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Inflation Watch

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May 19, 2010

The Bureau of Labor Statistics released the March Consumer Price Index on Wednesday, May 19th and released the March Producer Price Index on Tuesday, May 18th 2010.

The following tables contain statistics on the Consumer Price Index (including the Median CPI), the Producer Price Index, the Personal Consumption Expenditure Index, and various sub-indices and special indices for all three.

Additional Information

To see charts for all the indices shown in the attached tables, go to the Inflation Watch section of our web site (<http://www.biancoresearch.com>).

Consumer Price Inflation

The Consumer Price Index rose **2.24%** from April 2009 to April 2010.

Within the eight major sub-groups:

Four groups are growing faster than the base rate. They comprise 28.00% of the index:

- Transportation (12.91%)
- Medical Care (3.66%)
- All Item Less Food (SA) (2.61%)
- Education and Communication (2.42%)

Five are growing slower than the base rate. They comprise 72.00% of the index:

- Other Goods and Services (2.22%)
- Food and Beverages (0.59)
- Recreation (-0.37%)
- Housing (-0.48%)
- Apparel (-0.90%)

The commonly watched special index, all items less food and energy (or "core rate"), rose **0.99%** in the April to April period.

Many prefer to watch the Federal Reserve Bank of Cleveland's Median CPI as a better measure of the "core rate." This index rose **0.40%** on a year-over-year basis.

Two other special indices are notable on a year-over-year basis. The energy index **rose 18.77%** while the energy commodities index **rose 38.50%**.

Personal Consumption Expenditures

In the year ending **March** 2010, the PCE Index increased 2.02%. The "core" PCE Index (less food and energy) increased by 1.33%.

Producer Price Inflation

In the twelve months ending April 2010, the Producer Price Index for Finished Goods rose 5.39%, the Producer Price Index for Intermediate Goods rose 8.54%, and the Producer Price Index for Crude Materials rose 28.93%.

Owners' Equivalent Rent: An Update

We concluded in [October 2009](#) and affirmed in [January](#):

As the FOMC has stated its intention to wind down this facet of quantitative easing by the end of the first quarter of 2010, we should expect a shift at the margin from homeownership back to tenancy; this will support the OER indicator by the second quarter of 2010. Termination of the tax credit for qualified first-time homebuyers will have the same effect, if and when enacted.

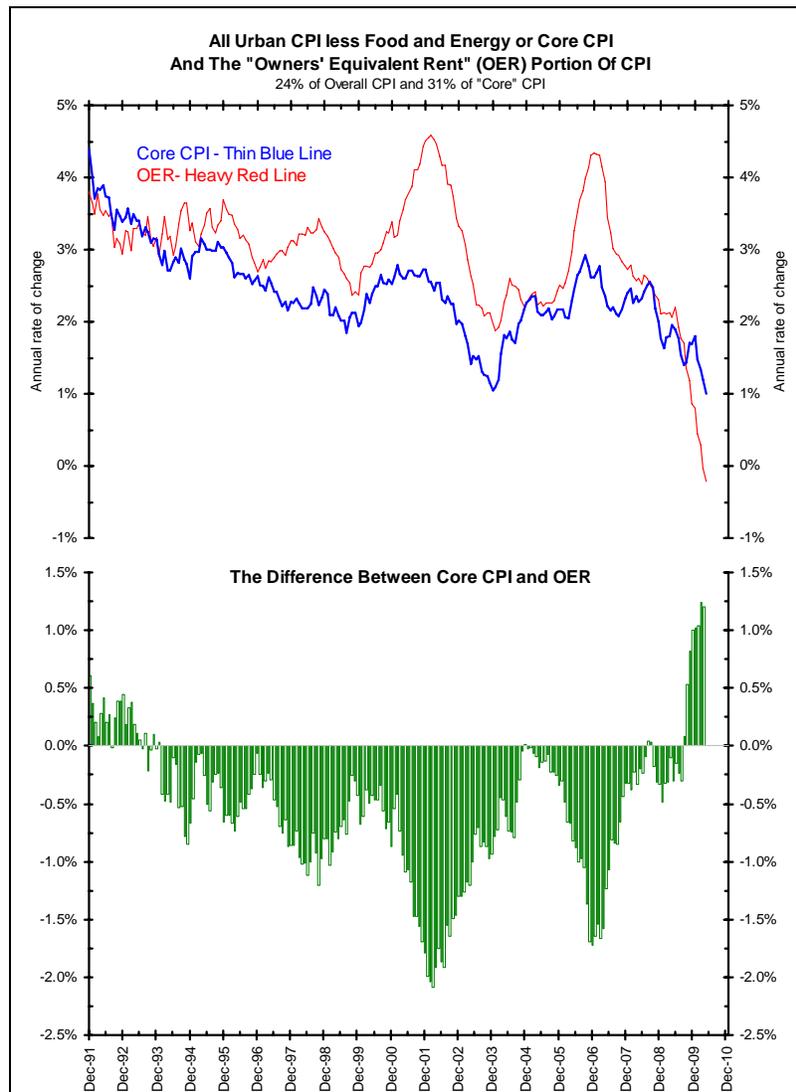
The end of downward pressure on consumer price indices resulting from OER is coming into view.

