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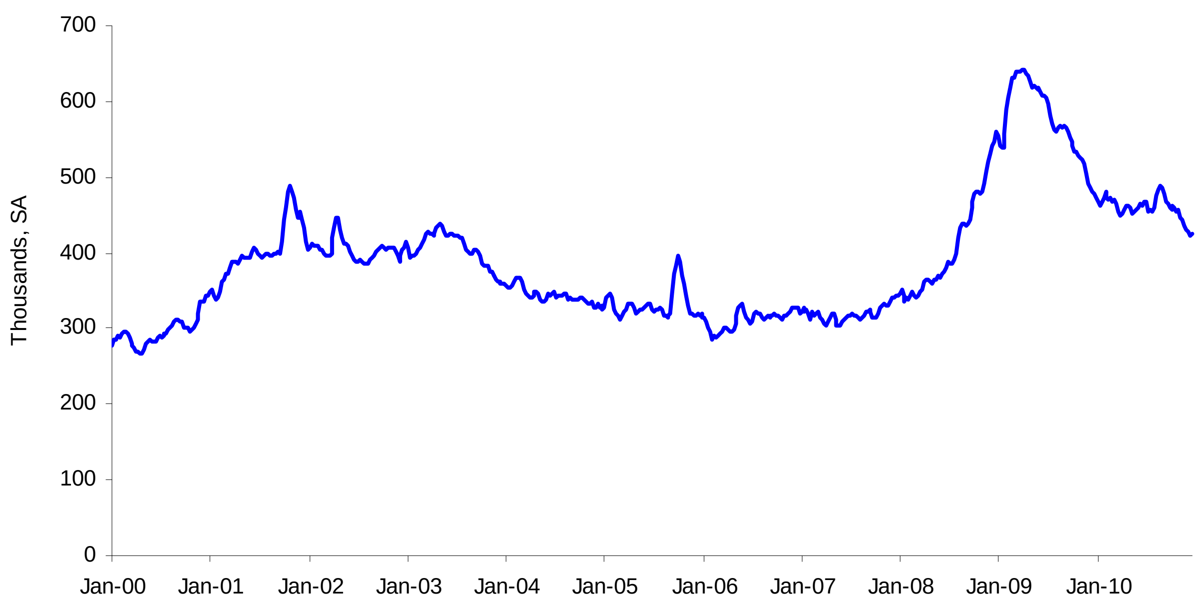
Consumption Growing Faster than Income; Farm Income Surging

Initial jobless claims remained at 420,000 in the week ending December 18. This is still high for a recovery, but improving. Weak personal income growth, especially wage and salary growth (which doesn't include transfer payments) remains a drag. We expect moderate GDP growth to continue into 2011, with persistent debt crises in Europe and, increasingly, in U.S. states and municipalities.

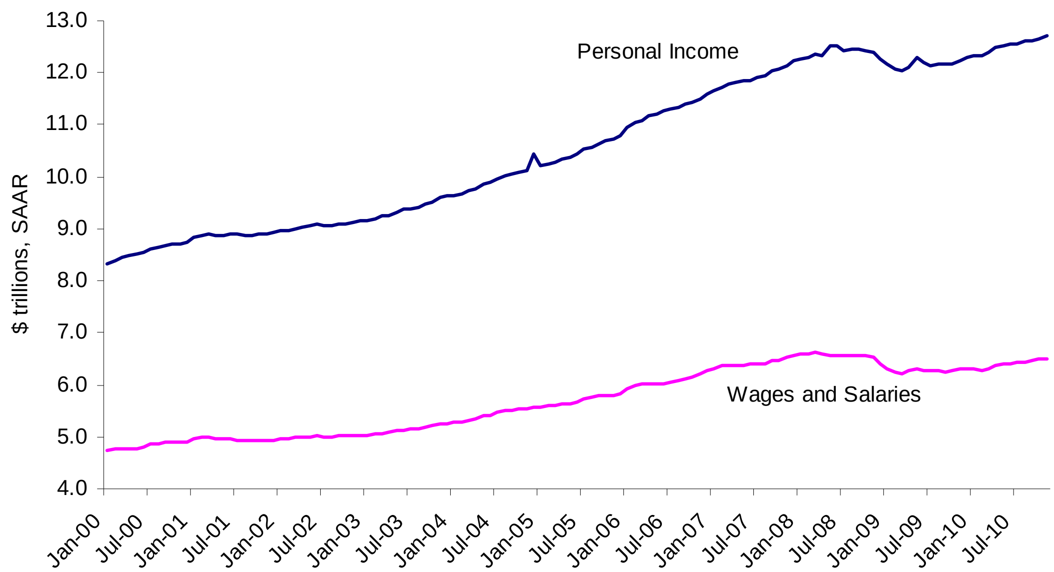
Initial Unemployment Claims – 4 Week Average (last obs. December 18, 2010)



