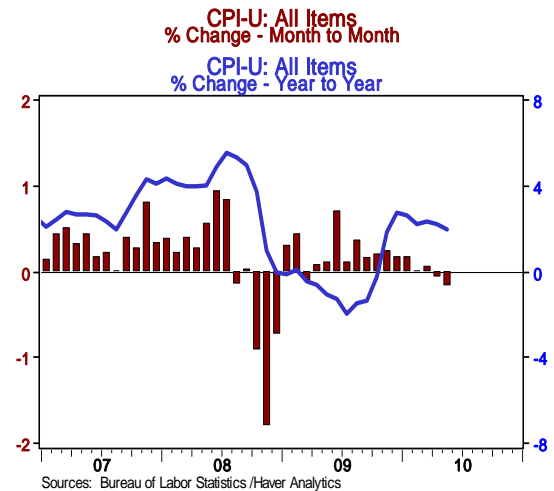


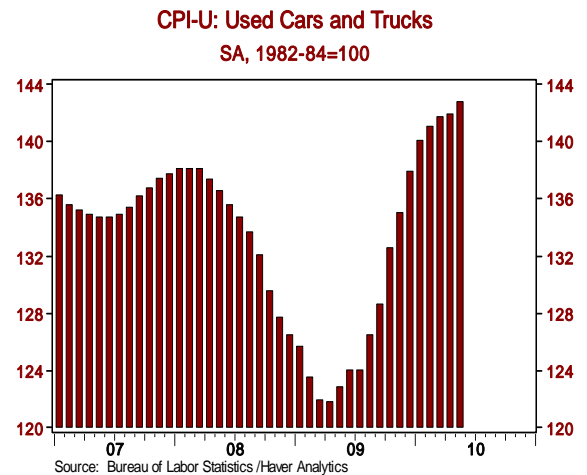
MAY CPI

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- The Consumer Price Index (CPI) declined 0.2% in May, matching the consensus. The CPI is up 2.0% versus a year ago.
- “Cash” inflation (which excludes the government’s estimate of what a homeowner would charge himself for rent) fell 0.2% in May but is up 2.7% in the past year.
- Energy prices fell 2.9% in May and made the largest contribution to the decline in the overall CPI. Food prices were unchanged. Excluding food and energy, the “core” CPI was up 0.1% in May and is up 1.0% versus a year ago.
- Real average hourly earnings – the cash earnings of production workers, adjusted for inflation – rose 0.5% in May but are down 0.1% versus a year ago. Real weekly earnings increased 0.8% in May and are up 1.1% in the past year.



Implications: Energy prices fell steeply in May, resulting in a drop in the headline CPI. Given the rise in energy prices so far in June, the CPI is very likely to show a rebound next month. On a year-ago basis, consumer prices, up only 2%, look benign. Moreover, given the 0.7% increase in prices in June 2009, the year-ago price comparison is likely to go lower next month. In addition, “core” prices, which exclude food and energy, are up only 1% since last year, the smallest increase since JFK was in the White House. In turn, the Federal Reserve may surmise that inflation is dead. We think that would be a mistake. “Cash” inflation better gauges the inflation consumers are experiencing. It counts everything, including food and energy, but takes out “owners’ equivalent rent” or OER – the government’s estimate of what homeowners would pay if they rented their own homes, and does not reflect an actual transaction. Excluding OER, consumer prices are up 2.7% versus a year ago. Meanwhile, as the economy has recovered, the nearly zero percent interest rate policy from the Fed has effectively become looser. This looseness takes time to influence prices. When it does, starting next year, it will be clear the Fed has been too easy for too long. In other news this morning, new claims for unemployment insurance increased 12,000 last week to 472,000. Continuing claims for regular state benefits increased 88,000 following the prior week’s decline of 234,000. Annual auto plant retooling may have added volatility last week and continue to do so for the next several weeks.



CPI - U <i>All Data Seasonally Adjusted</i>	May-10	Apr-10	Mar-10	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	-0.2%	-0.1%	0.1%	-0.7%	0.3%	2.0%
<i>Ex Food & Energy</i>	0.1%	0.0%	0.0%	0.8%	0.4%	1.0%
<i>Ex Energy</i>	0.1%	0.1%	0.1%	1.0%	0.7%	0.9%
Energy	-2.9%	-1.4%	0.0%	-16.2%	-2.8%	14.7%
<i>Food and Beverages</i>	0.0%	0.2%	0.2%	1.7%	1.7%	0.7%
<i>Housing</i>	0.0%	-0.1%	0.0%	0.0%	-0.7%	-0.5%
<i>Owners Equivalent Rent</i>	0.0%	0.0%	-0.1%	-0.4%	-0.4%	-0.3%
New Vehicles	0.1%	0.0%	0.1%	0.6%	-1.0%	1.9%
Medical Care	0.1%	0.2%	0.3%	2.6%	3.7%	3.4%
Services (Excluding Energy Services)	0.1%	0.2%	0.1%	1.6%	0.7%	0.9%
Real Average Hourly Earnings	0.5%	0.5%	-0.2%	2.7%	1.6%	-0.1%

Source: U.S. Department of Labor