



Economics Group

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Consumer Spending Picked Up in February...So Did Prices

Personal income increased 0.3 percent in February after a 1.2 percent jump the prior month. Spending picked up 0.7 percent as a spike in energy prices competes for a larger share of spending.

Higher Prices Competing for Consumers' Dollars

While the 0.7 percent jump in personal spending may appear to signal consumer strength, much of the increase simply reflects the price of goods and services going up. After accounting for higher prices, the increase in real spending was only 0.3 percent. On average across the United States, gasoline prices went from \$3.11/gallon for regular unleaded at the outset of the month to \$3.38 at the end of the month. Today's report shows that energy prices are growing 35.6 percent on a 3-month annualized basis.

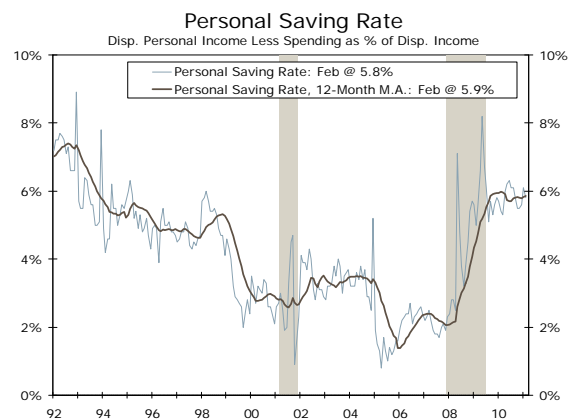
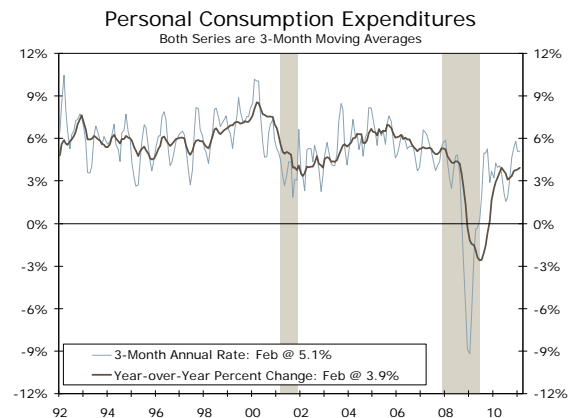
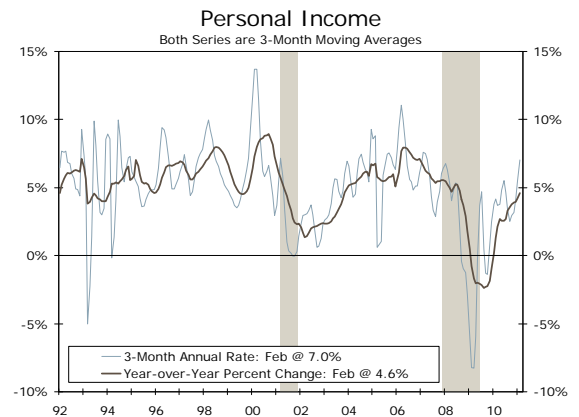
Personal income got a big boost in January from the temporary cut in the payroll tax which reduced employee contributions to Social Security. The initially reported gain of 1.0 percent in January was revised higher to 1.2 percent, and it looks as though the momentum continued in February as income picked up another 0.3 percent on the month. However energy prices are on the rise, and potential increases in local taxes cannot be ruled out later this year. The bottom line is that we are going to need stronger employment growth in order for disposable income to keep pace.

The big price increases (for now) are limited to food and energy costs. Core PCE was up just two tenths of a percent this month lifting the year-over-year measure of core consumer prices to just 0.9 percent. Businesses have been feeling the pinch of increased price pressures but have not been able to pass on those price increases with the unemployment rate still high. But keeping goods prices low as input costs rise crimps corporate profits; businesses will not eat the loss forever. As the recovery gains momentum, consumer prices could trend higher.

Real Spending Growth Softening

Real spending picked up 0.3 percent in February. While that is an increase from January when spending growth was essentially flat after accounting for price changes, it brings the 3-month annualized rate of real personal spending growth to 2.1 percent. That is far from the 4.0 percent pace for this measure in the fourth quarter, but not inconsistent with our forecast for 2.3 percent real personal consumption growth in the first quarter.

The saving rate for January was revised higher to 6.1 percent, and in February this measure slipped to 5.8. Going forward, we would expect there to be a tug of war with spending behavior as consumers decide whether to increase saving or go out and spend as they did in the fourth quarter of 2010. But if gas prices keep rising, part of that decision will be made for them. With the political instability in the Middle East further price spikes cannot be ruled out, but that is not our expectation. So far, geo-political events have not severely disrupted the global supply chain. So while energy prices might remain at their present elevated level, the risk premium of a moderate level of Middle East instability is priced in.



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