Source: Bureau of Labor Statistics; Encima Global

- Today's data on November personal income showed a 0.3% increase from October, reaching a $12.7 trillion annual rate. The November data showed that income from wages and salaries (which don't include transfer payments) rose 0.1% from October, to a $6.5 trillion annual rate.

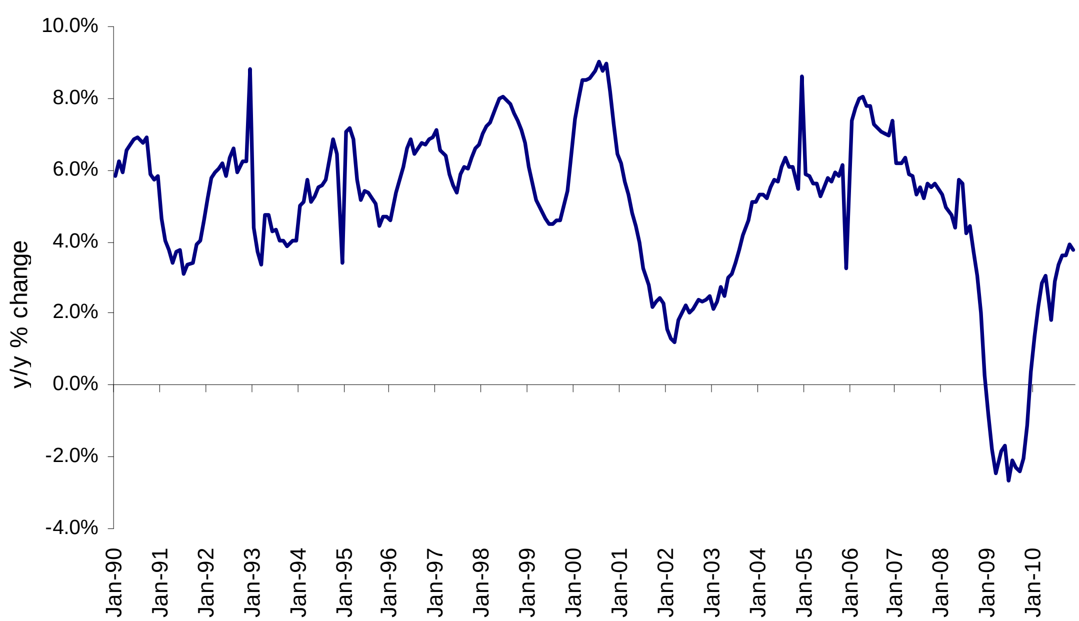
Personal Income and Wages and Salaries (last obs. November 2010)



Source: Bureau of Economic Analysis; Encima Global

- Personal income is up 3.8% year-over-year nominal, very weak compared to previous recoveries. Excluding transfer payments, it's up only 3.2%, the same as wage and salary income. The three-month annualized growth rate in personal income is now 2.8%, versus 5.6% for consumption.

Personal Income y/y (last obs. November 2010)