Most commentary about the recent inflation statistics concludes that core inflation is well-behaved. This brings great comfort to the Federal Reserve as they

believe their bloated balance sheet is not posing an inflation risk.

However, see the chart below. The top panel shows Core CPI in blue and the Owners' Equivalent Rent (OER) portion of CPI in red. Note that OER is the single largest category of CPI, accounting for 24% of headline (overall) CPI and 31% of core CPI. Considering it actually turned negative on an annual basis for the first time in the history of the data set, this is weighing heavily on the headline number.

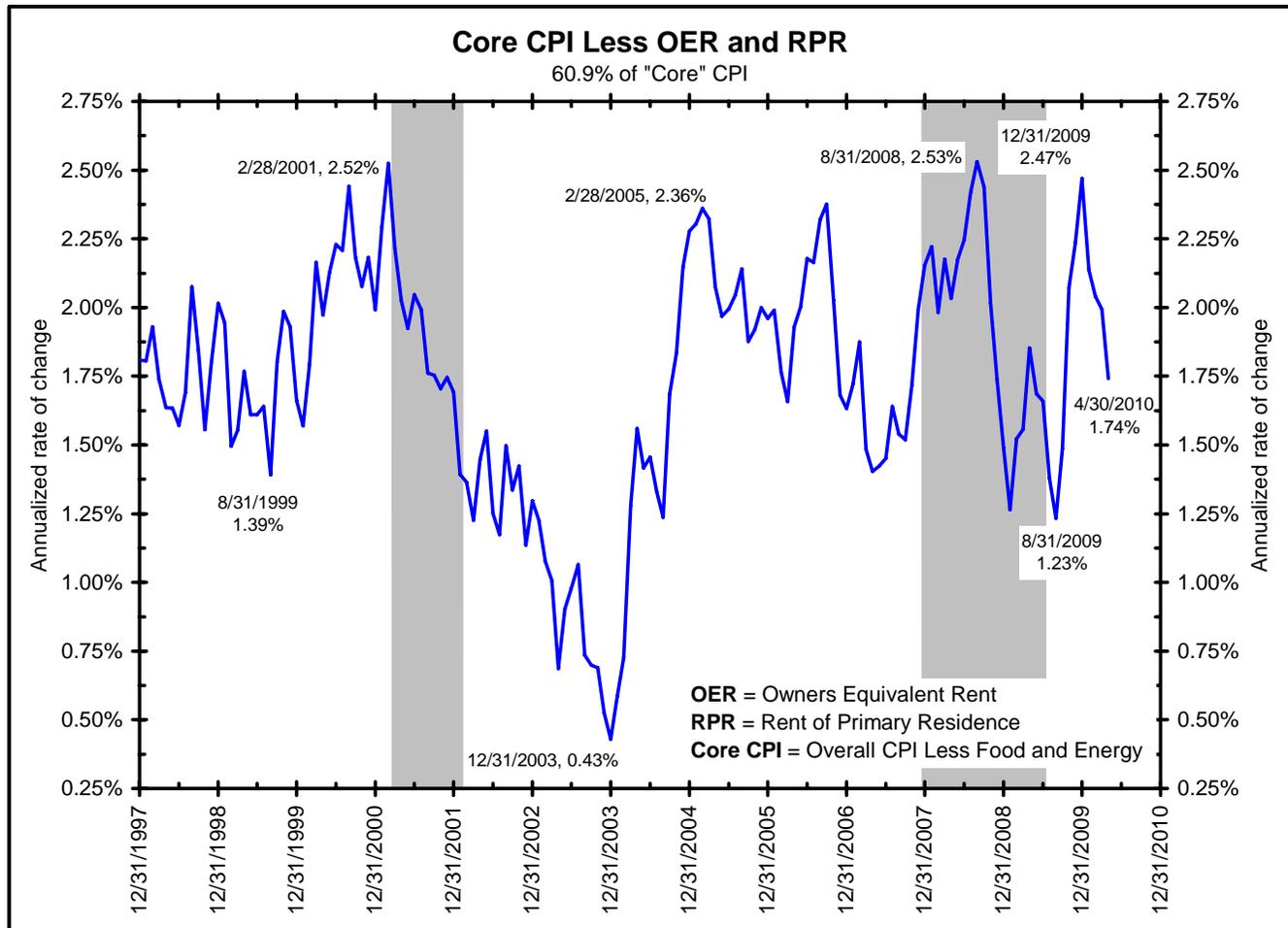
The bottom panel shows the difference between these two measures in green. Recently it turned positive for the first time in nearly 20 years. Restated, core CPI is showing more inflation **relative** to OER for the first time since OER was adopted in the 1990s.



