

June 17, 2009

Inflation Remained Tame in May

Both the overall and core CPI rose just 0.1 percent in May, continuing the recent moderating trend in inflation. The overall CPI has declined at a 0.2 percent rate over the past three months and is down 1.3 percent year-to-year. Most of the decline is due to lower energy prices. Excluding food and energy, the CPI is up 1.8 percent year-to-year.

Inflation Worries Are Overblown, For Now

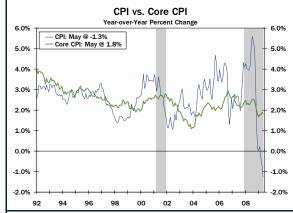
Critics of the Federal Reserve's aggressive unconventional response to the financial crisis got little support from this morning's inflation report. There is no evidence that inflation is a current problem or is about to become one. The Consumer Price Index rose just 0.1 percent in May, even though gasoline prices surged 3.1 percent during the month. The recession has left many businesses with way too much idle capacity, which has cut into pricing power. Prices are being slashed in many areas, as firms strive to reduce inventories.

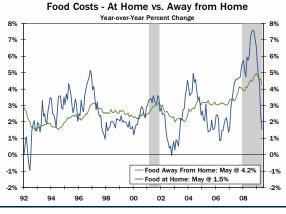
While gasoline prices rose sharply in May, prices for other energy products declined. Prices for household energy fell 1.8 percent in May, reflecting declines in fuel oil and natural gas prices. Prices for household energy, which account for 4.46 percent of the CPI, declined at a 20.6 percent pace during the past three months. Overall energy costs rose just 0.2 percent in May and are down 27.3 percent year-to-year.

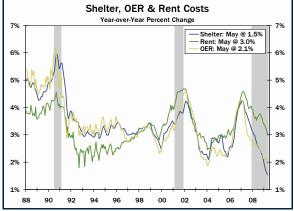
Food prices fell 0.2 percent in May and are now up just 2.7 percent over the past year. Grocery store prices fell even more dramatically, tumbling 0.5 percent in May and are now up just 1.5 percent over the past year, which is the smallest increase since December 2006. The food at home component of has fallen at a 5.5 percent annual rate over the past three months, reflecting declines in price of meats, dairy items, and cereals and bakery products. In addition, prices for fresh fruits and vegetables tumbled 1.0 percent in May and are now down 0.9 percent over the past year. The drop reflects sharply lower energy prices from one year ago, with gasoline down 39.4 percent over the past year.

The core CPI rose just 0.1 percent in May, which helped offset surprisingly large increases during the prior two months. Prices for tobacco products had been a huge contributor to those earlier price increases and prices gave back some of their recent gains in May, falling. 0.3 percent. There is very little evidence of inflationary pressures. Prices for clothing and apparel fell 0.2 percent in May, and prices for airline fares fell 1.5 percent. Both rent of primary residence and owners' equivalent rent rose 0.1 percent in May. Shelter costs, which account for 33.2 percent of the overall CPI and 42.7 percent of the core CPI are now up just 1.5 percent over the past year. Moreover, the trend is clearly moderating.

The latest CPI data give the Fed a free hand to continue operating the way they see fit. The flexibility is needed during this period of unprecedented financial strains. Any worries about inflation are at least a year premature. With unemployment rising and capacity utilization at its lowest level since the series began in 1967, we expect inflation to remain tame well into 2010.







Wachovia Economics Group publications are published by Wachovia Capital Markets, LLC ("WCM"). WCM is a US broker-dealer registered with the US Securities and Exchange Commission and a member of the New York Stock Exchange, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. This report is for your information only and is not an offer to sell, or a solicitation of an offer to buy, the securities or instruments named or described in this report. Interested parties are advised to contact the entity with which they deal, or the entity that provided this report to them, if they desire further information. The information in this report has been obtained or derived from sources believed by Wachovia Capital Markets, LLC, to be reliable, but Wachovia Capital Markets, LLC, does not represent that this information is accurate or complete. Any opinions or estimates contained in this report represent the judgment of Wachovia Capital Markets, LLC, at this time, and are subject to change without notice. © 2009 Wachovia Capital Markets, LLC.