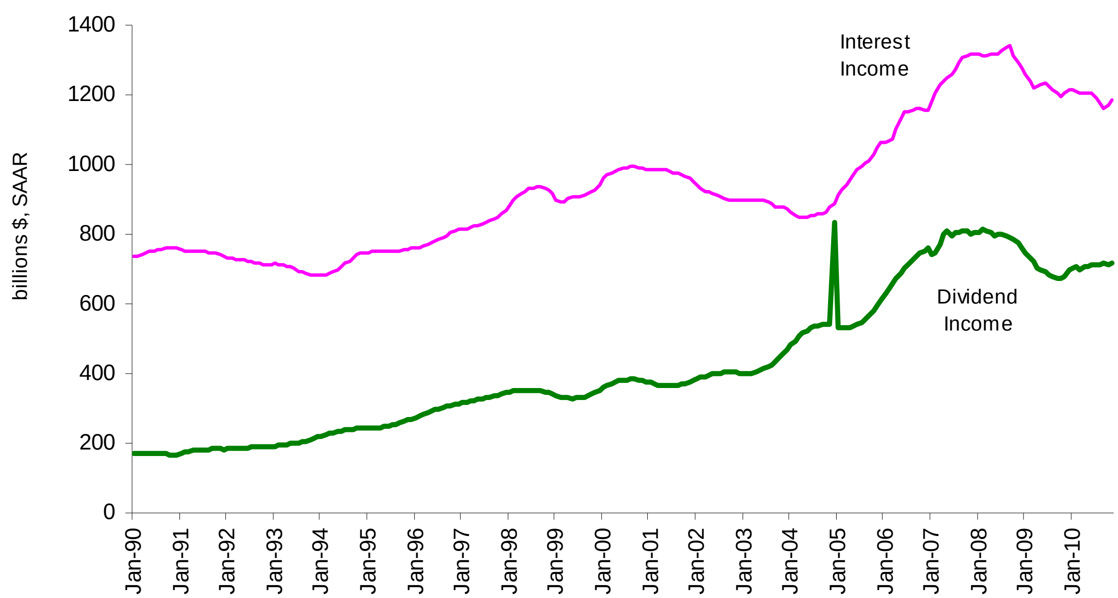


Source: Bureau of Economic Analysis; Encima Global

- Transfer payments rose to a $2.33 trillion annual rate in November, 18.3% of personal income. Transfer payments directly boost personal income and the personal savings rate at the expense of increased government debt. We think they give a small boost in consumption in the short term, but discourage business investment and hiring.

- Interest income (one component of personal income) stood at a $1.18 trillion annual rate in November, 1.6% below the November 2009 rate. Interest income peaked at a $1.34 trillion annual rate in September 2008. Dividend income in November was running at a $717.4 billion annual rate.

Income from Assets (last obs. November 2010)

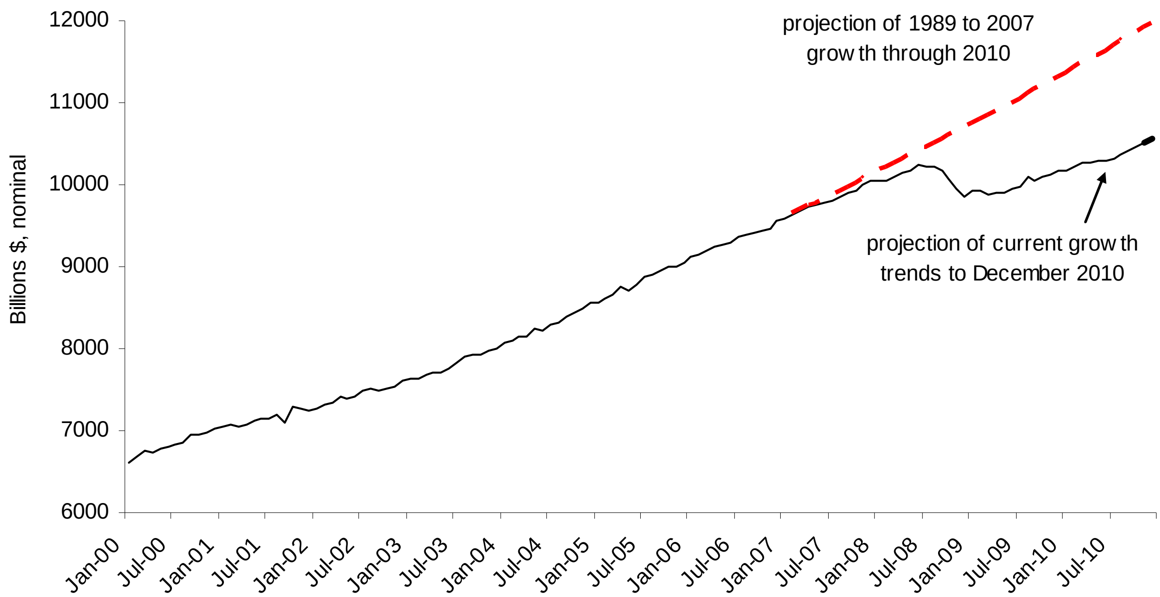


Source: Bureau of Economic Analysis; Encima Global

Consumption Growing From Very Low Base

November consumption, at a $10.5 trillion annual rate, was up 0.4% from October and up 3.8% from November 2009. Current consumption trends will leave personal consumption expenditures almost $1.5 trillion (annual rate) below the pre-Lehman trend at the end of 2010.

