First Trust DATAWATCH

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August CPI

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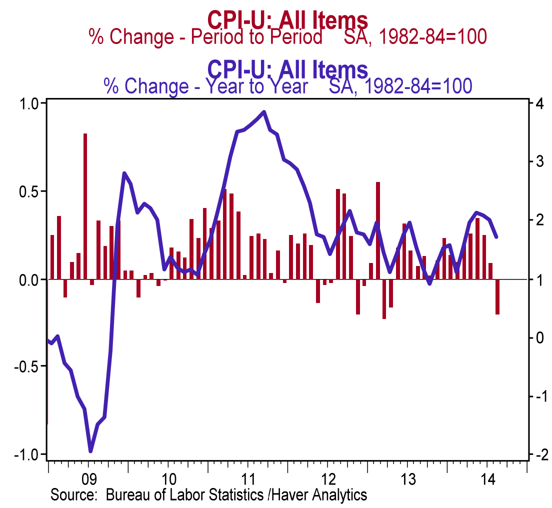
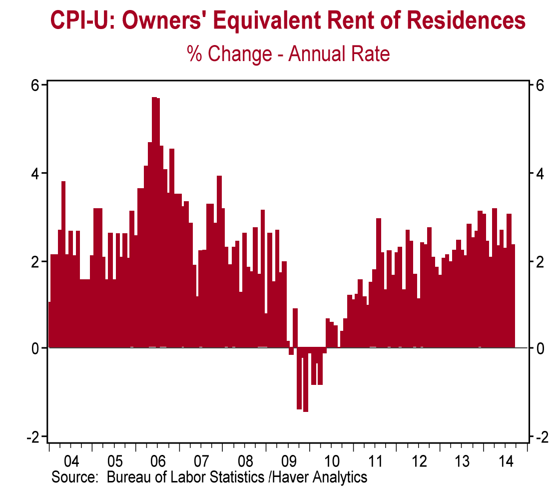
- The Consumer Price Index (CPI) declined 0.2% in August, below consensus expectations for no change. The CPI is up 1.7% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) declined 0.3% in August but is up 1.4% in the past year.
- Food prices increased 0.3% in August, while energy prices declined 2.6%. The "core" CPI, which excludes food and energy, was unchanged, below the consensus expected gain of 0.2%. Core prices are up 1.7% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – rose 0.4% in August and are up 0.4% in the past year. Real *weekly* earnings are up 0.4% in the past year.

Implications: Yellen and the doves could not have asked for a better inflation report for the day of their FOMC statement. After rising for 15 consecutive months, consumer prices took a breather in August, declining 0.2%. However, all of the drop was due to energy and one month by itself does not make a trend. So although today's report comes as welcome news to the doves, we do not believe it will change the Fed's plans for continued tapering, which will be announced later this afternoon. America's booming energy production continues to subdue the rise in consumer prices. The index for energy declined 2.6% in August, led by a 4.1% decline in the cost of gasoline, which subtracted 0.3% from the overall index. Core prices, which exclude food and energy, were unchanged in August, the first time that the core index has failed to show an increase since late 2010. Despite the August data, since the start of 2014, consumer prices are up 1.8% at an annual rate versus the 1.5% pace in first eight months of 2013. Owners' equivalent rent, which makes up about ¼ of the overall CPI, rose 0.2% in August, is up 2.7% over the past year, 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. The best news in today's report was that "real" (inflation-adjusted) average hourly earnings rose 0.4% in August, the largest monthly gain in over a year. Plugging today's CPI data into our models suggests the Fed's preferred measure of inflation, the PCE deflator, probably declined 0.1% in August. If so, it would be up 1.4% from a year ago, still below the Fed's target of 2%. We expect this measure to hit and cross the 2% target later this year or very early next year, consistent with our view that the Fed starts raising short-term interest rates in the first half of 2015. In other news this morning, the NAHB index, which measures confidence among home builders, rose three points to 59 in September, the best reading in nine years. Looks like a broad pick-up in both sales and foot traffic around the country.





CPI - U *All Data Seasonally Adjusted*	Aug-14	Jul-14	Jun-14	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**-0.2%**	0.1%	0.3%	0.6%	1.9%	1.7%
Ex Food & Energy	**0.0%**	0.1%	0.1%	1.0%	1.9%	1.7%
Ex Energy	**0.0%**	0.1%	0.1%	1.2%	2.2%	1.9%
Energy	**-2.6%**	-0.3%	1.6%	-5.3%	-0.6%	0.4%
Food and Beverages	**0.3%**	0.3%	0.0%	2.6%	3.7%	2.6%
Housing	**0.1%**	0.2%	0.1%	1.5%	2.2%	2.6%
Owners Equivalent Rent	**0.2%**	0.3%	0.2%	2.6%	2.7%	2.7%
New Vehicles	**0.2%**	0.3%	-0.3%	0.6%	1.3%	0.4%
Medical Care	**0.0%**	0.2%	0.1%	1.3%	2.2%	2.1%
Services (Excluding Energy Services)	**0.0%**	0.1%	0.1%	1.3%	2.5%	2.5%
Real Average Hourly Earnings	**0.4%**	0.0%	0.1%	2.0%	0.0%	0.4%

Source: U.S. Department of Labor