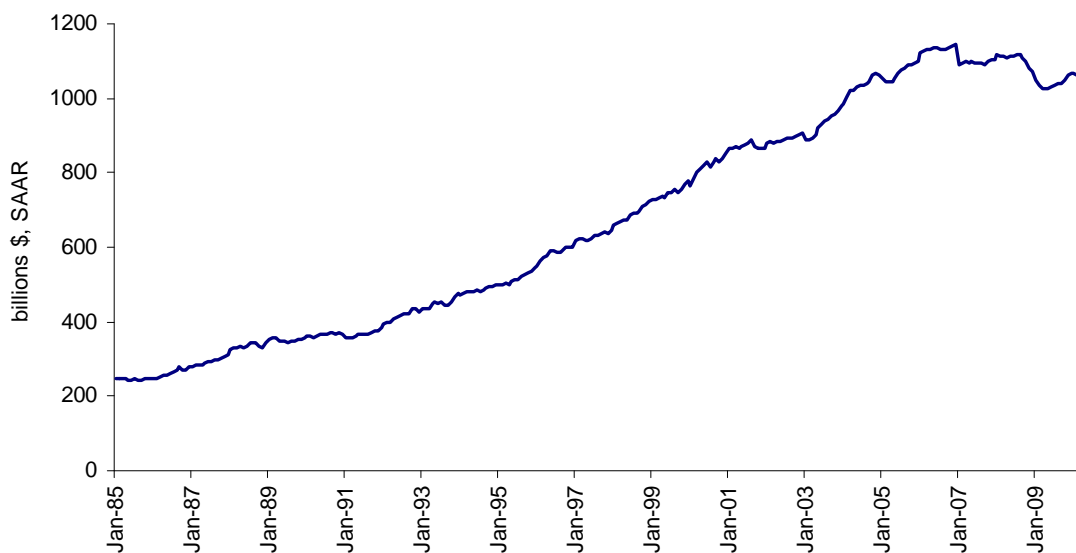


Source: Bureau of Economic Analysis; Encima Global

## Small Business Income Bounce

- Proprietors' income rose \$2.7 billion or 0.3% to \$1.07 trillion in March from February. Proprietor's income fell \$5.3 billion or 0.5% for the first two months of the year (January and February). On a year over year basis, it's up 3.7% and is still down 7.1% from the peak in December 2006.

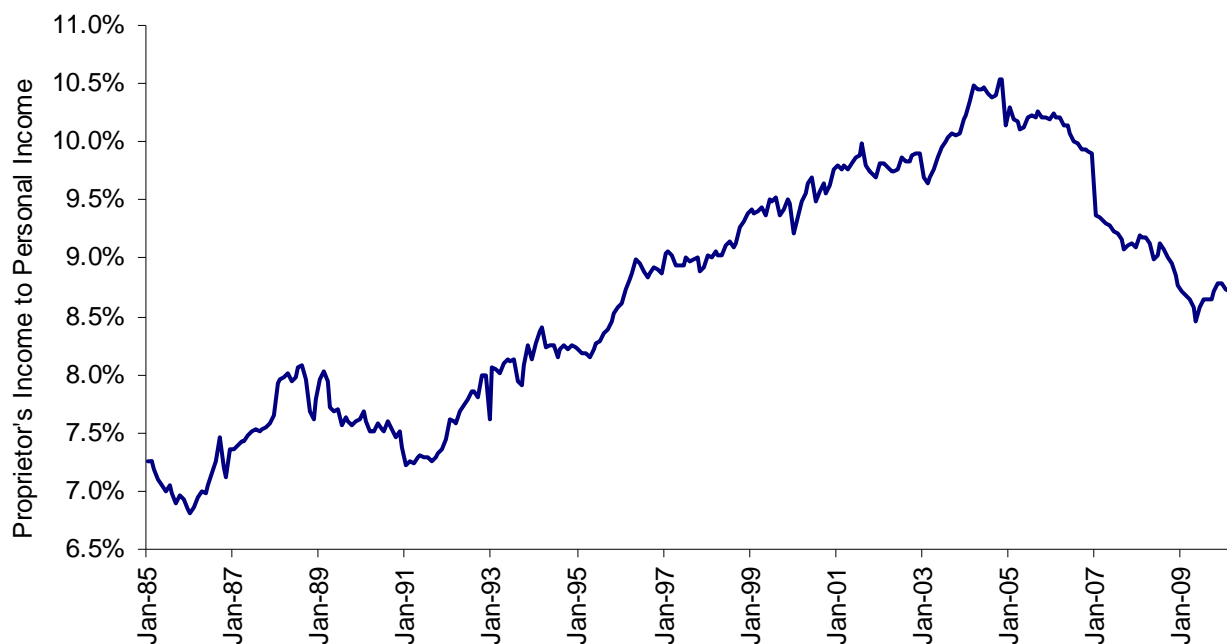
## Proprietors' Income with IVA and CCAdj (billions, last obs. March 2010)



Source: Bureau of Economic Analysis; Encima Global

- While governments, big corporations and especially banks are doing well in the recovery, small businesses have lost a major part of their share in the economy. As a percentage of personal income, proprietors' income remained at 8.7% in March, 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 a strong recovery, 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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