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Inflation Watch

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The Bureau of Labor Statistics released the August Consumer Price Index on Friday, September 17th and released the August Producer Price Index on Thursday, September 16th 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 **1.15%** from August 2009 to August 2010.

Within the eight major sub-groups:

Five groups are growing faster than the base rate. They comprise 31.39% of the index:

- Transportation (5.24%)
- Medical Care (3.16%)
- Other Goods and Services (2.96%)
- Education and Communication (1.88%)
- All Item Less Food (SA) (1.31%)

Four are growing slower than the base rate. They comprise 68.61% of the index:

- Food and Beverages (0.98)
- Housing (-0.21%)
- Apparel (-0.46%)
- Recreation (-1.18 %)

The commonly watched special index, all items less food and energy (or "core rate"), rose **0.95%** in the August to August 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 4.61%** while the energy commodities index **rose 6.34%**.

Personal Consumption Expenditures

In the year ending **July 2010**, the PCE Index increased 1.54%. The "core" PCE Index (less food and energy) increased by 1.38%.

Producer Price Inflation

In the twelve months ending August 2010, the Producer Price Index for Finished Goods rose 3.04%, the Producer Price Index for Intermediate Goods rose 4.96%, and the Producer Price Index for Crude Materials rose 18.17%.

Owners' Equivalent Rent: An Update

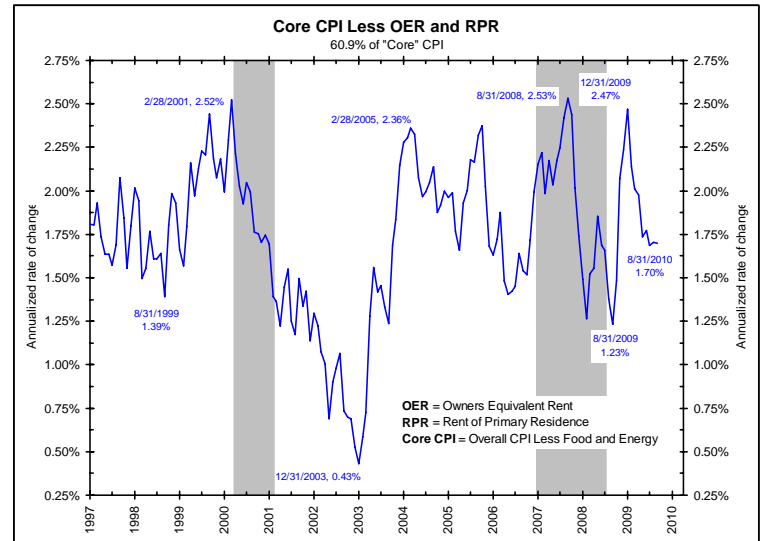
For several months [these pages](#) have closely watched Owners' Equivalent Rent (OER), arguing it is the most influential component of core inflation.

To this end we have demonstrated that rents are contra-cyclical with housing. That is, they rise when home prices struggle (as the migration from renting to owning slows) and they fall when home prices boom (as the migration from renting to owning speeds up).

In recent months, and especially in our April [Inflation Watch](#), we have been looking for a turn-around in OER coincident with the end of the first time homebuyers' tax credit. Although this now appears to be happening, the headline number is not following suit. Why is this?

The blue line in the chart below shows the growth in OER on a 3-month annualized basis. Over this shorter time frame, OER has turned higher as we would expect with sharply declining home purchases supporting home rental rates. However, as the red line shows, the annualized rate is still slightly negative. A chart showing Rents of Primary Residences (RPR) would look much the same.

1.70% as of August 31st. This is about the middle of its range over the last few years.

