



Inflation Observatory

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Core inflation exceeded expectations

- Falling energy and food prices stunted headline inflation
- Core prices increase across commodities and services
- Core inflation is expected to remain low but positive

Headline prices remained steady

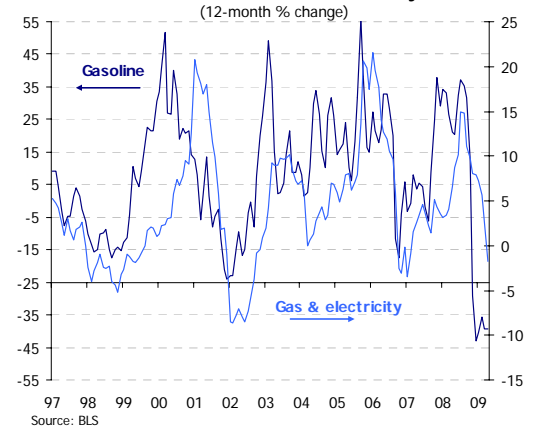
April's headline consumer prices exceeded expectations by exhibiting no change, after falling 0.1% in March. The index was pulled down by a 2.4% drop in energy prices, the second consecutive monthly decrease in 2009. The declines were widespread among motor fuel, fuel oil, natural gas and electricity. Food prices also had a negative impact, falling 0.2% for the third month in a row. Even though the price of food away from home increased, it was more than compensated for by the drop in food at home. On a year-over-year (yoy) basis, headline prices fell 0.7%, marking the second month (the first being March) since 1955 that levels came in below those of the prior year.

When food and energy are excluded, however, core consumer prices increased by 0.3%, exceeding our 0.2% forecast. Core commodities rose 0.5%. As in March, this component's prices were largely influenced by a 9.3% increase in tobacco and smoking products, due to the federal excise tax on cigarettes that went into effect in April. Prices of new and used vehicles also rose by 0.4% after exhibiting no change the month before. Apparel prices, however, dropped 0.2% for the second month in a row after rising for the first two months of the year. The core services component also rose (0.2%) due to increases across most of its components. Shelter prices went up for the first time in two months due to an about face in lodging away from home, which increased 0.5% after dropping sharply in the two prior months. The cost of medical care also increased 0.4%, the largest change since January. Core inflation came in at 1.9% yoy, the highest since November 2008. To date, average inflation is 1.8% yoy, which is 0.6% points below the average at this time a year ago.

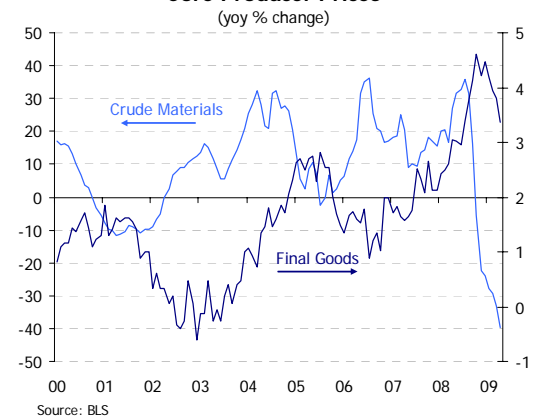
The results are in line with our baseline scenario

Excluding the transitory impact of tobacco prices, the core CPI figures are consistent with our baseline scenario of positive but low core inflation for 2009. Although, core producer prices of intermediate and crude goods are still decreasing, which could eventually translate into lower consumer prices, the expected increases in government spending, the Fed's expansionary monetary policy and increasing labor costs are expected to keep inflation positive. Therefore, we anticipate that the Federal Reserve will keep the Fed Funds rate at a low level for a prolonged period of time.

Gasoline and Gas & Electricity



Core Producer Prices



Average Hourly Earnings