Core CPI Less OER And RPR

The chart below shows Core CPI *less* OER and Rent of Primary Residence (RPR). Although this measure has declined since December, keep in mind that the data is only through April. The end of

the homebuyers' tax credit will not **start to** be reflected until next month's CPI release. Given the [abysmal mortgage purchase application numbers](#) since this credit expired, do not be surprised if the inflation numbers reflect this change in the coming months.



What Happens Next?

[Last October](#) we argued that all the government intervention in the housing market distorted the rental market in ways the BLS could not imagine. Specifically, we said:

The government subsidizes housing by suppressing forecloses and offering tax credits for first time home buyers. This causes rental vacancies to soar and rents to fall. These rentals are the basis for arguably the largest and most influential component of core inflation. It causes OER to plunge and will most likely take core measures of inflation with it.

As the chart on the previous page shows, this has largely happened. The year-over-year change in

OER (red line, top panel) has plunged in recent months and provided a negative influence on core CPI. So, what happens when OER bottoms? Core CPI could soar. When will OER bottom?

In last month's [Inflation Watch](#) we updated our use of REIT stocks to predict OER:

We should expect higher rates to manifest themselves in a reduced wealth transfer from taxpayers and prospective homebuyers to existing homeowners and mortgagees looking to sell. This effect, if allowed to operate, will lead to increased demand for tenancy, higher OER and an increase in the relative performance of apartment REITs vis-à-vis all REITs.

Consumer Price Index

	Annualized through April 2010								Index Weights as of 12/31/2008
	Apr 2010	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Consumer Price Index									
All Urban Consumers									
All Items (NSA)	0.17%	2.46%	1.70%	2.24%	1.79%	2.30%	2.44%	2.66%	100.000
All Items (SA)	-0.07%	-0.01%	1.13%	2.31%	1.84%	2.30%	2.44%	2.65%	100.000
Food and beverages (SA)	0.16%	1.75%	1.76%	0.59%	2.91%	2.86%	2.77%	2.63%	15.757
Housing (SA)	-0.07%	-0.10%	-0.77%	-0.48%	1.20%	2.14%	2.56%	2.69%	43.421
Owners' Equivalent Rent (SA)	-0.03%	-0.65%	-0.63%	-0.21%	1.48%	2.26%	2.64%	2.95%	24.433
Rent of Primary Residence (NSA)	-0.03%	-0.21%	0.10%	0.05%	2.24%	2.89%	3.17%	3.03%	5.957
Apparel-SA	-0.72%	-6.95%	-3.45%	-0.90%	-0.20%	-0.29%	-0.92%	-0.23%	3.691
Transportation (SA)	-0.49%	-2.76%	5.39%	12.91%	1.69%	2.17%	2.35%	2.48%	15.314
Medical care (SA)	0.23%	4.43%	4.11%	3.66%	3.66%	3.81%	4.12%	4.53%	6.390
Recreation (SA)	0.28%	0.31%	-0.91%	-0.37%	0.72%	0.83%	1.01%	N/A	5.741
Education and communication (SA)	0.25%	3.08%	2.46%	2.42%	3.00%	2.75%	2.43%	N/A	6.301
Other goods and services (SA)	-0.04%	0.42%	1.53%	2.22%	4.50%	3.99%	3.36%	4.52%	3.386
Special indexes									
All items less food (SA)	-0.11%	-0.32%	1.01%	2.61%	1.66%	2.20%	2.38%	2.66%	85.371
All items less energy (SA)	0.07%	0.76%	0.53%	0.92%	1.92%	2.11%	2.16%	2.54%	92.373
All items less food and energy (SA)	0.05%	0.55%	0.29%	0.99%	1.74%	1.98%	2.04%	2.53%	77.746
Energy (SA)	-1.42%	-7.59%	7.72%	18.77%	1.02%	4.20%	5.70%	3.94%	7.624
Energy commodities (SA)	-2.12%	-16.53%	10.15%	38.50%	0.89%	4.41%	6.55%	4.88%	3.465
Median CPI	0.00%	0.00%	0.00%	0.40%	2.02%	2.49%	2.65%	2.87%	100.000

