Brisk Growth Pushes Consumer Prices Higher

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So far, investors agree with Fed officials that inflationary pressure will be short-lived, but hotter-than-expected prices have introduced some creeping doubt. The headline consumer price index rose +0.6% in May while core CPI climbed +0.7%. Both readings were slightly above forecast, but slightly below April increases.

On a year-over-year basis, headline CPI was advancing at a +5.0% pace, *the biggest annual increase in almost 13 years*. Core CPI rose +3.8% year-over-year, *the most since 1992*. Much of the year-over-year gain can be attributed to the "base effect" as most prices were severely depressed 12 months ago while many U.S. businesses were shuttered.

The base effect was most pronounced in the elevated price of used cars, which accounted for roughly a third of the overall increase in May. Used car prices rose by +7.3% last month following a +10.0% April increase. In a similar vein, rental car prices rose +12.1% following a +16.2% increase the previous month and are up +110% over the past year. Lodging prices eased back in May with a +0.4% increase following a +7.6% jump in April, although the summer promises a resurgence in hotel and motel rates as Americans begin vacationing.

The base effect will become less and less of an issue going forward, but shortages of materials and labor promise to keep prices high for much of the year. When looking at prices over just the last three months (which in theory would not include a base effect) headline CPI is rising at a +6.9% annualized pace while core CPI is increasing at a +5.2% rate.

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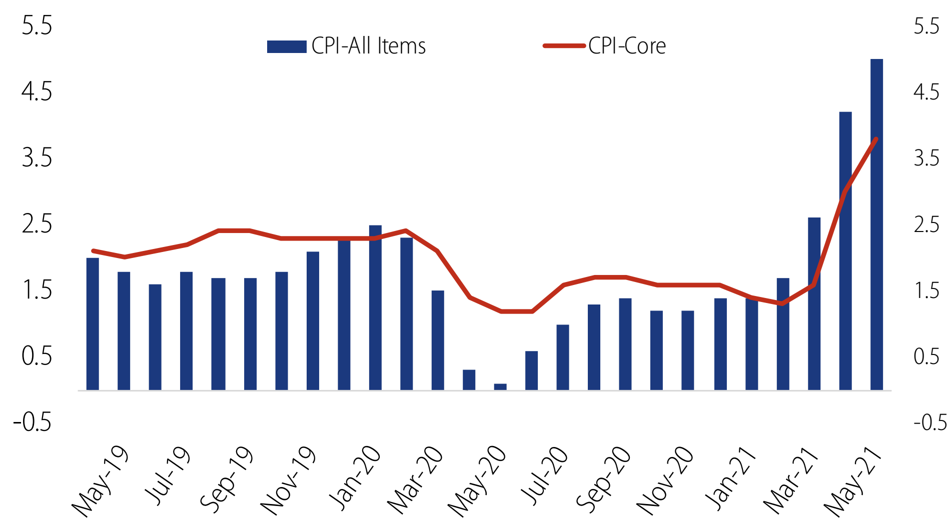
Inflation Indicators (Year-Over-Year percent change)



Source: Bureau of Labor Statistics.

U.S. investors seemed to have shrugged off any inflation concerns for the time being. After this morning's CPI numbers were announced, bond prices fell pushing yields slightly higher all along the curve. Ninety minutes later, bonds were essentially flat and the S&P 500 had climbed to a new record high.

The FOMC will meet next Tuesday and Wednesday to discuss monetary policy. Although few expect any significant changes to be announced, a number of committee members have already expressed caution. The June meeting will bring a fresh set of GDP and inflation forecasts, as well as an updated dot plot. It seems relatively certain that Fed members will boost their expected growth rates. It's also likely that the tightening timeline could be moved forward as the committee witnesses the combined effect of extreme government spending and ultra-accommodative monetary policy.

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This morning, European Central Bank President Christine Lagarde pledged to maintain ECB asset purchases at 80 billion euros per month. The European Union had tipped back into recession last quarter, so central bank accommodation is hardly a surprise. The idea that interest rates in Europe are likely to stay lower-for-longer maintains downward pressure on U.S. yields.

Market Indications as of 10:15 A.M. Central Time

DOW	Up 105 to 34,554 (HIGH: 34,778)
NASDAQ	Up 50 to 13,962 (HIGH: 14,139)
S&P 500	Up 10 to 4,230 (HIGH: 4,233)
1-Yr T-bill	current yield 0.04%; opening yield 0.04%
2-Yr T-note	current yield 0.15%; opening yield 0.16%
3-Yr T-note	current yield 0.31%; opening yield 0.31%
5-Yr T-note	current yield 0.74%; opening yield 0.75%
10-Yr T-note	current yield 1.49%; opening yield 1.49%
30-Yr T-bond	current yield 2.17%; opening yield 2.17%