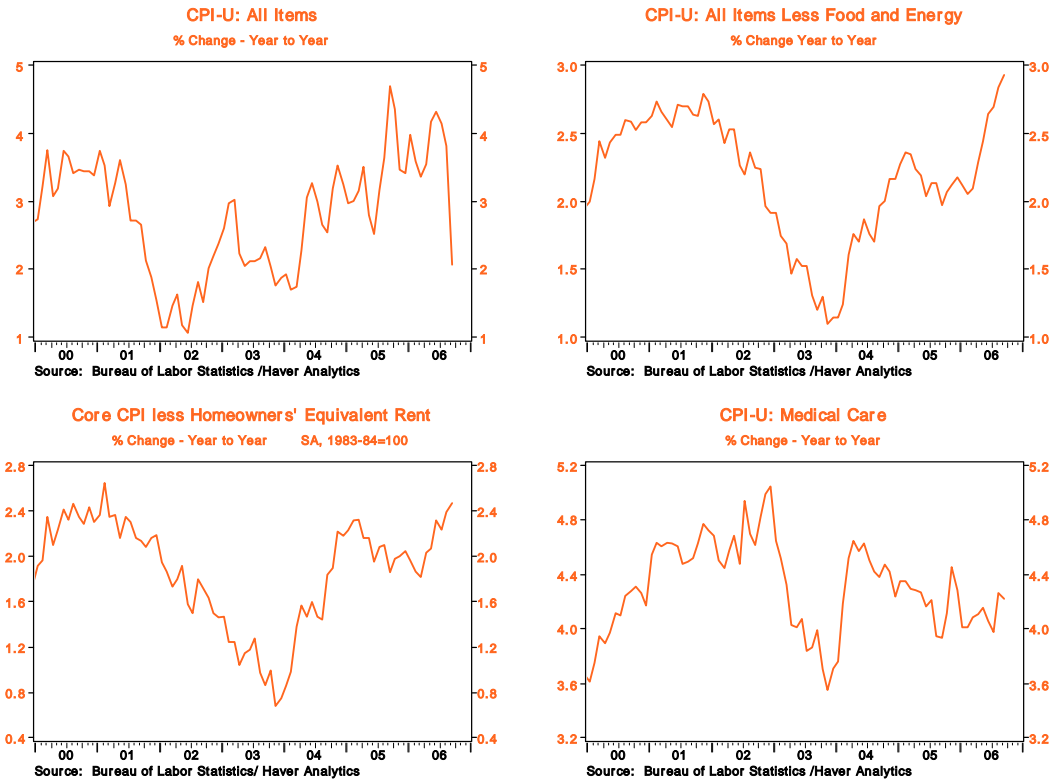


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SEPTEMBER CPI

- The Consumer Price Index (CPI) declined 0.5% in September after a 0.2% increase in August. The CPI has increased 2.1% in the past year.
- Energy prices plummeted 7.2% in September following a 0.3% gain in August. Food and beverage prices increased 0.4% last month. Excluding food and energy, the “core” CPI was up 0.2% in September. The “core” CPI is up an annualized 2.7% in the past three months and 2.9% in the past year – the fastest YOY gain since January 1996.

Implications: While many analysts comfort themselves by suggesting that falling energy prices will contain inflation, the data tell a different story. Energy prices declined 7.2% in September pulling the headline number down 0.5%. However, excluding energy prices, the “core” CPI rose 0.24% – the second consecutive month of 0.24% gains. The core CPI is up 2.9% in the past 12 months (a ten-year high) and is up 3.0% at an annual rate so far this year. Some analysts blame this sharp acceleration on rising owner equivalency rents. Yet, the “core” CPI excluding owner equivalency rent is still up 2.5% in the past year (a five-year high) which is significantly above the Fed’s comfort zone. This steady buildup in inflationary pressures suggests that easy Fed policy has made its way to consumer prices. Moreover, forward-looking measures suggest that inflationary pressures have yet to peak. Gold is still 34% above the 2005 average and the dollar has lost 5.5% of its value against the Euro this year. We expect the YOY gain in the “core” CPI to reach 3.5% in the next 12 months. With the “core” CPI above the Fed’s comfort zone and sensitive market indicators of inflation elevated, we can’t count the Fed out yet.



CPI - U <i>all data seasonally adjusted</i>	Sep-06	Aug-06	Jul-06	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr over Yr % Ch.
Consumer Price Index	-0.5%	0.2%	0.4%	0.8%	2.9%	2.1%
X Food & Energy	0.2%	0.2%	0.2%	2.7%	3.2%	2.9%
X Energy	0.2%	0.2%	0.2%	2.8%	3.1%	2.9%
Energy	-7.2%	0.3%	2.9%	-15.6%	2.2%	-4.3%
Food and Beverages	0.4%	0.3%	0.2%	3.3%	2.6%	2.6%
Housing	0.3%	0.2%	0.3%	3.8%	3.4%	4.1%
- Owners Equivalent Rent	0.3%	0.3%	0.4%	3.9%	4.7%	4.0%
Apparel	0.6%	0.9%	-1.2%	1.3%	2.2%	1.0%
Transportation	-4.1%	0.2%	1.6%	-9.2%	2.6%	-3.2%
- New Vehicles	-0.1%	-0.1%	0.1%	-0.3%	-1.0%	0.4%
Medical Care	0.3%	0.4%	0.2%	3.7%	3.8%	4.2%
Recreation	0.0%	-0.1%	0.3%	0.7%	1.5%	1.3%
Education & Communication	0.1%	0.3%	0.3%	3.1%	2.8%	2.7%
Commodities	-1.7%	0.2%	0.7%	-3.1%	2.0%	-0.7%
Commodities x Food & Beverages	-2.9%	0.2%	0.9%	-6.8%	1.7%	-2.6%
Services	0.4%	0.3%	0.3%	3.9%	3.7%	4.1%

Source: U.S. Department of Labor