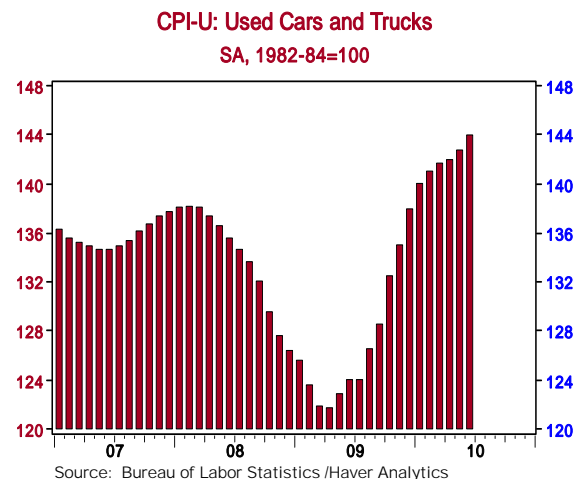
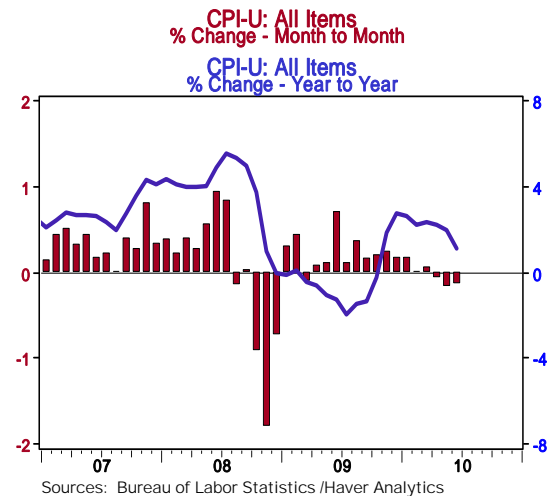


## JUNE CPI

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- The Consumer Price Index (CPI) declined 0.1% in June, matching consensus expectations. The CPI is up 1.1% 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 June but is up 1.6% in the past year.
- All of the decline in the CPI in June could be attributed to energy prices, which fell 2.9%. Food prices were unchanged. Excluding food and energy, the “core” CPI was up 0.2% in June (versus a consensus expected 0.1%) and is up 1.0% versus a year ago.
- Real average hourly earnings – the cash earnings of production workers, adjusted for inflation – rose 0.1% in June and are up 0.9% versus a year ago. Real *weekly* earnings for all private-sector workers are up 1.5% in the past year.

**Implications:** Inflation has been AWOL lately, with consumer prices falling for the third straight month in June. This is true not only for the overall CPI but also “cash” inflation, which includes everything in the CPI except owners’ equivalent rent” or OER – the government’s estimate of what homeowners would pay if they rented their own homes. OER does not reflect an actual transaction, so “cash” inflation better gauges the inflation being experienced by consumers. All the recent decline in both the overall CPI and cash inflation is attributable to falling energy prices. So, given the rise in energy prices so far in July, the CPI is very likely to start climbing again next month. Another factor that will push the overall CPI upward in the year ahead is the end of declines in OER, the very component we exclude from cash inflation. OER fell for six straight months in late 2009 and early 2010, helping hold down the overall CPI. Now this measure of rent is going up again and will help push up both the overall CPI and “core” CPI. The overall CPI is up 1.1% in the past year while core prices are up 1%. Look for both of these measures to start rising soon. Zero percent short-term rates may have been appropriate during the financial panic, but as the economy has recovered, that policy has become inflationary. Loose money takes time to influence prices. So while we believe inflation will remain benign through the rest of the year, next year it will become clear the Fed has been too easy for too long.



| CPI - U<br><i>All Data Seasonally Adjusted</i> | Jun-10       | May-10       | Apr-10       | 3-mo % Ch.<br>annualized | 6-mo % Ch.<br>annualized | Yr to Yr<br>% Change |
|--|--------------|--------------|--------------|--------------------------|--------------------------|----------------------|
| <b>Consumer Price Index</b>                    | <b>-0.1%</b> | <b>-0.2%</b> | <b>-0.1%</b> | <b>-1.5%</b>             | <b>-0.3%</b>             | <b>1.1%</b>          |
| <i>Ex Food &amp; Energy</i>                    | <b>0.2%</b>  | <b>0.1%</b>  | <b>0.0%</b>  | <b>1.3%</b>              | <b>0.6%</b>              | <b>1.0%</b>          |
| <i>Ex Energy</i>                               | <b>0.1%</b>  | <b>0.1%</b>  | <b>0.1%</b>  | <b>1.2%</b>              | <b>0.7%</b>              | <b>0.9%</b>          |
| <b>Energy</b>                                  | <b>-2.9%</b> | <b>-2.9%</b> | <b>-1.4%</b> | <b>-25.7%</b>            | <b>-9.9%</b>             | <b>3.0%</b>          |
| <b>Food and Beverages</b>                      | <b>0.0%</b>  | <b>0.0%</b>  | <b>0.2%</b>  | <b>0.7%</b>              | <b>1.3%</b>              | <b>0.7%</b>          |
| <b>Housing</b>                                 | <b>-0.1%</b> | <b>0.0%</b>  | <b>-0.1%</b> | <b>-0.6%</b>             | <b>-0.9%</b>             | <b>-0.6%</b>         |
| <i>Owners Equivalent Rent</i>                  | <b>0.1%</b>  | <b>0.0%</b>  | <b>0.0%</b>  | <b>0.3%</b>              | <b>-0.3%</b>             | <b>-0.2%</b>         |
| <b>New Vehicles</b>                            | <b>0.1%</b>  | <b>0.1%</b>  | <b>0.0%</b>  | <b>0.4%</b>              | <b>-0.4%</b>             | <b>1.3%</b>          |
| <b>Medical Care</b>                            | <b>0.3%</b>  | <b>0.1%</b>  | <b>0.2%</b>  | <b>2.3%</b>              | <b>4.0%</b>              | <b>3.5%</b>          |
| <b>Services (Excluding Energy Services)</b>    | <b>0.1%</b>  | <b>0.1%</b>  | <b>0.2%</b>  | <b>1.9%</b>              | <b>0.8%</b>              | <b>0.9%</b>          |
| <b>Real Average Hourly Earnings</b>            | <b>0.1%</b>  | <b>0.6%</b>  | <b>0.5%</b>  | <b>4.6%</b>              | <b>2.0%</b>              | <b>0.9%</b>          |

Source: U.S. Department of Labor