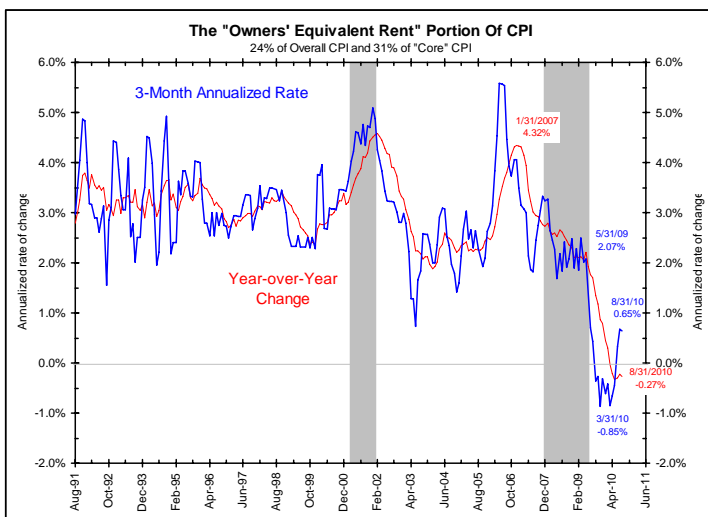


Conclusion

At roughly the same time that OER began to turn higher, the annualized rate of change in everything excluding OER and RPR peaked and turned lower. In essence these two measures have cancelled each other out, which is why the Core CPI number has not gone higher.

If the range on Core CPI Less OER and RPR between 1.25% and 2.50% holds, then a rising OER and RPR will result in a higher overall core inflation rate. Right now, we have no reason to believe that Core CPI less OER and RPR will break from this range that has held for 5 years, which encompasses the Great Recession. Sum it up and a core inflation rate of 1.25% to 1.50% is possible next year, as both OER and RPR settle back into this range which was common prior to 2009.

To the lay person a 1.25% to 1.50% core inflation rate versus a 0.9% core inflation rate may be nothing more than a rounding error. In normal times, it is. However, these are not normal times. With the Federal Reserve holding the funds rate near zero for an "extended period" and Quantitatively Easing, this type of uptick in inflation could make the markets uncomfortable with current FOMC policy.



Will Core Turn Soon?

Together OER and RPR make up 39.1% of core CPI and are growing at an annualized rate near zero.

What about the other 60.9% of core inflation? As the chart below shows, the 12-month annualized growth rate of "Core CPI Less OER and RPR" was

