Data Watch

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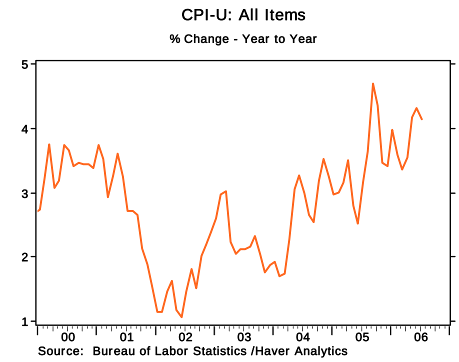
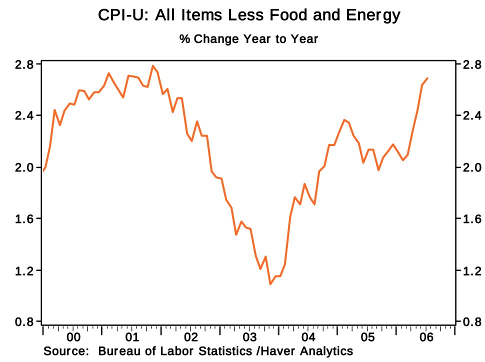
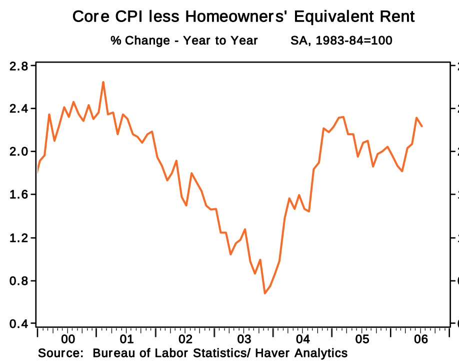
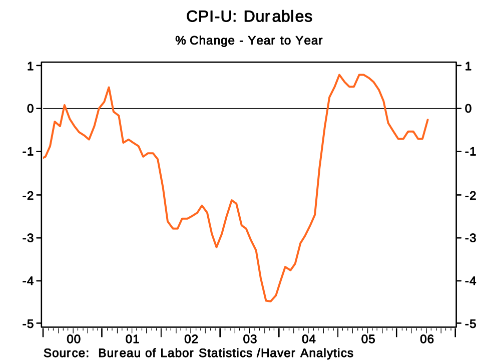
JULY CPI

- The Consumer Price Index (CPI) rose 0.4% in July after a 0.2% increase in June. The CPI has increased 4.5% at an annualized rate in the past three months and 4.1% in the past year.
- Energy prices jumped 2.9% in July, reversing the 0.9% decline in June. Food and beverage prices increased 0.2% last month. Excluding food and energy, the "core" CPI was up 0.2% in July. The "core" CPI is up an annualized 3.2% in the past six months and 2.7% in the past year – the fastest YOY gain since 2001.









Implications: Price pressures at the consumer level remain widespread, with the 12-month change in the "core" CPI rising at a post recession high of 2.7% in the past year. Of the 17 CPI components we track (see table), all but two are rising above the Fed's "comfort zone" of 1%-2%. This blows a hole in the notion that the buildup in inflation is just an energy phenomenon. Even the most recent excuse for inflation, that a slowing housing market is artificially raising owners' equivalent rent in the CPI, doesn't hold water. The "core" CPI excluding owners' equivalent rent has risen an annualized 2.1% in the past three months, 2.4% at an annual rate in the past six months, and 2.2% in the past year – again, all higher than the Fed's "comfort zone." While inflation is not out of control by historical standards, it has clearly been on an upswing. The $64,000 question for the Fed and investors is whether inflation will continue to rise. On one side, gold and commodity prices are up this year, while the dollar is down. These market-based indicators, along with the fact that real interest rates remain very low, suggest that inflationary pressures will continue to build. These forward-looking indicators have a strong historical record of forecasting inflation, including the current bulge over the last three years. The other side forecasts slower growth in the second half of this year that will contain inflation. This forecast is built on a Phillips Curve model that has been proven inaccurate time and time again. We obviously believe the market-based indicators are correct and expect inflation to continue to rise until the Fed reaches neutral.

CPI - U *all data seasonally adjusted*	**Jul-06**	**Jun-06**	**May-06**	**3-mo % Ch. annualized**	**6-mo % Ch. annualized**	**Yr over Yr % Ch.**
Consumer Price Index	**0.4%**	0.2%	0.4%	4.5%	4.3%	4.1%
X Food & Energy	**0.2%**	0.3%	0.3%	3.2%	3.2%	2.7%
X Energy	**0.2%**	0.3%	0.3%	3.2%	3.0%	2.6%
X Food, Energy & Owners' Equivalent Rent	**0.1%**	0.2%	0.2%	2.1%	2.4%	2.2%
Energy	**2.9%**	-0.9%	2.4%	19.1%	18.0%	20.5%
Food and Beverages	**0.2%**	0.3%	0.2%	2.7%	1.8%	2.2%
Housing	**0.3%**	0.2%	0.3%	3.8%	2.9%	4.1%
Owners' Equivalent Rent	**0.4%**	0.4%	0.6%	5.5%	5.0%	3.7%
Apparel	**-1.2%**	0.0%	0.2%	-3.9%	-0.8%	0.0%
Transportation	**1.6%**	-0.2%	1.5%	12.4%	12.8%	8.4%
New Vehicles	**0.1%**	-0.1%	-0.3%	-0.9%	-0.6%	0.4%
Medical Care	**0.2%**	0.3%	0.3%	3.2%	4.2%	4.0%
Recreation	**0.3%**	0.1%	0.2%	2.2%	2.6%	2.0%
Education & Communication	**0.3%**	0.3%	0.0%	2.4%	2.6%	3.0%
Commodities	**0.7%**	0.0%	0.7%	5.7%	6.0%	4.3%
Commodities x Food & Beverages	**0.9%**	-0.1%	1.0%	7.5%	8.5%	5.6%
Services	**0.3%**	0.3%	0.3%	3.8%	3.2%	4.0%

Source: U.S. Department of Labor