First Trust DATAWATCH

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May CPI

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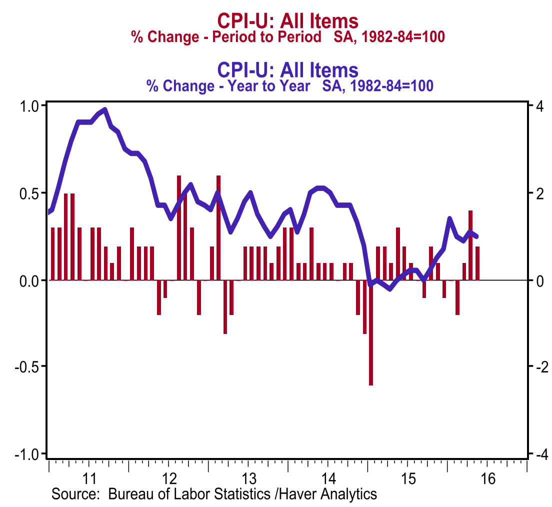
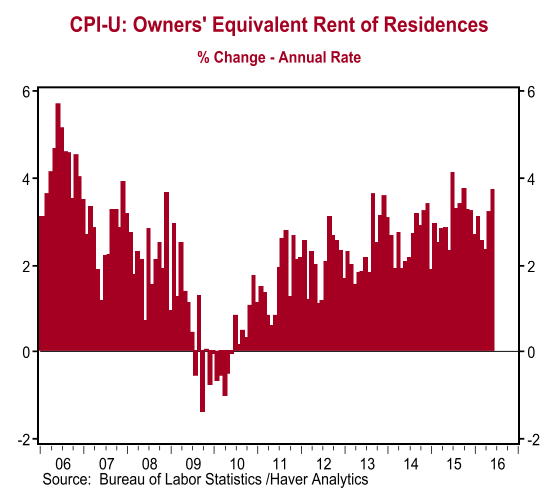
- The Consumer Price Index (CPI) increased 0.2% in May, coming in below the consensus expected rise of 0.3%. The CPI is up 1.0% from a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) rose 0.2% in May and is up 0.4% in the past year.
- Energy prices rose 1.2% in May, while food prices declined 0.2%. The "core" CPI, which excludes food and energy, increased 0.2% in May, matching consensus expectations. Core prices are up 2.2% versus a year ago.
- Real average hourly earnings – the cash earnings of all workers, adjusted for inflation – were unchanged in May but are up 1.4% in the past year. Real *weekly* earnings are up 1.1% in the past year.





Implications: Energy and housing led the consumer price index higher in May, to the fastest three-month pace of inflation since 2013. Energy prices rose 1.2%, as prices for gasoline and fuel oil more than offset declining electricity costs. While oil prices have moderated in June, the trend in higher energy costs looks likely to continue in the months ahead. Excluding just energy, consumer prices are up 2.0% in the past year. In other words, as energy prices rise, the headline index will follow at a faster pace than many are expecting. Food prices fell 0.2% in May as all major grocery store categories showed declines. "Core" consumer prices, which exclude the volatile food and energy components, rose 0.2% in May and show annualized readings near or above 2% over the past three, six, and twelve-month periods. While the Fed kicked the can once again at yesterday's meeting, this consistent pace of "core" inflation around 2% – paired with continued employment gains – shows the economy is ready for the next rate hike. The increase in the core CPI in May was led by housing rents, medical care and apparel. Owners' equivalent rent, which makes up about ¼ of the CPI, rose 0.3% in May, is up 3.3% in the past year, and will be a key source of higher inflation in the year ahead. One negative piece of news in today's report is that the rising CPI offset wage gains, leaving "real" (inflation-adjusted) average hourly earnings unchanged in May. However real wages are up 1.4% in the past year and we think wages will rise faster than prices in the months ahead as employment continues to grow at a healthy clip. In other news this morning, new claims for unemployment benefits rose 13,000 to 277,000 while continuing claims increased 45,000 to 2.16 million. Plugging these figures into our payroll models suggests June will show a substantial rebound from May's modest report. On the manufacturing front, the Philadelphia Fed index, a measure of sentiment in East Coast manufacturing, came in at 4.7 in June versus -1.8 in May, a stronger-than-expected reading that signals manufacturing in that region may be turning a corner.

CPI - U *All Data Seasonally Adjusted Except for Yr to Yr*	May-16	Apr-16	Mar-16	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.2%**	0.4%	0.1%	2.9%	0.9%	1.0%
Ex Food & Energy	**0.2%**	0.2%	0.1%	1.9%	2.4%	2.2%
Ex Energy	**0.1%**	0.2%	0.0%	1.5%	2.0%	2.0%
Energy	**1.2%**	3.4%	0.9%	25.0%	-11.6%	-10.1%
Food and Beverages	**-0.2%**	0.2%	-0.2%	-0.8%	-0.3%	0.7%
Housing	**0.3%**	0.2%	0.1%	2.6%	2.3%	2.4%
Owners Equivalent Rent	**0.3%**	0.3%	0.2%	3.5%	3.3%	3.3%
New Vehicles	**-0.1%**	-0.3%	0.0%	-1.9%	0.0%	-0.2%
Medical Care	**0.3%**	0.3%	0.1%	3.1%	3.8%	3.2%
Services (Excluding Energy Services)	**0.3%**	0.3%	0.2%	3.2%	3.3%	3.2%
Real Average Hourly Earnings	**0.0%**	-0.1%	0.2%	0.4%	1.7%	1.4%

Source: U.S. Department of Labor