Consumer Price Index

	Annualized through August 2010								Index Weights as of 12/31/2008
	Aug 2010	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Consumer Price Index									
All Urban Consumers									
All Items (NSA)	0.14%	0.25%	1.46%	1.15%	1.64%	2.14%	2.37%	2.56%	100.000
All Items (SA)	0.25%	1.72%	0.51%	1.26%	1.64%	2.15%	2.36%	2.56%	100.000
Food and beverages (SA)	0.15%	0.36%	1.03%	0.98%	2.45%	2.81%	2.66%	2.55%	15.757
Housing (SA)	0.04%	0.19%	0.09%	-0.21%	1.00%	2.00%	2.42%	2.59%	43.421
Owners' Equivalent Rent (SA)	0.02%	0.65%	0.10%	-0.27%	1.31%	2.13%	2.56%	2.83%	24.433
Rent of Primary Residence (NSA)	-0.04%	0.16%	0.01%	0.00%	1.91%	2.70%	3.04%	2.94%	5.957
Apparel-SA	-0.14%	5.03%	0.65%	-0.46%	0.64%	0.13%	-0.67%	-0.18%	3.691
Transportation (SA)	1.24%	6.28%	-0.44%	5.24%	1.46%	1.70%	2.33%	2.37%	15.314
Medical care (SA)	0.23%	1.77%	2.16%	3.16%	3.26%	3.71%	4.02%	4.39%	6.390
Recreation (SA)	-0.20%	-0.64%	-0.07%	-1.18%	0.65%	0.72%	0.90%	N/A	5.741
Education and communication (SA)	0.01%	1.35%	1.91%	1.88%	2.75%	2.79%	2.39%	N/A	6.301
Other goods and services (SA)	0.28%	5.89%	3.42%	2.96%	4.83%	4.09%	3.54%	4.45%	3.386
Special indexes									
All items less food (SA)	0.27%	1.96%	0.44%	1.31%	1.51%	2.04%	2.31%	2.57%	85.371
All items less energy (SA)	0.06%	1.18%	1.07%	0.95%	1.76%	2.10%	2.11%	2.46%	92.373
All items less food and energy (SA)	0.05%	1.35%	1.09%	0.95%	1.63%	1.97%	2.00%	2.45%	77.746
Energy (SA)	2.29%	7.58%	-5.07%	4.61%	0.48%	2.71%	5.38%	3.67%	7.624
Energy commodities (SA)	3.76%	15.09%	-8.83%	6.34%	-0.39%	2.38%	6.45%	4.37%	3.465
Median CPI	0.10%	1.21%	0.60%	0.40%	1.85%	2.36%	2.58%	2.79%	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 August 2010	10 Year High ¹	Date	10 Year Low ¹	Date
Consumer Price Index					
All Urban Consumers					
All Items (NSA)	1.15%	5.60%	Jul 2008	-2.10%	Jul 2009
All Items (SA)	1.26%	5.36%	Aug 2008	-2.15%	Jul 2009
Food and beverages (SA)	0.98%	6.11%	Oct 2008	-0.49%	Nov 2009
Housing (SA)	-0.21%	4.80%	Jan 2001	-0.76%	Jul 2009
Owners' Equivalent Rent (SA)	-0.27%	4.59%	Feb 2002	-0.33%	May 2010
Rent of Primary Residence (NSA)	0.00%	4.69%	Dec 2001	-0.06%	May 2010
Apparel-SA	-0.46%	2.46%	Feb 2007	-3.99%	Apr 2003
Transportation (SA)	5.24%	14.22%	Jan 2010	-14.42%	Jul 2009
Medical care (SA)	3.16%	5.15%	Dec 2007	2.52%	Jan 2009
Recreation (SA)	-1.18%	2.42%	Aug 2008	-1.18%	Aug 2010
Education and communication (SA)	1.88%	3.68%	Jul 2008	0.89%	Sep 2000
Other goods and services (SA)	2.96%	8.05%	Dec 2009	0.98%	Sep 2003
Special indexes					
All items less food (SA)	1.31%	5.26%	Jul 2008	-2.62%	Jul 2009
All items less energy (SA)	0.95%	3.11%	Aug 2008	0.90%	Jun 2010
All items less food and energy (SA)	0.95%	2.93%	Sep 2006	0.93%	Jun 2010
Energy (SA)	4.61%	34.25%	Sep 2005	-29.45%	Jul 2009
Energy commodities (SA)	6.34%	52.47%	Sep 2005	-40.79%	Dec 2008
Median CPI	0.40%	4.01%	Nov 2001	0.30%	May 2010

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
¹ Education and communication Index started January 1994
¹ Recreation Index started January 1994