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

Federal Reserve Bank of Cleveland (<http://www.clev.frb.org/Research/index.htm#cp>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

	12 Months through April 2010	10 Year High ¹	Date	10 Year Low ¹	Date
Consumer Price Index					
All Urban Consumers					
All Items (NSA)	2.24%	5.60%	Jul 2008	-2.10%	Jul 2009
All Items (SA)	2.31%	5.36%	Aug 2008	-2.15%	Jul 2009
Food and beverages (SA)	0.59%	6.11%	Oct 2008	-0.49%	Nov 2009
Housing (SA)	-0.48%	4.80%	Jan 2001	-0.76%	Jul 2009
Owners' Equivalent Rent (SA)	-0.21%	4.59%	Feb 2002	-0.21%	Apr 2010
Rent of Primary Residence (NSA)	0.05%	4.69%	Dec 2001	0.05%	Apr 2010
Apparel-SA	-0.90%	2.46%	Feb 2007	-3.99%	Apr 2003
Transportation (SA)	12.91%	14.22%	Jan 2010	-14.42%	Jul 2009
Medical care (SA)	3.66%	5.15%	Dec 2007	2.52%	Jan 2009
Recreation (SA)	-0.37%	2.42%	Aug 2008	-1.06%	Mar 2010
Education and communication (SA)	2.42%	3.68%	Jul 2008	0.89%	Sep 2000
Other goods and services (SA)	2.22%	8.05%	Dec 2009	0.98%	Sep 2003
Special indexes					
All items less food (SA)	2.61%	5.26%	Jul 2008	-2.62%	Jul 2009
All items less energy (SA)	0.92%	3.11%	Aug 2008	0.92%	Apr 2010
All items less food and energy (SA)	0.99%	2.93%	Sep 2006	0.99%	Apr 2010
Energy (SA)	18.77%	34.25%	Sep 2005	-29.45%	Jul 2009
Energy commodities (SA)	38.50%	52.47%	Sep 2005	-40.79%	Dec 2008
Median CPI	0.40%	4.01%	Nov 2001	0.40%	Apr 2010

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

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NSA = Not seasonally adjusted

