



Economics Group

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Consumer Prices Jump in August

Led by gains in housing, gasoline and food, headline CPI inflation increased a stronger-than-expected 0.4 percent in August. Excluding food and energy, prices rose a trend-like 0.2 percent.

Despite Slowing Demand, Price Gains Remain Firm

Led by a wide range of price increases, the Consumer Price Index (CPI) surprised the markets this morning, rising a stronger-than-expected 0.4 percent in August. The increase lifted the year-over-year change to 3.8 percent, a level not seen since September 2008. Leading the August increase in headline CPI was a 1.2 percent rise in energy, its second consecutive monthly gain. The increase was primarily the result of the 1.9 percent boost in gasoline, which has held up quite well in the face of this summer's economic headwinds.

Higher food prices also cut into consumers' purchasing power this month, as the food index increased by a substantial 0.5 percent in August. With five of the six major grocery groups rising, the food at home index matched its July increase of 0.6 percent, while the cost of dining away from home rose 0.4 percent. While grocers and restaurateurs will likely continue to promote value items to drive traffic through the doors, rising food costs should remain problematic for consumers for quite some time.

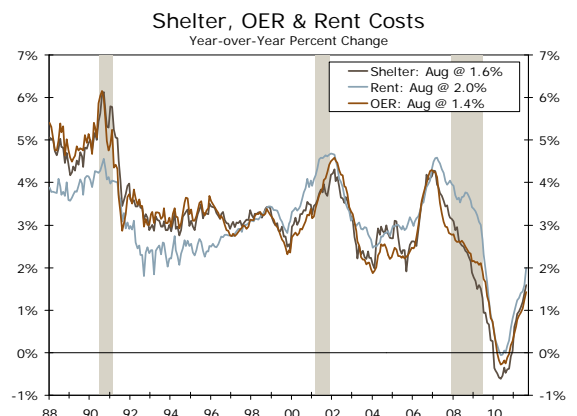
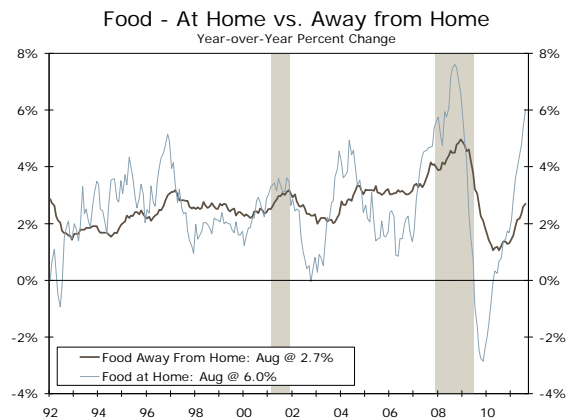
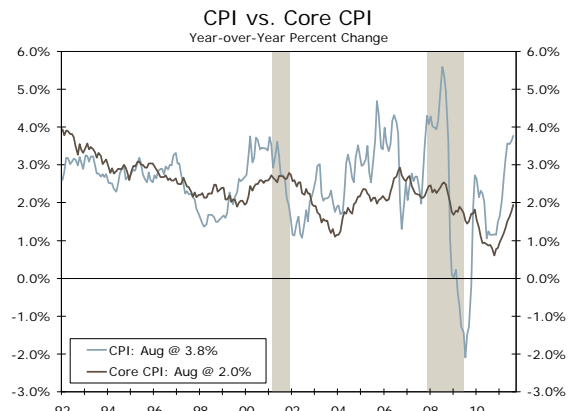
Core Inflation Strengthens

Excluding food and energy, consumer prices matched the year-to-date monthly average and increased 0.2 percent in August. Over the past three months, however, core CPI has increased at an annual rate of 2.9 percent, a rapid acceleration from the 0.4 percent pace set back in October. Year over year, the core CPI accelerated to a 2.0 percent pace. That is the highest level seen since November 2008 and far above the disinflationary levels that prevailed prior to the Federal Reserve's announcement of its QE2 program back in November 2010.

Gains in the core CPI were broad based. Reflecting higher cotton costs, apparel prices increased 1.1 percent, marking the fourth straight monthly rise of more than 1.0 percent. New vehicle prices increased 0.2 percent after much larger increases earlier this year due to cutbacks in sales incentives following the Japanese supply-chain disruptions. Owners' equivalent rent, which accounts for 32 percent of the core CPI, continued to press forward, rising 0.2 percent. Demand for rental properties remains strong. With little moderation in sight, we expect rental price increases to persist over the next year, keeping upward pressure on core inflation.

Deflation Not an Issue

Today's report provides further evidence of persistent price increases across a broad range of goods and services despite slowing demand. With regard to monetary policy, in our opinion, today's report raises the bar for additional easing at next week's FOMC meeting. Core inflation continues to rise more than the Fed had projected and suggests to us that the bar for additional security purchases (QE3) remains quite high.



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