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Data Watch

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October CPI

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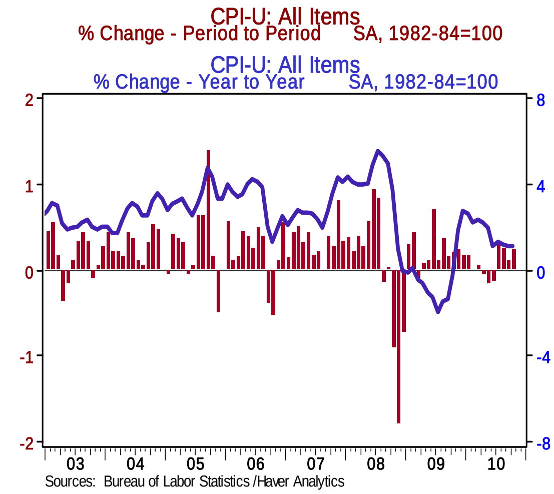
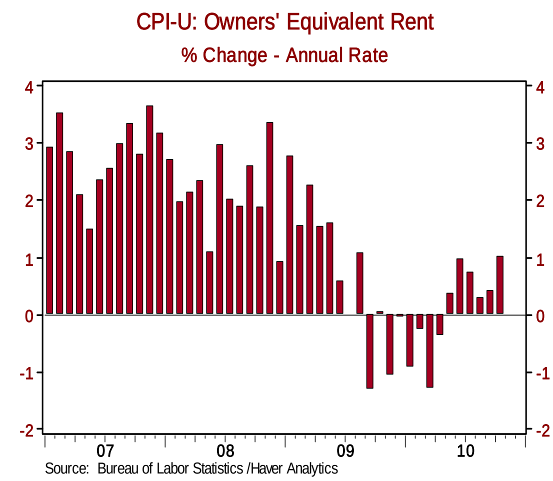
- The Consumer Price Index (CPI) increased 0.2% in October, slightly below the consensus expected gain of 0.3%. The CPI is up 1.2% versus a year ago.

- "Cash" inflation (which excludes the government's estimate of what a homeowner would charge himself for rent) was up 0.3% in October and is up 1.5% in the past year.

- Most of the increase in the CPI in October can be attributed to energy prices, which increased 2.6%. Food prices were up 0.1%. Excluding food and energy, the "core" CPI was unchanged in October, below the 0.1% increase the consensus expected. Core prices are up 0.6% versus last year.

- Real average hourly earnings – the cash earnings of production workers, adjusted for inflation – fell 0.1% in October but are up at a 0.8% annual rate in the past six months. Due to an increase in work hours, real *weekly* earnings are up at a 2.0% annual rate in the past six months.





Implications: Today's report on consumer prices again shows no signs of deflation. In the past three months, consumer prices are up at a 2.4% annual rate. Like the previous two months, most of the gain in October was due to energy. "Core" prices, which exclude food and energy, were unchanged in October and have been essentially unchanged in the past three months. Despite higher energy prices, overall consumer prices are up only 1.2% in the past year while core prices are up only 0.6%. So, although we don't have deflation, inflation has not yet become a serious problem either. However, the linkage between monetary policy and inflation is a long one, taking at least a year, possibly two. It was not until 17 months ago that the US economy emerged from a recession where nominal GDP growth – real GDP growth plus inflation – was negative. So it was only then when the policy of, essentially, zero percent interest rates became loose. Now that the economy is growing consistently and prices are rising, Fed policy is getting looser by the month, even without any additional round of "quantitative easing." Inflation will be up significantly in 2011.

CPI - U *All Data Seasonally Adjusted*	Oct-10	Sep-10	Aug-10	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.2%**	0.1%	0.3%	2.4%	1.2%	1.2%
Ex Food & Energy	**0.0%**	0.0%	0.0%	0.2%	0.9%	0.6%
Ex Energy	**0.0%**	0.0%	0.1%	0.5%	0.9%	0.7%
Energy	**2.6%**	0.7%	2.3%	24.6%	4.2%	5.9%
Food and Beverages	**0.1%**	0.3%	0.1%	2.1%	1.0%	1.4%
Housing	**0.1%**	-0.1%	0.0%	0.3%	0.2%	-0.2%
Owners Equivalent Rent	**0.1%**	0.0%	0.0%	0.6%	0.6%	0.0%
New Vehicles	**-0.2%**	0.1%	0.3%	0.8%	1.0%	0.4%
Medical Care	**0.1%**	0.6%	0.2%	4.2%	2.6%	3.4%
Services (Excluding Energy Services)	**0.1%**	0.1%	0.0%	0.8%	1.2%	0.8%
Real Average Hourly Earnings	**-0.1%**	0.1%	0.0%	0.0%	0.8%	0.5%

Source: U.S. Department of Labor