SA = Seasonally adjusted

¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

Personal Consumption Expenditures

	Annualized through March 2010							
	Mar 2010	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years
Personal Consumption Expenditures								
PCE								
All Items (SA)	0.09%	1.10%	1.79%	2.02%	1.89%	2.24%	1.05%	1.67%
Core PCE - Less Food and Energy	0.08%	0.49%	1.13%	1.33%	1.80%	1.98%	0.96%	1.64%
Durable Goods								
All (SA)	0.11%	-3.00%	-1.82%	-1.67%	-1.59%	-1.59%	-0.79%	-0.60%
Motor Vehicles and Parts (SA)	0.14%	2.10%	5.42%	5.58%	0.97%	0.46%	0.23%	1.05%
Furniture and Household Equipment	-0.09%	-3.14%	-4.29%	-4.11%	-1.47%	-1.10%	-0.64%	-2.04%
Other (SA)	0.67%	-11.76%	-5.23%	-1.98%	1.58%	1.91%	1.02%	0.67%
Nondurable Goods								
All (SA)	-0.06%	2.77%	3.00%	5.21%	2.33%	2.73%	1.21%	1.54%
Food (SA)	0.32%	2.28%	1.86%	-0.50%	2.81%	2.74%	1.35%	1.74%
Clothing and Shoes (SA)	-0.56%	-4.16%	-2.87%	-0.41%	-0.49%	-0.59%	-0.25%	-0.51%
Gasoline, Fuel Oil, and Other Energy	-0.97%	10.05%	16.02%	35.17%	2.02%	6.20%	1.89%	2.74%
Other (SA)	0.18%	3.12%	1.37%	3.11%	3.14%	2.63%	1.32%	1.88%
Services								
All (SA)	0.14%	1.19%	1.95%	1.57%	2.33%	2.76%	1.33%	2.22%
Housing (SA)	0.13%	0.78%	0.69%	0.09%	1.91%	2.85%	1.37%	2.19%
Household Operation (SA)	0.17%	1.41%	2.13%	1.66%	2.44%	2.85%	1.49%	1.47%
Transportation (SA)	0.25%	0.82%	2.61%	2.37%	3.58%	3.51%	1.70%	2.26%
Medical care (SA)	0.18%	1.93%	2.52%	2.46%	2.58%	2.88%	1.46%	2.61%
Recreation (SA)	-0.01%	-3.53%	-5.04%	-6.24%	-5.41%	-5.52%	-2.59%	0.24%
Other (SA)	0.54%	3.51%	3.62%	2.59%	3.09%	3.15%	1.36%	2.34%

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

Federal Reserve Bank of Cleveland (<http://www.clev.frb.org/Research/index.htm#pci>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

	12 Months through March 2010	10 Year High ¹	Date	10 Year Low ¹	Date
Personal Consumption Expenditures					
PCE					
All Items (SA)	2.02%	4.51%	Jul 2008	-0.88%	Jul 2009
Core PCE - Less Food and Energy (SA)	1.33%	2.68%	Jul 2008	1.15%	Jul 2009
Durable Goods					
All (SA)	-1.67%	-0.56%	Dec 2004	-4.19%	Oct 2003
Motor Vehicles and Parts (SA)	5.58%	5.68%	Dec 2009	-4.04%	Oct 2003
Furniture and Household Equipment (SA)	-4.11%	1.27%	Apr 2009	-4.11%	Mar 2010
Other (SA)	-1.98%	7.06%	Apr 2008	-3.08%	Jan 2003
Non-Durable Goods					
All (SA)	5.21%	9.24%	Jul 2008	-5.62%	Jul 2009
Food (SA)	-0.50%	7.03%	Oct 2008	-1.85%	Nov 2009
Clothing and Shoes (SA)	-0.41%	2.16%	Dec 2009	-4.08%	Jan 2002
Gasoline, Fuel Oil, and Other Energy (SA)	35.17%	54.14%	Sep 2005	-39.52%	Dec 2008
Other (SA)	3.11%	5.41%	Jul 2009	-0.26%	Jun 2003
Services					
All (SA)	1.57%	3.88%	Jul 2008	0.90%	Sep 2009
Housing (SA)	0.09%	5.16%	May 2001	-0.01%	Feb 2010
Household Operation (SA)	1.66%	3.99%	Jul 2008	1.03%	Sep 2009
Transportation (SA)	2.37%	6.85%	Sep 2008	-1.03%	Oct 2001
Medical care (SA)	2.37%	4.25%	Feb 2004	2.18%	Dec 2008
Recreation (SA)	2.46%	-3.60%	Nov 2008	-7.59%	Sep 2001
Other (SA)	-6.24%	4.83%	Jul 2008	1.33%	Aug 2009

