



## Economics Group

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### CPI: Core Inflation Strengthens in May

*While the drop in gasoline prices restrained the headline's 0.2 percent gain, core CPI increased a stronger-than-expected 0.3 percent in May. Inflation continues to eat into consumers' purchasing power.*

#### Price Gains Stronger than Expected

Following a similar story line we saw from yesterday's producer price report, headline CPI rose a more modest 0.2 percent in May compared to the nearly half percentage point increases recorded over the past five months. That said, the CPI report was much stronger than the market had expected given the diverse make up of solid price increases. On a year-over-year basis, headline CPI is now up 3.6 percent, more than triple the pace consumer prices were exhibiting back in November.

Breaking a 10 month string of consecutive advances, the 2.0 percent drop in gasoline brought energy prices down 1.0 percent on the month. Despite last month's decline, gasoline prices have increased almost 24 percent over the past six months. Food and beverage prices continued to strengthen, rising 0.4 percent with increases in meats and cereal & bakery products offsetting declines in fruits & vegetables.

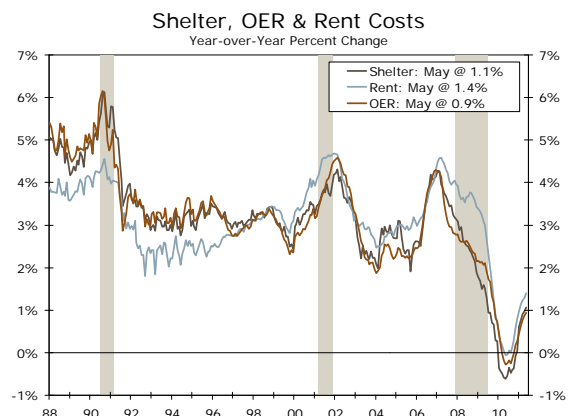
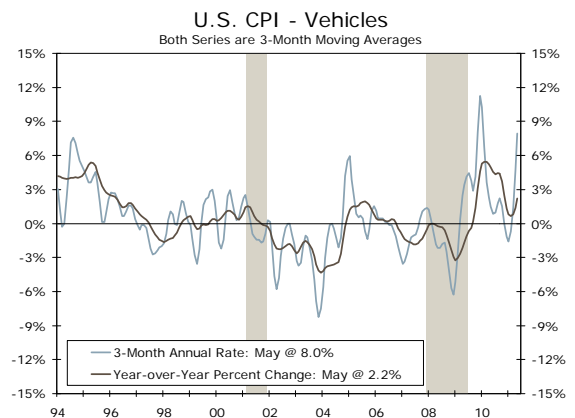
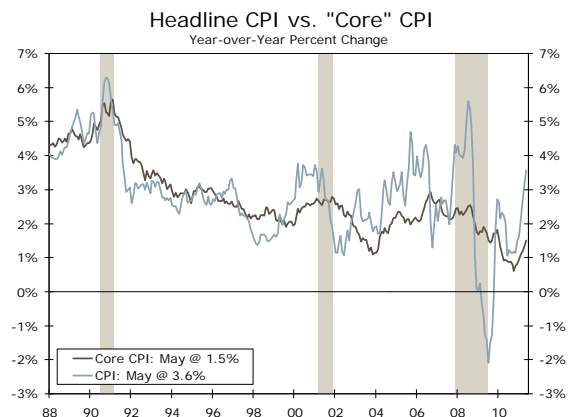
#### Core Price Increases Strengthening

Excluding food and energy, consumer prices outpaced the year-to-date monthly average and increased a stronger-than-expected 0.3 percent in May. Over the past three months, core CPI has increased at an annual rate of 2.5 percent, a rapid acceleration from the 0.4 percent pace set back in October.

Gains in the core were broad based. Both new and used car prices increased 1.1 percent last month. Improved demand coupled with supply shortages of some popular models due to supply-chain disruptions have manufacturers and auto dealers feeling more confident on the pricing front, a trend we expect to continue. Elsewhere, apparel prices jumped 1.2 percent while shelter costs increased 0.2 percent, primarily on the 2.9 percent jump in lodging away from home. Rents posted a modest 0.1 percent increase as more homeowners continue to choose to rent rather than purchase a home.

#### Consumer Inflation Outlook Still Biased Higher

Today's report provides further evidence of persistent price increases across a broad range of goods and services. We expect moderate upward price pressure to continue on both the headline and core measures. Although it's well below the 5.6 percent pace set back in mid-2008, headline consumer inflation is still poised to rise above 4.0 percent year-over-year before the year's end. Headline price increases are expected to moderate slightly in 2012, but should still rise in excess of 3.0 percent. Supported by persistent gains in shelter costs, the year-over-year pace of core CPI should increase to 2.1 percent by the fourth quarter. Given relatively sluggish income growth, our call for higher inflation suggests consumers' purchasing power should remain under downward pressure for some time, particularly for low and middle-income households.



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