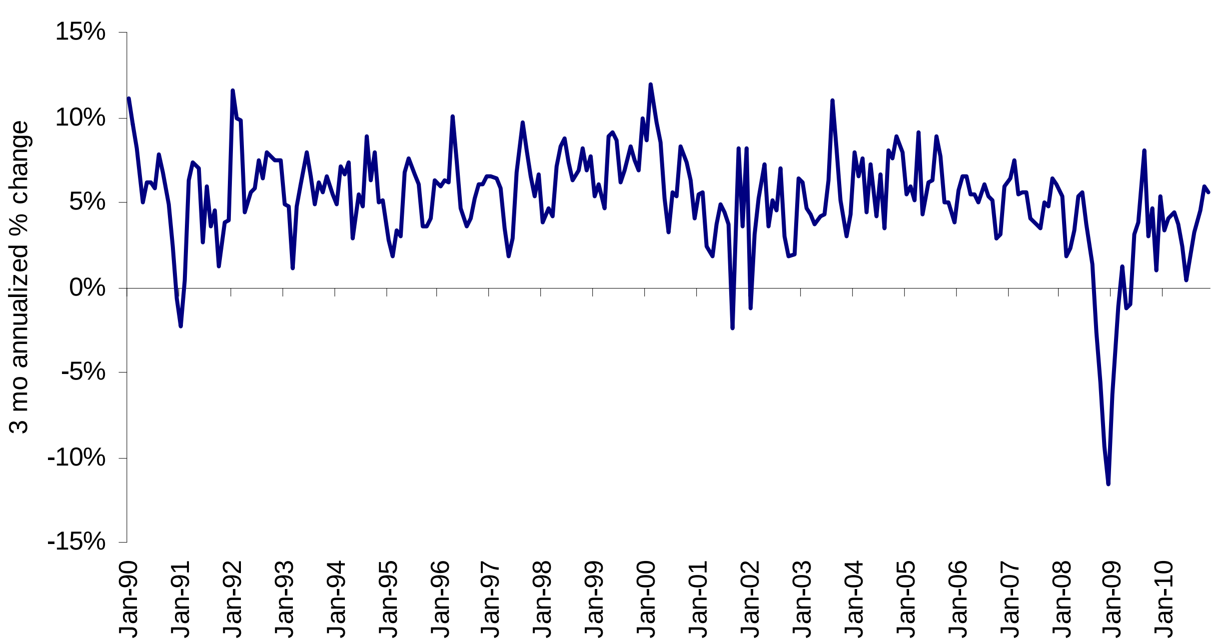
Nominal PCE (last obs. November 2010, broad line projects through Dec 2010)



Source: Bureau of Economic Analysis; Encima Global

- The three-month annualized growth rate in consumption is now 5.6%, up sharply from the summer soft patch and handily outpacing the growth in income.

