



Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
 Erik Nelson, Economic Analyst
erik.f.nelson@wellsfargo.com • (704) 410-3267

Income Growth: The Taxman Cometh

The following report is an update to the previously released report of the same title. Changes to the BLS methodology skewed the after-tax data. These changes and their implications are discussed below.

Lackluster Income Growth

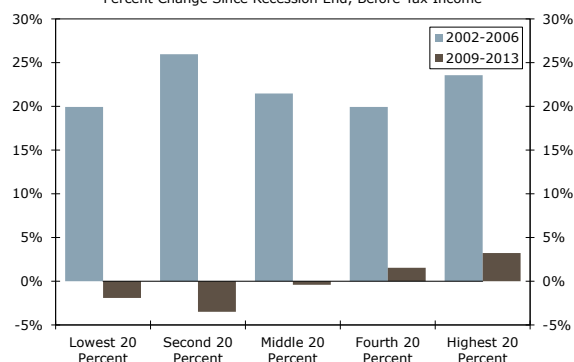
In our previous report, we first discussed the lack of before-tax income growth since the end of the recession. This story remains true, as the data in the top chart have not been affected by the methodology changes implemented by the BLS in 2013, which we discuss later. However, the BLS data tells a slightly different story than the BEA personal income data, which shows income dropping in January 2013 but recovering these losses afterwards (bottom chart). This drop was likely a result of companies ramping up dividend and bonus payments ahead of the tax policy changes on January 1, 2013. Among these changes were the expiration of the Bush-era 2 percent payroll tax cut for all workers, increased capital gains taxes and a tax hike on the highest income earners.

In 2013, the BLS changed their methodology in their consumer expenditure survey (CEX), the source of data for our original report. While in previous years the BLS used survey responses to calculate tax burdens, in 2013 they started using Census tax software to calculate tax burdens more precisely. The previous methodology was subject to large errors because non-responses were recorded as zeroes. This likely underestimated the actual tax burden of respondents. Thus, the new methodology, while more accurate, overestimates the change in after-tax income from 2012 to 2013.

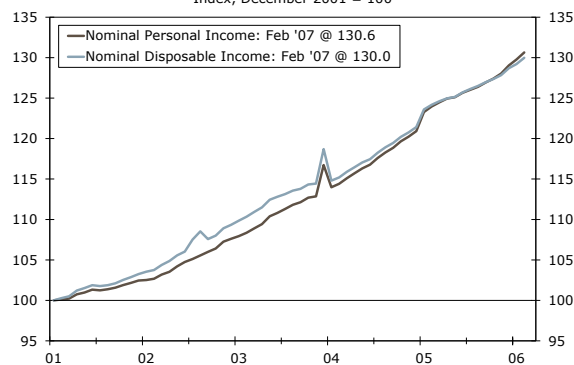
Although the original BLS data we used overestimated the effects of tax policy on income growth, we can use BEA personal income data to compare the tax situation in this cycle to the previous one. In the previous recovery, President Bush enacted broad-based tax cuts, including specific tax cuts for the highest income earners, whose effects can be seen in the middle chart. Nominal disposable income, or nominal personal income less current taxes, increased by roughly the same amount as nominal pre-tax income over the course of the five years following the end of the 2001 recession. Conversely, growth in disposable income in the five years following the most recent recession is lagging roughly 3.5 percentage points behind pre-tax income growth, which itself has been growing slowly relative to the previous cycle.

The divergence in growth between before and after-tax income has been exacerbated since the aforementioned Bush-era tax cuts expired. The effects of the tax policy can clearly be seen in the bottom chart, as before and after-tax income spiked and then sharply declined at the start of 2013. However, disposable income has still grown roughly 10 percent since the end of the recession, contrary to the negative growth our prior data had suggested. Thus, while changes in tax policy seem to indeed have had an impact on the income picture in the United States, it seems as though the data we previously used overestimated the effects of these changes. We unfortunately do not have access to other data on after-tax income by quintile, so we cannot make the same comparisons across income levels that we did in our original report.

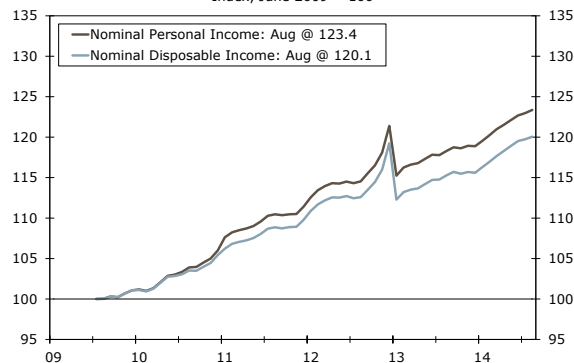
Income Growth During Economic Recoveries
 Percent Change Since Recession End, Before-Tax Income



Income and Tax Growth Since Trough
 Index, December 2001 = 100



Income and Tax Growth Since Trough
 Index, June 2009 = 100



Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC ("WFS") is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. ("WFBNA") is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. WFS and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2014 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

