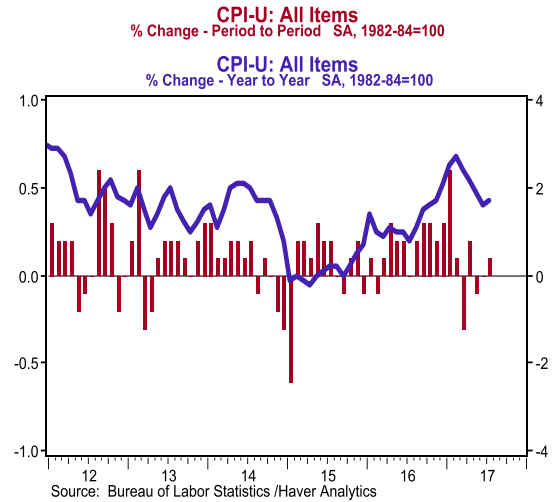


July CPI

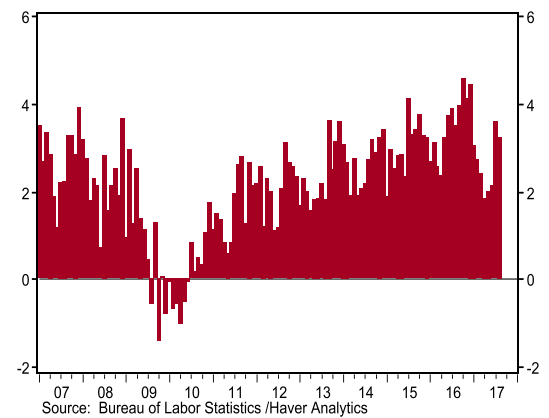
Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elss – Economist

- The Consumer Price Index (CPI) rose 0.1% in July, coming in below the consensus expected increase of 0.2%. The CPI is up 1.7% from a year ago.
- “Cash” inflation (which excludes the government’s estimate of what homeowners would charge themselves for rent) rose 0.1% in July and is up 1.3% in the past year.
- Food prices rose 0.2% in July, while energy prices declined 0.1%. The “core” CPI, which excludes food and energy, increased 0.1% in July, slightly below the consensus expected rise of 0.2%. Core prices are up 1.7% versus a year ago.
- Real average hourly earnings – the cash earnings of all workers, adjusted for inflation – rose 0.2% in July and are up 0.7% in the past year. Real average weekly earnings are up 1.1% in the past year.

Implications: Consumer prices rose 0.1% in July, continuing the tame inflation that started in February. Consumer prices rose at a 3.6% annual rate in the six months ending in January, and are now down at a 0.1% annual rate over the past six months. So what’s changed? Energy prices declined substantially from mid-2014 through the start of 2016 and then rose through much of last year. That rise helped push overall consumer prices up at a 3.6% rate in the six months ending in January. But with energy prices generally down since then, overall inflation has been quiet as well. Still, we think inflation is in a general rising trend. Prices rose 0.2% in the twelve months through July 2015, 0.8% in the twelve months through July 2016, and 1.7% in the last twelve months. Moreover, that acceleration in inflation has arrived despite oil prices being lower today than in 2015. “Core” prices, which strip out the volatile food and energy components, have shown steadily rising prices of late, increasing in eleven of the last twelve months. Within core inflation, a small sub-set of categories have kept prices from reaching or exceeding the Fed’s 2% inflation target. Cellphone service prices have declined 13.3% in the past year, while major household appliances are down 5.2% and vehicle costs are falling. For the consumer these falling prices - which are the result of technological improvements and competition – plus rising wages mean increased spending power on all other goods. But it tempers inflation readings. Meanwhile, costs for medical care and rent continue to push overall consumer prices higher. We expect rents to accelerate in the year ahead as supply constraints get tighter in the housing market. We still expect inflation to trend towards 2% in the medium term, and don’t think the gains to consumers from falling prices in select areas are reason for concern or a justification for the Fed to slow the pace of rate hikes. The best news in today’s report is that real average hourly earnings rose 0.2% in July. These earnings are up 0.7% over the past year, up at a 2.6% annual rate over the past six months, and a 3.0% annual rate over the past three months. Because the Fed believes in the Phillips Curve, the trend of accelerating price and wage gains should have Fed officials focusing more on the potential for inflation to rise faster than desired as the jobless rate continues to fall below their long-term target. That’s why we expect the Fed to stick to their plan of starting to unwind the balance sheet while also raising rates one more time in 2017.



CPI-U: Owners' Equivalent Rent of Residences
 % Change - Annual Rate



CPI - U <i>All Data Seasonally Adjusted Except for Yr to Yr</i>	Jul-17	Jun-17	May-17	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	0.1%	0.0%	-0.1%	-0.2%	-0.1%	1.7%
Ex Food & Energy	0.1%	0.1%	0.1%	1.2%	0.9%	1.7%
Ex Energy	0.1%	0.1%	0.1%	1.2%	1.1%	1.6%
Energy	-0.1%	-1.6%	-2.7%	-16.3%	-14.0%	3.4%
Food	0.2%	0.0%	0.2%	1.1%	2.2%	1.1%
Housing	0.1%	0.1%	0.2%	1.7%	2.2%	2.8%
Owners Equivalent Rent	0.3%	0.3%	0.2%	3.0%	2.8%	3.2%
New Vehicles	-0.5%	-0.3%	-0.2%	-3.9%	-3.3%	-0.6%
Medical Care	0.4%	0.4%	0.0%	3.2%	1.8%	2.6%
Services (Excluding Energy Services)	0.2%	0.2%	0.2%	2.2%	1.8%	2.4%
Real Average Hourly Earnings	0.2%	0.3%	0.3%	3.0%	2.6%	0.7%

Source: U.S. Department of Labor