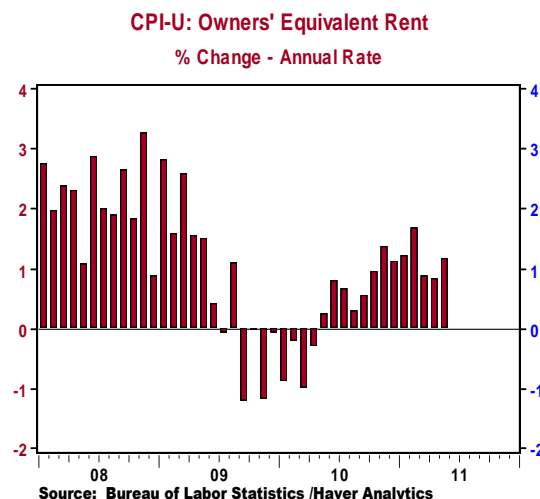
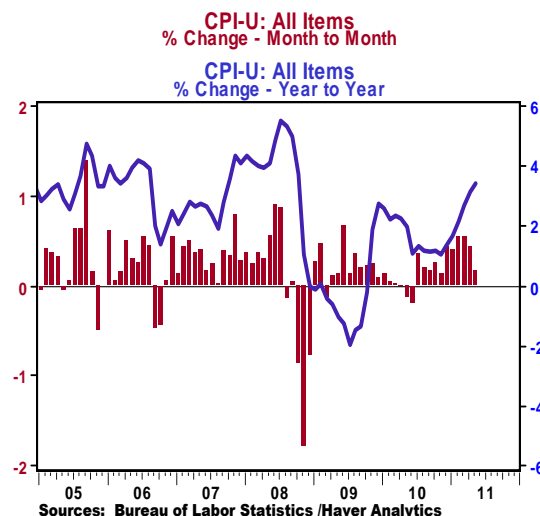


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May CPI

- The Consumer Price Index (CPI) increased 0.2% in May versus a consensus expected gain 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 up 0.2% in May and is up 4.2% in the past year.
- The rise in the CPI came despite a 1.0% drop in energy prices. Food prices were up 0.4%. Excluding food and energy, the “core” CPI increased 0.3% versus a consensus expected gain of 0.2%. Core prices are up 1.5% versus last year.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – rose 0.1% in May but are down 1.6% in the past year. Real *weekly* earnings are down 1.0% in the past year.

Implications: The Federal Reserve is running out of room to hide. Policymakers have used low “core” consumer 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 1.5% in the past year, they increased 0.3% in May – the most for any month since 2006 – and are up at a 2.5% annual rate in the past three months. The increase in core prices in May was broad-based, led by vehicle costs, shelter (homes and hotels), and clothing. The unusually sharp increase in auto prices in May is related to supply-chain disruptions from Japan. But accelerating core inflation is evident even without autos. The surprising news in today’s report was that, despite a 1% drop in energy prices, overall consumer prices still climbed 0.2%, which was more than the consensus expected. The CPI is up 3.6% in the past year. The measure we closely follow, “cash inflation,” is everything in the CPI (including food and energy) but without owners’ equivalent rent (the government’s estimate of what homeowners would pay if they rented their own homes). Cash inflation also increased 0.2% in May and is up 4.2% versus a year ago. 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 mid-2012.



CPI - U <i>All Data Seasonally Adjusted</i>	May-11	Apr-11	Mar-11	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	0.2%	0.4%	0.5%	4.6%	5.1%	3.6%
Ex Food & Energy	0.3%	0.2%	0.1%	2.5%	2.1%	1.5%
Ex Energy	0.3%	0.2%	0.2%	3.0%	2.6%	1.8%
Energy	-1.0%	2.2%	3.5%	20.3%	32.1%	21.5%
Food and Beverages	0.4%	0.4%	0.7%	6.1%	5.4%	3.4%
Housing	0.2%	0.2%	0.1%	2.0%	2.0%	1.2%
Owners Equivalent Rent	0.1%	0.1%	0.1%	0.9%	1.1%	0.9%
New Vehicles	1.1%	0.7%	0.7%	10.7%	6.7%	3.4%
Medical Care	0.2%	0.4%	0.2%	3.2%	3.2%	3.0%
Services (Excluding Energy Services)	0.2%	0.1%	0.2%	1.9%	1.9%	1.6%
Real Average Hourly Earnings	0.1%	-0.3%	-0.5%	-2.7%	-3.1%	-1.6%

Source: U.S. Department of Labor