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



Source: Bureau of Economic Analysis; Encima Global

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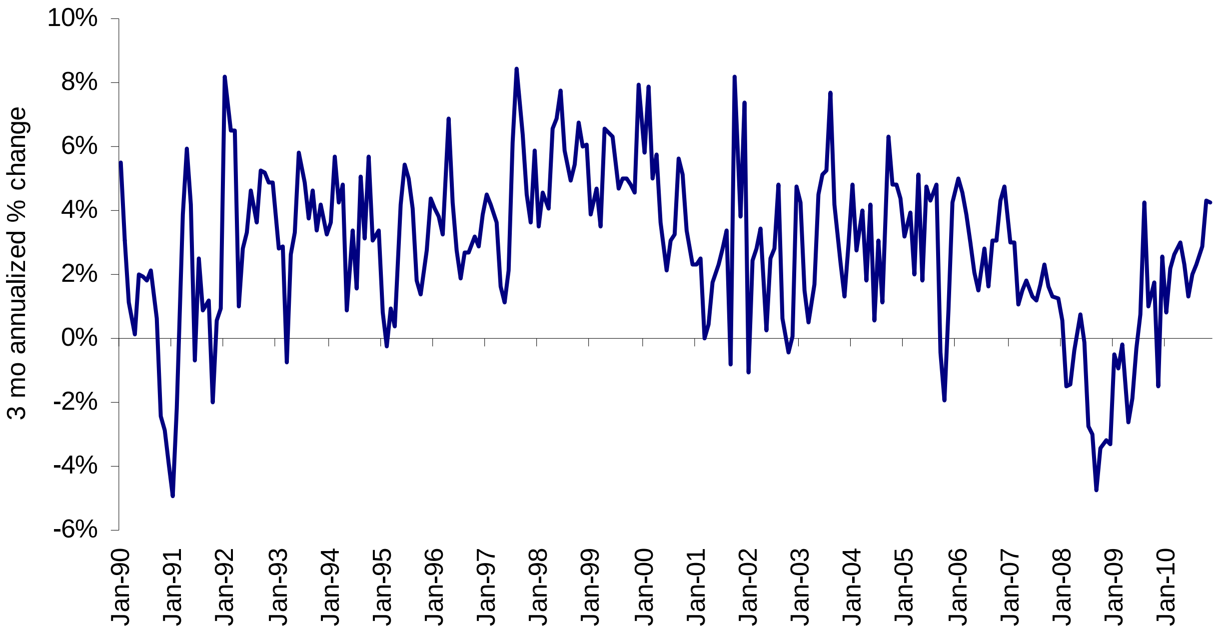
- In real terms, consumption rose 0.3% in November from October and is now growing at a 4.3% annualized rate for the three months ending in November. This supports the October increase in our fourth quarter 2010 GDP growth forecast to 3%.

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

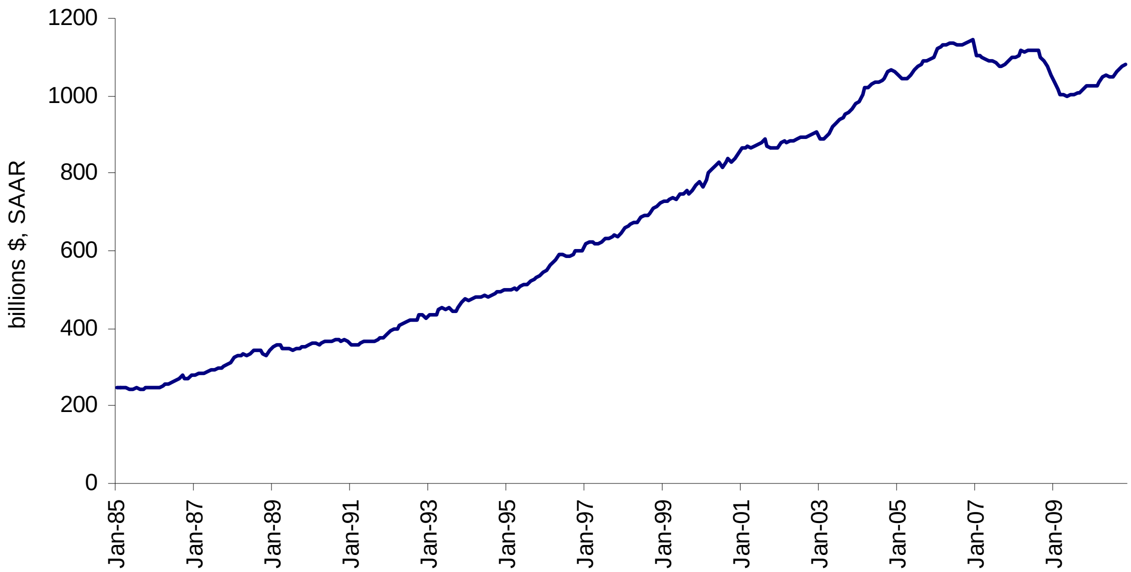


Source: Bureau of Economic Analysis; Encima Global

Small Business Income

Proprietors' income rose 0.7% to $1.08 trillion in November from October. Whereas personal income and wage and salary income have exceeded their pre-crisis highs, proprietors' income is still well below the December 2006 peak. This reflects the challenging small business climate, including taxes, regulation, health care costs, credit conditions and weakness in demand.

