



Inflation Observatory

July 15, 2009

June headline inflation exceeds expectations

- Energy prices drive up headline inflation
- Core price increases are modest but widespread
- Core inflation is expected to remain low but positive

Surging gasoline prices boost headline prices

June's headline consumer prices rose 0.7%, the largest increase since July 2008. Prices were primarily driven up by the 7.4% jump in energy prices, the largest monthly change since September 2005. Even though household fuels continued its eleven month decline, gasoline prices surged 17.3%, resulting in higher prices at the pump for consumers. Food prices broke their four month downward trend by remaining steady in June. Even though food prices are 2.1% above those of last June, energy prices have dropped 25.2%. As a result, in spite of the boost from gasoline, headline consumer prices dropped 1.4% from those twelve months ago. This is the fourth consecutive monthly decline and the largest in the history of the data.

Excluding food and energy, consumer prices rose 0.2% in June, up from 0.1% in May. Price increases were fairly widespread across the major components. Shelter rose 0.1%, boosted solely by a 0.4% increase in lodging away from home because rent of primary residence and owner's equivalent rent did not change. Putting an end to three months of declines, apparel rose 0.7%, driven by a 1.6% increase in women's clothing. Prices of new and used automobiles rose (0.5%), marking the sixth consecutive increase, as did those of medical care (0.2%), recreation (0.4%), education (0.1%) and other goods and services (0.35). Communication was the only major component that dropped (-0.1%). On a year-over-year basis, core inflation is 1.7% above that of last year and has averaged 1.8% for the first half of 2009.

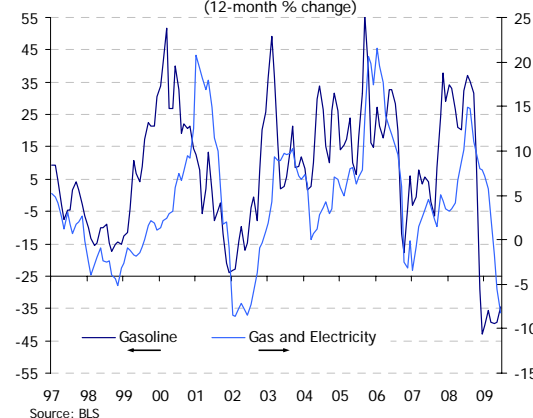
The results are in line with our baseline scenario

Given that the year-over-year decline in headline inflation can be attributed to energy prices, the declining trend is most likely transitory. Core prices, however, are in line with our baseline scenario and are expected to remain low but positive throughout 2009. The widespread price increases across most core components could indicate that downward price pressures are easing. Even though economic slack persists, inflation expectations are rising. In addition, the fiscal stimulus package and expansionary monetary policy could be relieving some of the downward pressure on prices. Taking into consideration that economic slack is expected to continue for some time, we expect the Federal Reserve to keep the Fed Funds rate unchanged for a prolonged period.

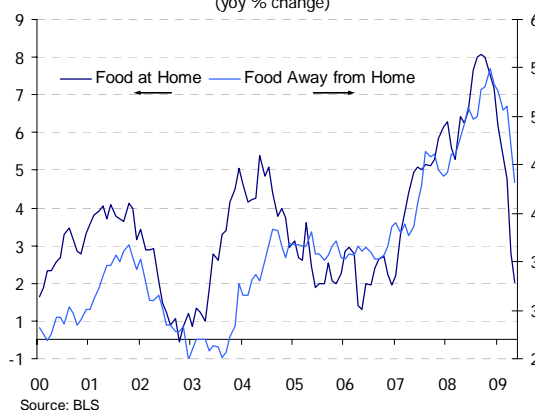
Kristin Lomicka

Kristin.Lomicka@bbvacompass.com

Gasoline and Gas & Electricity
(12-month % change)



Food Prices
(yoy % change)



Shelter Prices
(yoy % change)

