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May CPI

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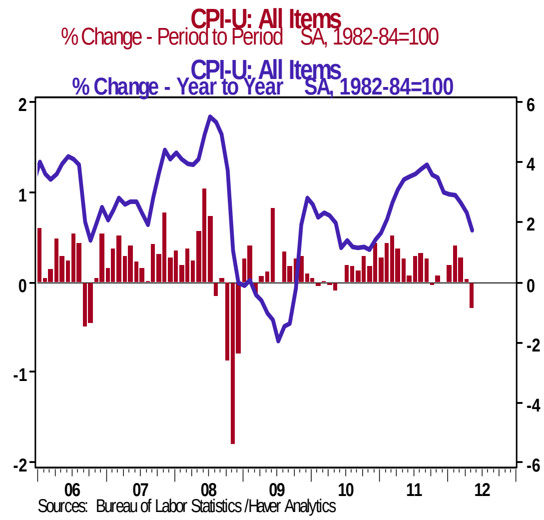
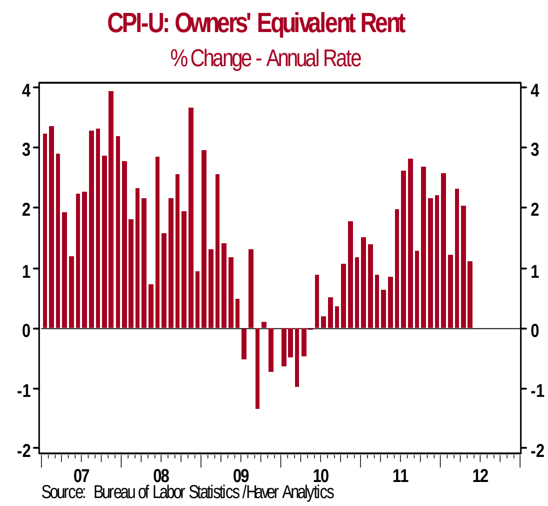
- The Consumer Price Index (CPI) fell 0.3% in May, coming in below the consensus expected drop of 0.2%. The CPI is up 1.7% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was down 0.4% in May, but is up 1.6% in the past year.
- The drop in CPI in May was lead by a 4.3% drop in energy, which more than offset widespread gains in most other major categories. The "core" CPI, which excludes food and energy, was up 0.2%, matching consensus expectations, and is up 2.3% versus last year.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were up 0.3% in May but are down 0.1% in the past year. Real *weekly* earnings are flat the past year.





Implications: Gas prices plummeted in May. As a result, consumer prices fell 0.3% in May, coming in slightly below consensus expectations. Excluding energy, consumer prices were up across the board. "Core" inflation, which excludes food and energy, was up 0.2% again in May and is up 2.3% from a year ago, hovering near the largest 12-month gain since September 2008. In the past three months, core prices are up at a 2.7% annual rate. These figures are already above the Federal Reserve's supposed target of 2%. Meanwhile, monetary policy is very loose and housing costs (which are measured by rents, not asset values) are rising. Owners' equivalent rent was up 0.1% in May and is up 2.1% versus a year ago. The ongoing shift from home ownership toward rental occupancy should boost this inflation measure even more in the year ahead. With loose monetary policy and housing costs accelerating, it's hard to see core inflation getting back down to the Fed's 2% target anytime soon. On the earnings front, "real" (inflation-adjusted) wages per hour were up 0.3% in May. Although these earnings are down 0.1% from a year ago, the number of hours worked is up 1.8%, giving consumers more purchasing power. In other news this morning, new claims for jobless benefits increased 6,000 last week to 386,000. Continuing claims for regular state benefits declined 33,000 to 3.28 million. Recent data on claims suggest weak payroll growth in June, roughly 50,000 non-farm and 60,000 private, although data over the next two weeks may revise this forecast. Regardless, June payroll growth has been relatively weak the past few years, so don't read too much into those figures. Job growth should accelerate again in the second half of the year.

CPI - U *All Data Seasonally Adjusted*	May-12	Apr-12	Mar-12	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**-0.3%**	0.0%	0.3%	0.2%	1.3%	1.7%
Ex Food & Energy	**0.2%**	0.2%	0.2%	2.7%	2.3%	2.3%
Ex Energy	**0.2%**	0.2%	0.2%	2.6%	2.2%	2.3%
Energy	**-4.3%**	-1.7%	0.9%	-18.9%	-6.4%	-3.9%
Food and Beverages	**0.0%**	0.2%	0.1%	1.6%	1.7%	2.7%
Housing	**0.0%**	0.1%	0.1%	1.0%	1.2%	1.6%
Owners Equivalent Rent	**0.1%**	0.2%	0.2%	1.8%	1.9%	2.1%
New Vehicles	**0.2%**	0.4%	0.2%	3.4%	2.5%	1.3%
Medical Care	**0.4%**	0.3%	0.3%	4.1%	3.8%	3.6%
Services (Excluding Energy Services)	**0.2%**	0.3%	0.2%	2.9%	2.6%	2.5%
Real Average Hourly Earnings	**0.3%**	0.1%	-0.1%	1.2%	0.2%	-0.1%

Source: U.S. Department of Labor