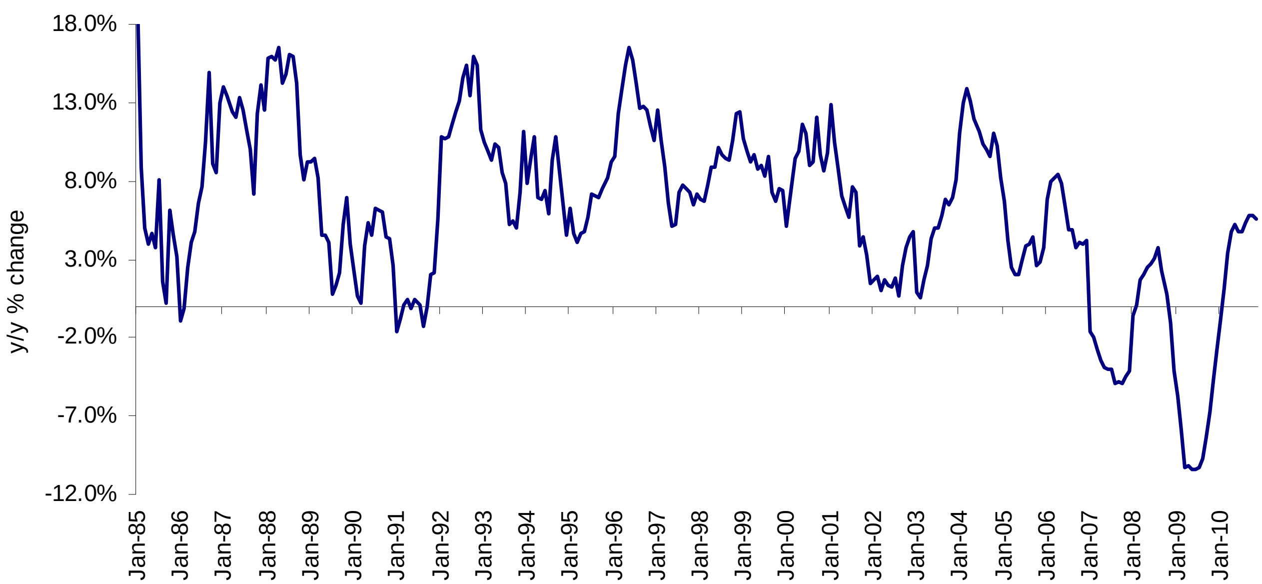
Proprietors' Income with IVA and CCAdj (billions, last obs. November 2010)



Source: Bureau of Economic Analysis; Encima Global

- On a year over year basis, proprietors' income is up 5.6%.

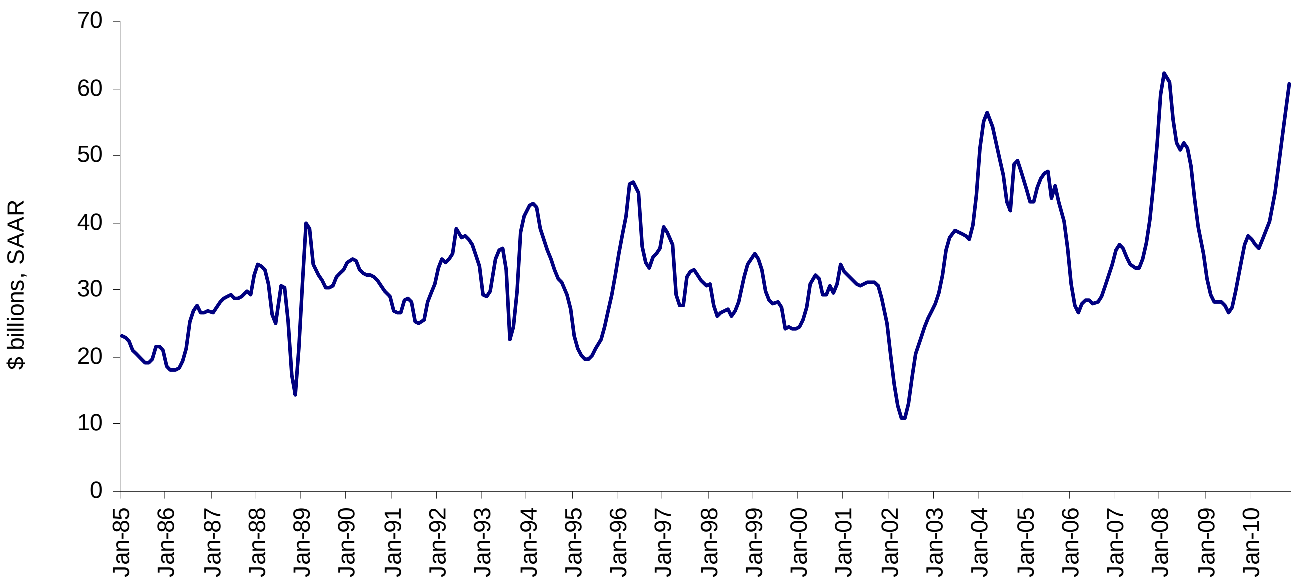
Proprietors' Income y/y % change (last obs. November 2010)



