July CPI

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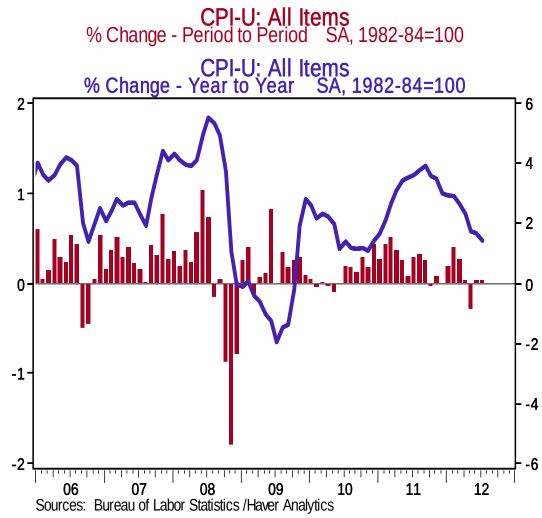
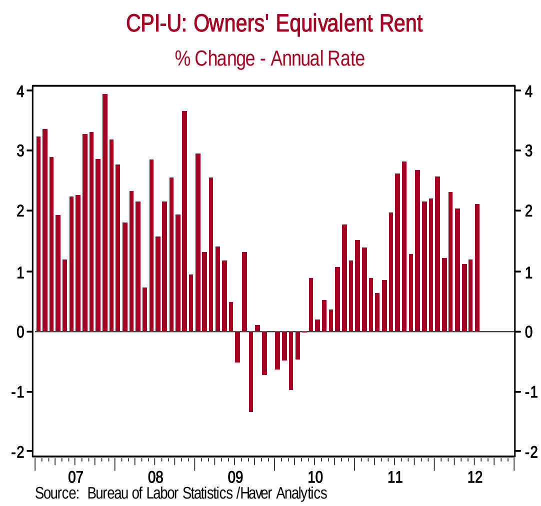
- The Consumer Price Index (CPI) was unchanged in July, coming in below the consensus expected gain of 0.2%. The CPI is up 1.4% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was also unchanged in July and is up 1.3% in the past year.
- The CPI was flat in July due to a 0.3% drop in energy, which offset widespread gains in most other major categories. The "core" CPI, which excludes food and energy, was up 0.1%, versus a consensus expected gain of 0.2%, and is up 2.1% versus last year.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were unchanged in July but are up 0.2% in the past year. Real *weekly* earnings are up 0.6% in the past year.



Implications: The CPI was unchanged in July for the third time in four months, and the one exception was when the CPI declined in May. The CPI is now up only 1.4% from a year ago. However, all of the flat to negative readings in the past four months have been the result of declining energy prices. Excluding energy, prices have continued to rise, up 2.1% from a year ago and also up at a 2.1% annual rate in the past four months. In July, ex-energy prices were up across the board. "Core" prices, which exclude food and energy, were up 0.1% in July and are up 2.1% from a year ago. If we expected energy prices to keep falling, none of this would matter, but oil prices are already up from July. Moreover, the underlying trend is above the Federal Reserve's supposed target of 2%. In other words, we don't think today's data support the case for another round of quantitative easing. Monetary policy is already very loose and housing costs (which are measured by rents, not asset values) are rising. Owners' equivalent rent was up 0.2% in July and is up 2% versus a year ago. The ongoing shift from home ownership toward rental occupancy should boost this inflation measure even more in the year ahead. With loose monetary policy and housing costs accelerating, it's hard to see core inflation getting back down below the Fed's 2% target anytime soon. On the earnings front, "real" (inflation-adjusted) wages per hour were flat in July. These earnings are up 0.2% from a year ago. Worker hours are up 2% in the past year. Combining these two factors means workers' purchasing power is up about 2.2 % from a year ago. In other news this morning, the NAHB Index, which measures confidence among homebuilders, increased to 37 in August from 35 in July. It's now at its highest point in five years.



CPI - U *All Data Seasonally Adjusted*	Jul-12	Jun-12	May-12	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.0%**	0.0%	-0.3%	-0.8%	1.1%	1.4%
Ex Food & Energy	**0.1%**	0.2%	0.2%	2.0%	2.2%	2.1%
Ex Energy	**0.1%**	0.2%	0.2%	1.9%	2.0%	2.1%
Energy	**-0.3%**	-1.4%	-4.3%	-21.9%	-7.4%	-5.0%
Food and Beverages	**0.1%**	0.2%	0.0%	1.1%	1.4%	2.3%
Housing	**0.0%**	0.1%	0.0%	0.4%	0.9%	1.4%
Owners Equivalent Rent	**0.2%**	0.1%	0.1%	1.5%	1.7%	2.0%
New Vehicles	**-0.1%**	0.2%	0.2%	1.1%	3.1%	0.8%
Medical Care	**0.4%**	0.6%	0.4%	5.5%	4.4%	4.1%
Services (Excluding Energy Services)	**0.1%**	0.2%	0.2%	2.1%	2.3%	2.5%
Real Average Hourly Earnings	**0.0%**	0.3%	0.4%	2.8%	1.0%	0.2%

Source: U.S. Department of Labor