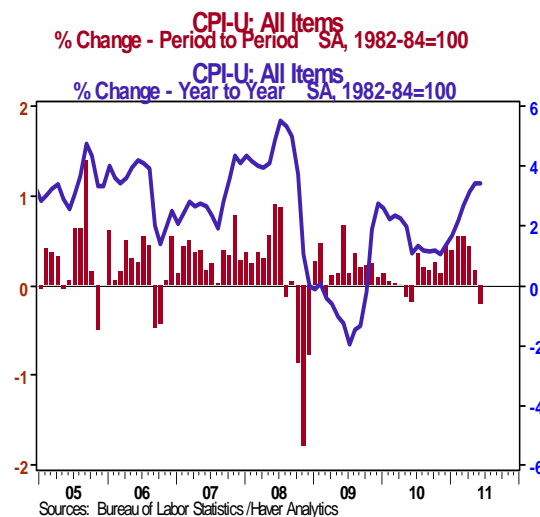


Brian S. Wesbury – Chief Economist
 Robert Stein, CFA – Senior Economist
 Strider Elass – Economic Analyst
 Andrew Hull – Economic Analyst

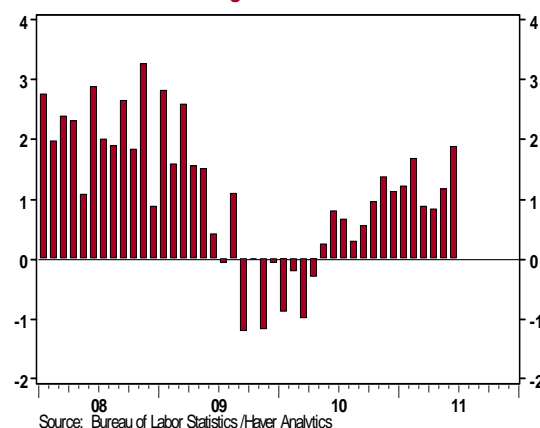
June CPI

- The Consumer Price Index (CPI) fell 0.2% in June versus a consensus expected decline of 0.1%. The CPI is up 3.6% versus a year ago.
- “Cash” inflation (which excludes the government’s estimate of what homeowners would charge themselves for rent) was down 0.3% in June but is up 4.2% in the past year.
- The fall in the CPI was all due to a 4.4% drop in energy prices. Food prices were up 0.2%. Excluding food and energy, the “core” CPI increased 0.3% versus a consensus expected gain of 0.2%. Core prices are up 1.6% versus last year.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – rose 0.2% in June but are down 1.5% in the past year. Real *weekly* earnings are down 0.9% in the past year.

Implications: The Federal Reserve is losing its main excuse for keeping short-term rates near zero. Although the headline inflation number fell 0.2% in June, it was all due to what now appears to have been a temporary drop in energy prices. Higher energy prices in July mean the headline CPI will start moving up again in next month’s report. Today’s news is not a reason for the Fed or investors to become complacent about inflation. Despite the drop in June, consumer prices are up 3.6% in the past year and up 4.2% if we focus on “cash” inflation, which excludes the government’s estimate of what homeowners would pay themselves in rent. Moreover, monetary policymakers have been using low “core” inflation (which excludes food and energy) to justify keeping short-term interest rates near zero. But core inflation is accelerating. Although core prices are still up only 1.6% in the past year, they increased 0.3% in June following another 0.3% increase in May. In the past two months ‘core’ prices are up at a 3.3% annual rate, the fastest two-month pace since 2006. The sharp increase in auto prices in June is related to supply-chain disruptions from Japan. Vehicle prices increased 1% in June and are up at an 11.2% annual rate in the past four months, the fastest pace on record (dating back to 1993). Inflation has been evident at the producer level for some time. Now, producers are passing some of those costs on to consumers. Rising inflation is a concern *now*, but we fully expect the Fed to maintain short-term interest rates near zero until at least mid-2012.



CPI-U: Owners' Equivalent Rent
 % Change - Annual Rate



CPI - U	Jun-11	May-11	Apr-11	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
<i>All Data Seasonally Adjusted</i>						
Consumer Price Index	-0.2%	0.2%	0.4%	1.5%	3.8%	3.6%
Ex Food & Energy	0.3%	0.3%	0.2%	2.9%	2.5%	1.6%
Ex Energy	0.2%	0.3%	0.2%	3.1%	3.0%	2.0%
Energy	-4.4%	-1.0%	2.2%	-12.5%	11.6%	20.1%
Food and Beverages	0.2%	0.4%	0.4%	4.0%	5.5%	3.6%
Housing	0.1%	0.2%	0.2%	1.7%	1.8%	1.3%
Owners Equivalent Rent	0.2%	0.1%	0.1%	1.3%	1.3%	1.0%
New Vehicles	0.6%	1.1%	0.7%	10.1%	8.3%	4.0%
Medical Care	0.2%	0.2%	0.4%	3.2%	3.1%	2.9%
Services (Excluding Energy Services)	0.1%	0.2%	0.1%	1.9%	2.0%	1.6%
Real Average Hourly Earnings	0.2%	0.1%	-0.2%	0.4%	-1.7%	-1.5%

Source: U.S. Department of Labor