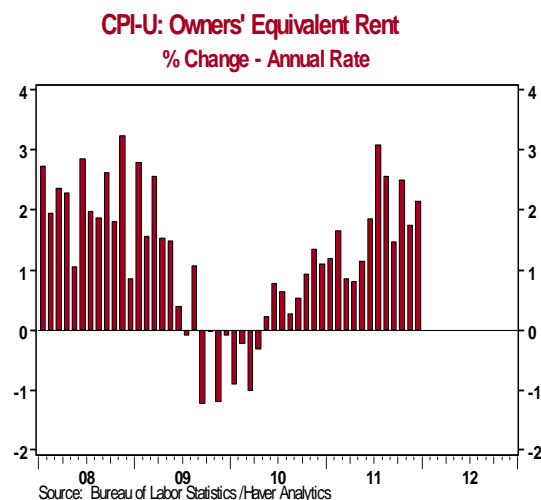
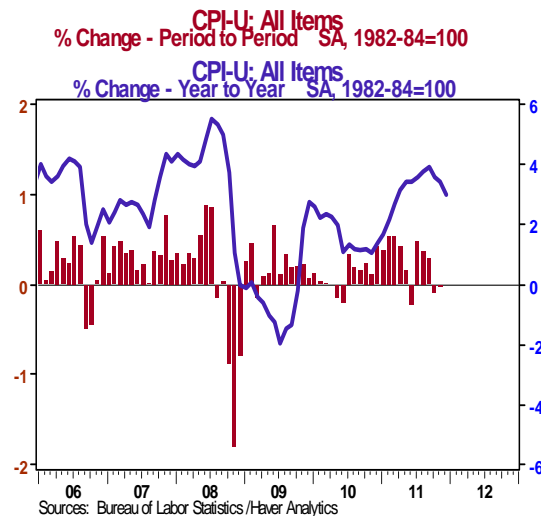


December CPI

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- The Consumer Price Index (CPI) was unchanged in December. The consensus expected an increase of 0.1%. The CPI is up 3.0% versus a year ago.
- “Cash” inflation (which excludes the government’s estimate of what homeowners would charge themselves for rent) was unchanged in December, but is up 3.4% in the past year.
- The lack of increase in the CPI was due to a 1.3% drop in energy prices. Food prices were up 0.2%. The “core” CPI, which excludes food and energy, was up 0.1%, matching consensus expectations. Core prices are up 2.2% versus last year.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – rose 0.2% in December but are down 0.9% in the past year. Real *weekly* earnings are down 0.3% in the past year.

Implications: Energy prices have dropped substantially over the past three months. As a result, overall consumer prices remained unchanged for the second consecutive month in December, after a slight decline in October. Overall, consumer prices are down at a 0.4% annual rate in the past three months. However, the respite from inflation has been brief and we do not expect it to last. Monetary policy is very loose and the upward trend for inflation, *on a monthly basis*, will re-start soon. Despite this, the rapid increases in prices in the first three months of 2011 will now mean that the *year-ago comparison* for inflation – which now stands at 3% -- will look tamer over the next few months, even as prices move upward. Subdued prices over the past three months are not a justification for the Federal Reserve to pursue another round of quantitative easing. “Core” CPI, which excludes food and energy, was up 0.1% in December and is up 2.2% in the past year. This is higher than the Fed’s target range, which is supposed to max out at 2%. Moreover, in the past year, while core prices have grown 2.2%, owners’ equivalent rent, which makes up one-third of the core, is up 1.8%. Given the shift from home ownership toward rental occupancy, owners’ equivalent rent should accelerate over the next year, putting more upward pressure on the core. On the earnings front, “real” (inflation-adjusted) earnings per hour were up 0.2% in December. Although these earnings are down 0.9% from a year ago, the number of hours worked is up 2.4%, giving consumers more purchasing power.



CPI - U <i>All Data Seasonally Adjusted</i>	Dec-11	Nov-11	Oct-11	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	0.0%	0.0%	-0.1%	-0.4%	2.2%	3.0%
<i>Ex Food & Energy</i>	0.1%	0.2%	0.1%	1.8%	2.0%	2.2%
<i>Ex Energy</i>	0.2%	0.2%	0.1%	1.8%	2.2%	2.6%
Energy	-1.3%	-1.6%	-2.0%	-18.0%	1.9%	6.6%
Food and Beverages	0.2%	0.1%	0.1%	1.5%	3.4%	4.5%
Housing	0.1%	0.1%	0.1%	1.4%	2.0%	1.9%
Owners Equivalent Rent	0.2%	0.1%	0.2%	2.1%	2.3%	1.8%
New Vehicles	-0.2%	-0.3%	-0.3%	-3.4%	-1.7%	3.2%
Medical Care	0.4%	0.4%	0.5%	5.1%	3.9%	3.5%
Services (Excluding Energy Services)	0.3%	0.2%	0.2%	2.7%	2.5%	2.3%
Real Average Hourly Earnings	0.2%	0.0%	0.4%	2.4%	-0.2%	-0.9%

Source: U.S. Department of Labor