January 31, 2011

Economics Group

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Jump in Consumer Spending Caps Best Quarter Since 2006

Personal spending increased 0.7 percent in December, capping off the strongest quarter for consumer spending since 2006. Income grew 0.4 percent on the month and the saving rate slipped to 5.3 percent.

Solid Finish to 2010, Spending Growth Likely to Slow in 2011

The major takeaway from this report is that consumer spending finished 2010 on a high note, increasing 0.7 percent in the final month of the year and growing at a 4.4 percent annualized basis in the fourth quarter. This marks the strongest outturn for consumer spending since the first quarter of 2006. While we do look for continued spending growth from here, this break-neck pace of growth does not seem sustainable with more than nine percent of the workforce still looking for a job. A growth rate between two and three percent for consumer spending seems likely for 2011.

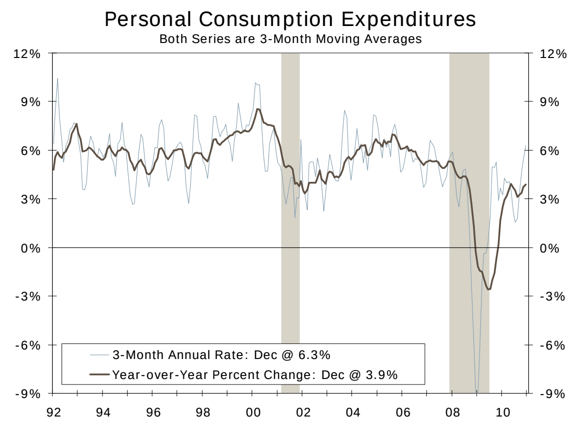
That said, this report shows evidence of improving fundamentals for those workers who have been fortunate enough to hold down a job through all the turmoil of the last few years. Wages and salary disbursements, for example, rose to the highest level since 2008 and are now only 1.5 percent below the pre-recession peak. The growth here was supported by broad-based gains in wages and salaries for both goods and services producing industries as well as government positions. Proprietors' income added $8.1 billion in December which included a $2.8 billion boost in farm proprietors' income, as a decent crop year and higher food prices lifted income for farmers. Even rental income, which was battered during the recession, seems to be reflecting some of the recent signs of life in the housing market as rental income added $1.9 billion, a 0.6 percent monthly gain.

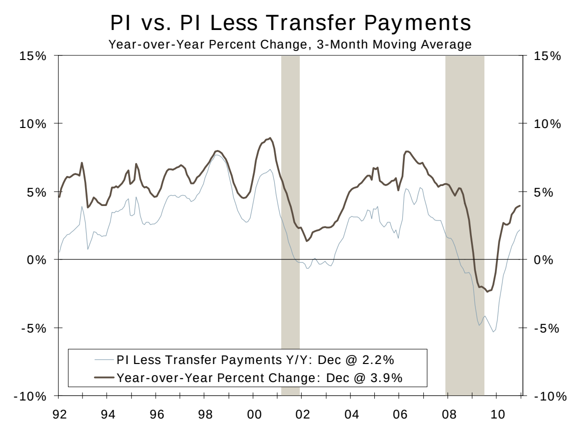
Perhaps most encouraging is the gain in income outside of transfer payments. At the outset of this recovery, much of the income growth was concentrated in transfer payments, which includes categories such as social security payments and unemployment benefits. Stripping away those government payments, personal income growth less transfer payments is now growing 4.4 percent on a 3-month annualized basis, suggesting solid growth for consumer income.

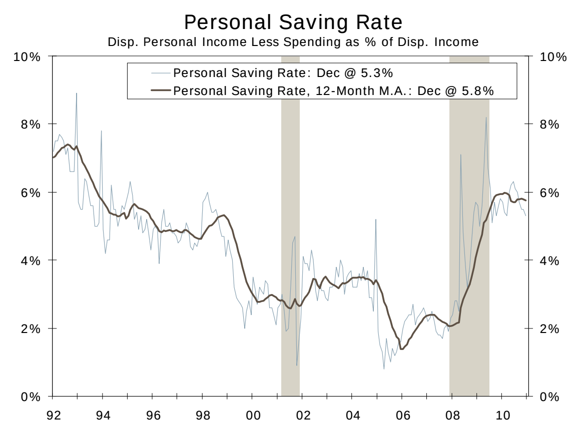
Core PCE was unchanged on the month bringing the year-over-year rate of core PCE inflation to 0.7 percent—the lowest level in a half century. This gives the Fed the flexibility to keep rates low.

Saving Rate Slips

The U.S. consumer has unwound debt levels in a fairly dramatic fashion over the last couple of years. Total household debt as a percent of disposable personal income has come down from more than 123 percent at the outset of the recession to less than 110 percent through the third quarter of 2010. Still, even at the new lower levels, consumers remain rather levered. The saving rate rose to more than six percent earlier this year. The big increase in spending in December caused the saving rate to drop to 5.3 percent. We think that consumers will continue to unwind debt and consequently the saving rate should remain north of five percent.







Source: U.S. Department of Commerce and Wells Fargo Securities, LLC.

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