Producer Price Index

	Annualized through April 2010								Index Weights as of 12/31/2007
	Apr 2010	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Producer Price Index									
Commodities									
All (NSA)	0.60%	5.38%	10.65%	9.05%	2.47%	3.53%	3.50%	2.43%	100.000
Industrial (NSA)	0.65%	4.85%	10.37%	10.07%	2.43%	3.52%	3.52%	2.54%	85.907
Farm Products (NSA)	-1.06%	14.63%	25.51%	8.92%	1.78%	4.30%	3.90%	1.38%	14.093
Finished Goods									
All (SA)	-0.11%	0.00%	7.64%	5.39%	2.78%	3.12%	2.76%	2.15%	100.000
All Less Energy (SA)	0.11%	3.49%	3.98%	1.91%	2.70%	2.44%	1.98%	1.72%	78.252
Finished consumer goods (SA)	-0.16%	0.00%	8.44%	7.94%	3.13%	3.60%	3.28%	2.47%	78.317
Capital equipment (SA)	0.19%	0.51%	1.41%	0.38%	1.84%	1.75%	1.29%	1.28%	21.683
Intermediate Goods									
All (SA)	0.77%	5.66%	10.23%	8.54%	2.75%	3.86%	3.61%	2.44%	100.000
Manufacturing (SA)	0.25%	1.52%	1.01%	0.88%	-0.17%	1.98%	2.24%	1.52%	41.976
Construction (SA)	0.63%	7.94%	4.00%	1.78%	2.41%	3.30%	3.14%	2.62%	13.391
Processed fuels and lubricants (SA)	0.06%	-8.74%	19.55%	23.47%	2.13%	5.15%	6.39%	4.16%	22.234
Containers (SA)	0.81%	15.09%	7.06%	1.47%	3.73%	3.60%	2.81%	2.26%	2.933
Supplies (SA)	0.23%	1.39%	2.11%	1.05%	2.61%	2.83%	2.44%	1.91%	19.466
Crude materials									
All (SA)	-1.17%	-6.20%	30.54%	28.93%	1.03%	3.78%	6.60%	3.66%	100.000
Foodstuffs and feedstuffs (SA)	0.94%	12.05%	23.13%	9.26%	1.16%	3.60%	3.76%	1.36%	32.604
Nonfood except fuel (SA)	3.70%	34.08%	39.86%	60.02%	9.02%	11.38%	10.30%	5.91%	40.991
Fuel (SA)	-14.76%	-67.14%	24.68%	10.73%	-11.19%	-7.18%	4.82%	3.60%	26.405

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

Federal Reserve Bank of Cleveland (<http://www.clev.frb.org/Research/index.htm#pci>)

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SA = Seasonally adjusted

	12 Months through April 2010	10 Year High ¹	Date	10 Year Low ¹	Date
Producer Price Index					
Commodities					
All (NSA)	9.05%	17.42%	Jul 2008	-16.10%	Jul 2009
Industrial (NSA)	10.07%	17.82%	Jul 2008	-16.60%	Jul 2009
Farm Products (NSA)	8.92%	29.96%	May 2007	-24.50%	Jul 2009
Finished Goods					
All (SA)	5.39%	9.51%	Aug 2008	-6.59%	Jul 2009
All Less Energy (SA)	1.91%	5.22%	Aug 2008	-0.94%	Sep 2002
Finished consumer goods (SA)	7.94%	11.75%	Aug 2008	-9.02%	Jul 2009
Capital equipment (SA)	0.38%	4.17%	Jan 2009	-1.00%	Aug 2002
Intermediate Goods					
All (SA)	8.54%	16.81%	Jul 2008	-15.14%	Jul 2009
Manufacturing (SA)	0.88%	15.54%	Aug 2008	-15.41%	Aug 2009
Construction (SA)	1.78%	13.82%	Sep 2008	-8.09%	Sep 2009
Processed fuels and lubricants (SA)	23.47%	37.59%	Oct 2005	-35.44%	Jul 2009
Containers (SA)	1.47%	9.33%	Sep 2008	-3.27%	Nov 2009
Supplies (SA)	1.05%	10.37%	Aug 2008	-4.14%	Aug 2009
Crude materials					
All (SA)	28.93%	55.06%	Jan 2001	-45.02%	Jul 2009
Foodstuffs and feedstuffs (SA)	9.26%	31.79%	May 2007	-25.68%	Jul 2009
Nonfood except fuel SA)	60.02%	68.93%	Jan 2010	-47.84%	Apr 2009
Fuel (SA)	10.73%	223.46%	Jan 2001	-67.56%	Jan 2002

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

Federal Reserve Bank of Cleveland (<http://www.clev.frb.org/Research/index.htm#pci>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

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