Source: Bureau of Economic Analysis; Encima Global

- One of the strong components of proprietors' income is from farms, which make up 5.6% of overall proprietors' income. Farm proprietors' income rose 7.1% in November 2010 from October and is 65.4% higher than in November 2009 (and up 100% from July 2009.) Note the spikes in 2004 and 2008 when commodity prices were also surging.

Farm Proprietors' Income with IVA and CCAdj (last obs. November 2010)

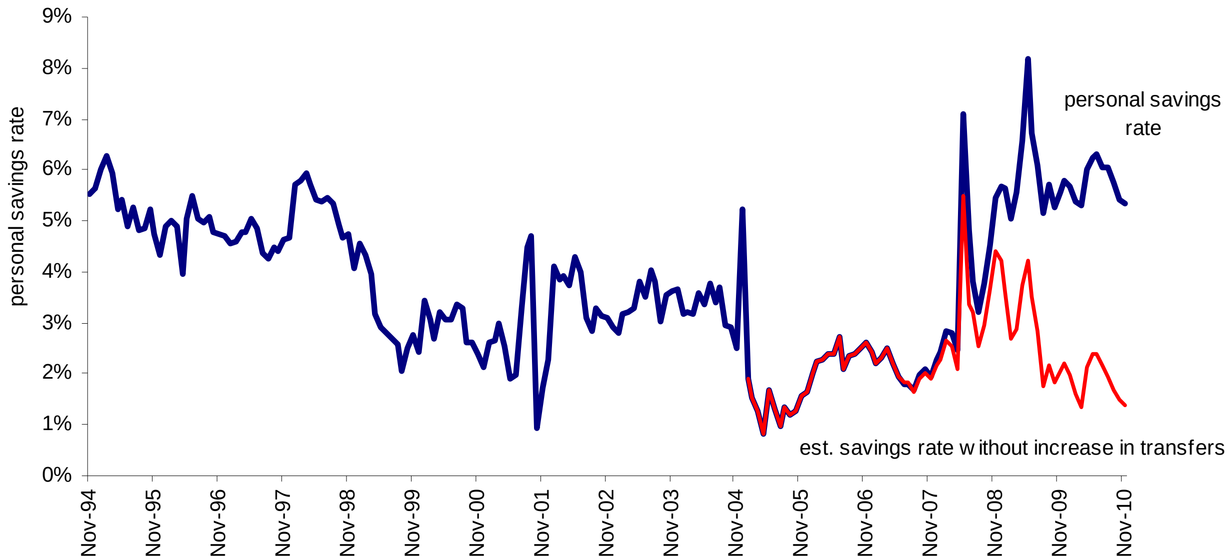


Source: Bureau of Economic Analysis; Encima Global

Personal Savings

The official personal savings rate stood at 5.3% in November, down from 5.4% in October. Without the increase in federal transfer payments since the end of 2007, however, we estimate the PSR in November would be 1.4%. The PSR has been negatively affected by the low yield on savings.

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



Source: Bureau of Economic Analysis; Encima Global

- As discussed in detail in our previous pieces, we note problems with the PSR which make it unusable for economic purposes: it doesn't reflect the flow into savings nor can it be reconciled to the stock of savings (which the Fed correctly tracks in its savings data); the PSR doesn't help predict consumption; it derives savings by subtracting a cash-basis measure of consumption (outlays of any type including income and capital gains taxes) from a narrower measure of income (which excludes realized and unrealized capital gains and the inside buildup in pensions and 401ks.)

Bottom Line

Consumption grew enough to sustain a recovery (up 0.4% in November, 3.8% year-over-year.) Wage and salary growth remained weak in November (up 0.1%, 3.2% yoy). Transfers as a percentage of total income remain elevated near the peak. Low interest rates have hurt savers and reduced interest income. Proprietors' income (small businesses) improved (up 0.7% mom, 5.6% yoy.) One component, farm proprietors' income, is surging, gaining 7.1% mom and 65.4% yoy. Savings rates are coming down.