First Trust DATAWATCH

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July CPI

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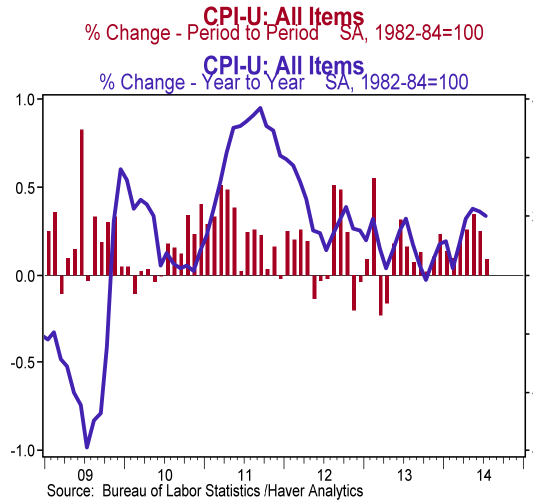
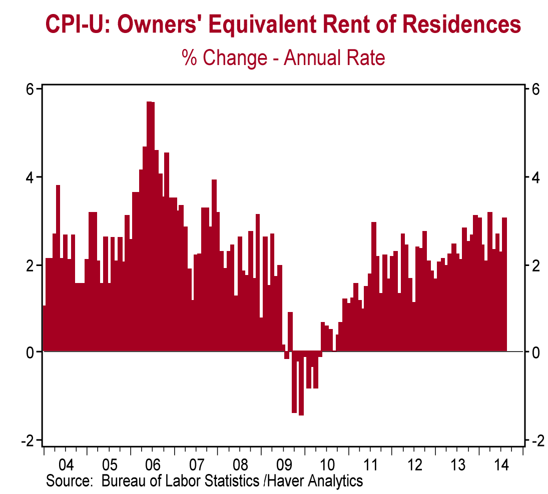
- The Consumer Price Index (CPI) increased 0.1% in July, matching consensus expectations. The CPI is up 2.0% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was unchanged in July and is up 1.8% in the past year.
- Food prices increased 0.3% in July, while energy prices declined 0.3%. The "core" CPI, which excludes food and energy, increased 0.1%, below the consensus expected 0.2%. The gain in core prices was led by owners' equivalent rent. Core prices are up 1.9% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were unchanged in July and unchanged in the past year. Real *weekly* earnings are up 0.3% in the past year.

Implications: Consumer prices continued to move higher in July, though only at the tepid 0.1% pace the consensus expected. Although consumer prices are up a moderate 2% from a year ago, the year-over-year number masks an acceleration. The CPI is up at a 2.5% annual rate in the past six months and up at a 2.8% rate in the past three months. Since the start of 2014, consumer prices are up 2.4% at an annual rate versus the 1.2% pace in first seven months of 2013. Owners' equivalent rent (what homeowners would pay if they were renting their homes from someone else) led the way in July, up 0.3%, accounting for most of the increase in the overall index. Owners' equivalent rent, which makes up about ¼ of the overall CPI, is up 2.7% over the past 12 months and will be a key source of the acceleration in inflation in the year ahead, in large part fueled by the shift toward renting rather than owning. And while energy prices declined 0.3% in July, muting the rise in the overall CPI, we expect this measure to move higher in the months ahead, continuing the trend higher we have seen over the past twelve months. The worst news in today's report was that "real" (inflation-adjusted) average hourly earnings remained flat in July and are unchanged in the past year. Plugging today's CPI data into our models suggests the Fed's preferred measure of inflation, the PCE deflator, probably increased 0.1% in July. If so, it would be up 1.6% from a year ago, barely below the Fed's target of 2%. We expect to hit and cross the 2% target later this year, consistent with our view that the Fed starts raising short-term interest rates in the first half of 2015.





CPI - U *All Data Seasonally Adjusted*	Jul-14	Jun-14	May-14	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	0.3%	0.4%	2.8%	2.5%	2.0%
Ex Food & Energy	**0.1%**	0.1%	0.3%	2.0%	2.1%	1.9%
Ex Energy	**0.1%**	0.1%	0.3%	2.2%	2.4%	2.0%
Energy	**-0.3%**	1.6%	0.9%	9.1%	3.8%	2.6%
Food and Beverages	**0.3%**	0.0%	0.4%	3.3%	3.9%	2.4%
Housing	**0.2%**	0.1%	0.3%	2.5%	2.5%	2.7%
Owners Equivalent Rent	**0.3%**	0.2%	0.2%	2.7%	2.6%	2.7%
New Vehicles	**0.3%**	-0.3%	0.2%	0.6%	1.1%	0.2%
Medical Care	**0.2%**	0.1%	0.3%	2.6%	2.8%	2.6%
Services (Excluding Energy Services)	**0.1%**	0.1%	0.3%	2.5%	2.8%	2.6%
Real Average Hourly Earnings	**0.0%**	0.0%	-0.2%	-0.8%	-0.6%	0.0%

Source: U.S. Department of Labor