Personal Consumption Expenditures

	Annualized through July 2010							
	Jul 2010	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years
Personal Consumption Expenditures								
PCE								
All Items (SA)	0.24%	0.02%	0.36%	1.54%	1.73%	2.15%	1.03%	1.62%
Core PCE - Less Food and Energy	0.11%	1.04%	1.08%	1.38%	1.78%	1.99%	0.99%	1.60%
Durable Goods								
All (SA)	-0.26%	-3.21%	-2.09%	-1.42%	-1.58%	-1.57%	-0.80%	-0.62%
Motor Vehicles and Parts (SA)	0.27%	2.89%	2.86%	5.26%	1.38%	0.75%	0.35%	1.13%
Furniture and Household Equipment	-0.49%	-6.19%	-5.19%	-4.96%	-1.97%	-1.41%	-0.70%	-2.13%
Other (SA)	0.38%	2.60%	2.43%	2.46%	4.02%	3.89%	1.89%	1.09%
Nondurable Goods								
All (SA)	0.69%	-2.06%	-2.34%	1.79%	1.79%	2.38%	1.06%	1.45%
Food (SA)	0.04%	-0.59%	0.99%	0.68%	2.45%	2.60%	1.28%	1.69%
Clothing and Shoes (SA)	0.68%	7.67%	-0.62%	-0.33%	0.16%	-0.16%	-0.07%	-0.49%
Gasoline, Fuel Oil, and Other Energy	3.84%	-18.98%	-17.24%	8.12%	-0.72%	4.21%	1.26%	2.53%
Other (SA)	0.69%	-2.06%	-2.34%	1.79%	2.62%	2.24%	1.07%	1.73%
Services								
All (SA)	0.16%	1.25%	1.67%	1.93%	2.25%	2.73%	1.35%	2.17%
Housing (SA)	0.17%	0.15%	0.37%	0.34%	1.64%	2.60%	1.27%	2.10%
Household Operation (SA)	0.14%	1.12%	1.66%	2.00%	2.38%	2.82%	1.38%	1.53%
Transportation (SA)	0.21%	0.85%	2.16%	2.87%	3.52%	3.48%	1.73%	2.30%
Medical care (SA)	0.05%	1.73%	2.32%	2.62%	2.70%	2.95%	1.44%	2.55%
Recreation (SA)	-0.42%	-6.91%	-5.10%	-5.82%	-5.42%	-5.71%	-2.93%	0.03%
Other (SA)	0.18%	1.68%	2.80%	3.02%	3.16%	3.07%	1.61%	2.27%

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#cpi>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

	12 Months through July 2010	10 Year High ¹	Date	10 Year Low ¹	Date
Personal Consumption Expenditures					
PCE					
All Items (SA)	1.54%	4.51%	Jul 2008	-0.79%	Jul 2009
Core PCE - Less Food and Energy (SA)	1.38%	2.63%	Jul 2008	1.15%	Jul 2009
Durable Goods					
All (SA)	-1.42%	-0.56%	Dec 2004	-4.19%	Oct 2003
Motor Vehicles and Parts (SA)	5.26%	6.03%	Feb 2010	-4.04%	Oct 2003
Furniture and Household Equipment (SA)	-4.96%	1.22%	Apr 2009	-5.16%	Jun 2010
Other (SA)	2.46%	7.06%	Apr 2008	-3.08%	Jan 2003
Non-Durable Goods					
All (SA)	1.79%	9.24%	Jul 2008	-5.14%	Jul 2009
Food (SA)	0.68%	7.03%	Oct 2008	-1.64%	Nov 2009
Clothing and Shoes (SA)	-0.33%	2.05%	Dec 2009	-4.08%	Jan 2002
Gasoline, Fuel Oil, and Other Energy (SA)	8.12%	54.14%	Sep 2005	-39.52%	Dec 2008
Other (SA)	1.79%	3.63%	Jun 2009	-0.26%	Jun 2003
Services					
All (SA)	1.93%	3.88%	Jul 2008	0.96%	Sep 2009
Housing (SA)	0.34%	5.16%	May 2001	0.00%	Feb 2010
Household Operation (SA)	2.00%	3.99%	Jul 2008	1.17%	Jul 2009
Transportation (SA)	2.87%	6.85%	Sep 2008	-1.03%	Oct 2001
Medical care (SA)	2.87%	4.25%	Feb 2004	2.18%	Dec 2008
Recreation (SA)	2.62%	-3.60%	Nov 2008	-7.59%	Sep 2001
Other (SA)	-5.82%	4.83%	Jul 2008	1.58%	Sep 2000

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#cpi>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

