First Trust DATAWATCH

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July CPI

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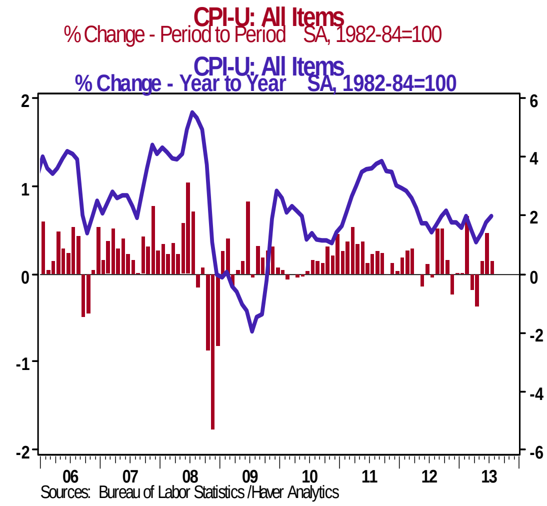
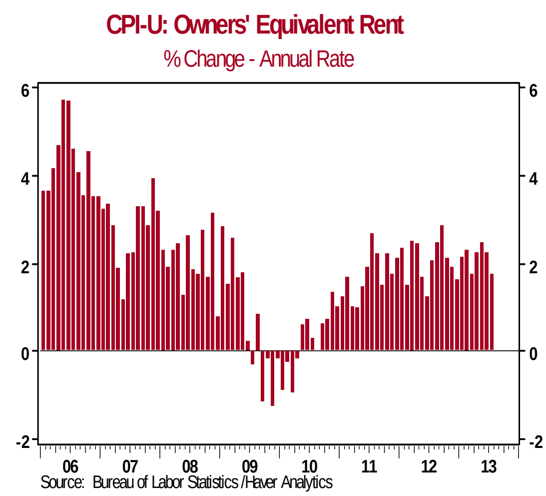
- The Consumer Price Index (CPI) increased 0.2% in July, coming in exactly as consensus expected. The CPI is up 2.0% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was up 0.2% in July and is up 1.9% in the past year.
- The gain in the CPI in July was led by shelter, with some additional contributions from energy, food, and medical care. Energy and food each rose 0.2%. The "core" CPI, which excludes food and energy, was up 0.2% in July, exactly as the consensus expected. Core prices are up 1.7% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were down 0.2% in July, and are down 0.1% in the past year. Real *weekly* earnings are also down 0.1% in the past year.





Implications: Modest gains almost across the board lifted both the overall CPI and "core" CPI in July, exactly the 0.2% the consensus expected. Compared to a year ago, overall consumer prices are up 2% while core prices are up 1.7%. Neither of these figures sets off alarm bells. Instead, they suggest the Federal Reserve's preferred measure of inflation, the PCE deflator (which usually runs a ¼ point below the CPI) will remain below the Fed's target of 2%. We don't expect this to last. Inflation bottomed in April when it was up only 1.1% from the prior year, and we expect it will be noticeably higher a year from now. Recent figures underscore the acceleration, with the overall CPI up at a 3.2% annual rate in the past three months. However, for the Fed, the key measure of inflation is its own forecast of future inflation. So, even if inflation moves higher, as long as the Fed projects the rise to be temporary it will not react to that inflation alone by raising short-term interest rates. The Fed is more focused on the labor market and, we believe, is willing to let inflation exceed its long-term target of 2% for a prolonged period of time in order to get the unemployment rate down. The worst news in today's report was that "real" (inflation-adjusted) average hourly earnings were down 0.2% in July, and are now down 0.1% in the past year. However, increases in jobs and hours are helping workers offset lower inflation-adjusted wages *per* hour. In other news this morning, new claims for jobless benefits declined 15,000 last week to 320,000. Continuing claims for regular state benefits dropped 54,000 to 2.97 million. It's early, but our payroll models are now forecasting an August gain of 158,000 nonfarm and 161,000 for the private sector. These figures are below the recent trend, but note that our models consider that, in recent years, the first report on August payrolls has been tepid, with large upward revisions for August in later reports.

CPI - U *All Data Seasonally Adjusted*	Jul-13	Jun-13	May-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.2%**	0.5%	0.1%	3.2%	1.8%	2.0%
Ex Food & Energy	**0.2%**	0.2%	0.2%	1.9%	1.6%	1.7%
Ex Energy	**0.2%**	0.2%	0.1%	1.8%	1.6%	1.7%
Energy	**0.2%**	3.4%	0.4%	17.3%	4.5%	4.7%
Food and Beverages	**0.2%**	0.2%	-0.1%	0.9%	1.2%	1.5%
Housing	**0.0%**	0.2%	0.3%	1.9%	2.1%	2.3%
Owners Equivalent Rent	**0.1%**	0.2%	0.2%	2.2%	2.2%	2.2%
New Vehicles	**0.1%**	0.3%	0.0%	1.4%	0.7%	1.2%
Medical Care	**0.2%**	0.4%	-0.1%	2.1%	1.9%	1.9%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.2%	2.3%	2.1%	2.4%
Real Average Hourly Earnings	**-0.2%**	-0.1%	-0.1%	-1.5%	-0.2%	-0.1%

Source: U.S. Department of Labor