Producer Price Index

	Annualized through August 2010								Index Weights as of 12/31/2007
	Aug 2010	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Producer Price Index									
Commodities									
All (NSA)	0.16%	-1.08%	4.02%	5.43%	2.29%	3.20%	3.33%	2.33%	100.000
Industrial (NSA)	0.11%	-0.85%	3.85%	5.23%	2.25%	3.06%	3.30%	2.42%	85.907
Farm Products (NSA)	0.68%	-4.98%	8.04%	13.53%	1.70%	5.22%	4.56%	1.42%	14.093
Finished Goods									
All (SA)	0.39%	0.22%	0.67%	3.04%	2.60%	2.82%	2.67%	2.07%	100.000
All Less Energy (SA)	0.00%	-0.23%	1.38%	1.85%	2.59%	2.47%	1.96%	1.67%	78.252
Finished consumer goods (SA)	0.59%	0.21%	0.53%	3.58%	2.89%	3.20%	3.15%	2.35%	78.317
Capital equipment (SA)	0.06%	1.27%	1.28%	0.38%	1.84%	1.76%	1.30%	1.25%	21.683
Intermediate Goods									
All (SA)	0.33%	-3.86%	1.44%	4.96%	2.24%	3.47%	3.47%	2.36%	100.000
Manufacturing (SA)	0.06%	0.75%	1.39%	0.38%	-0.64%	2.11%	2.24%	1.52%	41.976
Construction (SA)	-0.15%	-2.67%	2.37%	2.23%	2.13%	3.27%	3.20%	2.61%	13.391
Processed fuels and lubricants (SA)	1.07%	-8.07%	-2.74%	8.24%	1.22%	3.43%	5.80%	3.88%	22.234
Containers (SA)	0.39%	7.75%	8.81%	6.14%	4.42%	4.27%	3.00%	2.42%	2.933
Supplies (SA)	0.23%	1.15%	1.86%	1.87%	2.53%	2.78%	2.45%	1.92%	19.466
Crude materials									
All (SA)	2.34%	10.54%	3.42%	18.17%	1.34%	2.94%	5.97%	3.27%	100.000
Foodstuffs and feedstuffs (SA)	3.50%	4.92%	10.29%	16.55%	1.02%	4.94%	4.83%	1.45%	32.604
Nonfood except fuel (SA)	2.91%	0.15%	11.04%	16.20%	4.02%	7.68%	8.64%	4.55%	40.991
Fuel (SA)	-0.71%	50.91%	-18.91%	26.30%	-2.55%	-5.84%	3.93%	4.45%	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>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

	12 Months through August 2010	10 Year High ¹	Date	10 Year Low ¹	Date
Producer Price Index					
Commodities					
All (NSA)	5.43%	17.42%	Jul 2008	-16.10%	Jul 2009
Industrial (NSA)	5.23%	17.82%	Jul 2008	-16.60%	Jul 2009
Farm Products (NSA)	13.53%	29.96%	May 2007	-24.50%	Jul 2009
Finished Goods					
All (SA)	3.04%	9.51%	Aug 2008	-6.59%	Jul 2009
All Less Energy (SA)	1.85%	5.22%	Aug 2008	-0.94%	Sep 2002
Finished consumer goods (SA)	3.58%	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)	4.96%	16.81%	Jul 2008	-15.14%	Jul 2009
Manufacturing (SA)	0.38%	15.54%	Aug 2008	-15.41%	Aug 2009
Construction (SA)	2.23%	13.82%	Sep 2008	-8.09%	Sep 2009
Processed fuels and lubricants (SA)	8.24%	37.59%	Oct 2005	-35.44%	Jul 2009
Containers (SA)	6.14%	9.33%	Sep 2008	-3.27%	Nov 2009
Supplies (SA)	1.87%	10.37%	Aug 2008	-4.14%	Aug 2009
Crude materials					
All (SA)	18.17%	55.06%	Jan 2001	-45.02%	Jul 2009
Foodstuffs and feedstuffs (SA)	16.55%	31.79%	May 2007	-25.68%	Jul 2009
Nonfood except fuel SA)	16.20%	68.93%	Jan 2010	-47.84%	Apr 2009
Fuel (SA)	26.30%	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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