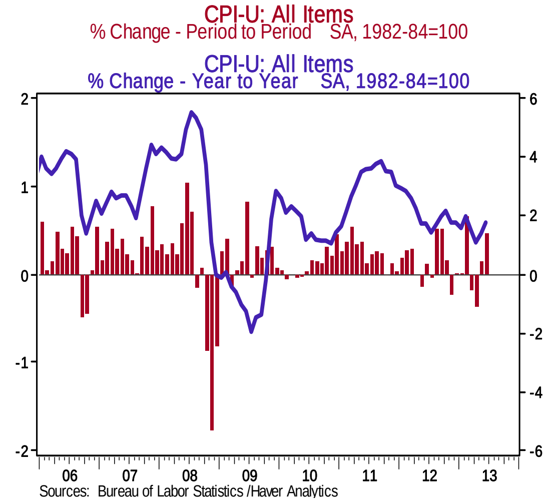
First Trust DATAWATCH

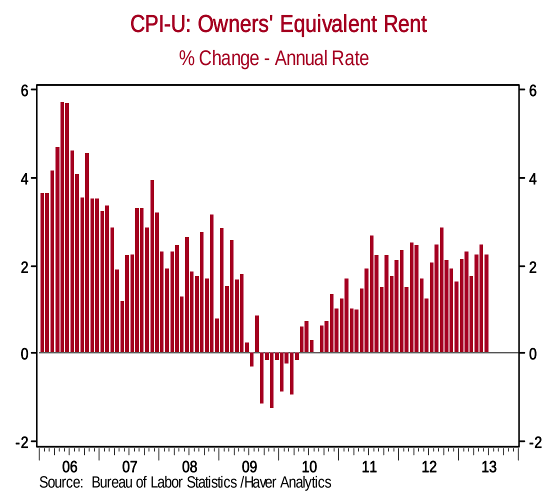
July 16, 2013 • 630.517.7756 • www.ftportfolios.com

June CPI

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

- The Consumer Price Index (CPI) increased 0.5% in June, coming in above the consensus expected gain of 0.3%. The CPI is up 1.8% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was up 0.6% in June and is up 1.6% in the past year.
- The gain in the CPI in June was mostly due to energy, with some additional contributions from housing rents, food, and medical care. Food prices were up 0.2%. The "core" CPI, which excludes food and energy, was up 0.2% in June, exactly as the consensus expected. Core prices are up 1.6% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were flat in June, but are up 0.4% in the past year. Real *weekly* earnings are up 0.7% in the past year.





Implications: A surge in gasoline led consumer prices higher in June, generating the largest monthly gain in the overall CPI since February. Gasoline, up 6.3% in June, accounted for roughly two-thirds of the overall 0.5% monthly gain for the consumer price index. The "core" CPI, which excludes food and energy, increased 0.2% in June, exactly as the consensus expected. The gain in the core CPI was led by rent (both actual rent and owners' equivalent rent) as well as medical care. Compared to a year ago, overall consumer prices are up 1.8% while core prices are up 1.6%. Neither of these figures sets off alarm bells. Instead, they suggest the Federal Reserve's preferred measure of inflation, the PCE deflator (which usually runs a ¼ point below the CPI) will remain below the Fed's target of 2%. We don't expect this to last. Inflation probably bottomed in April when it was up only 1.1% from the prior year, and will be noticeably higher a year from now. However, for the Fed, the key measure of inflation is its own forecast of future inflation. So, even if inflation goes to roughly 3% in 2014, as long as the Fed projects the rise to be temporary it will not react to that inflation alone by raising short-term interest rates. The Fed is more focused on the labor market and, we believe, is willing to let inflation exceed its long-term target of 2% for a prolonged period of time in order to get the unemployment rate down. The worst news in today's report was that "real" (inflation-adjusted) average hourly earnings were flat in June, although they are still up 0.4% in the past year. Given today's news it looks like "real" (inflation-adjusted) consumer spending grew at a 1.3% annual rate in Q2, consistent with our forecast of 1.5% real GDP growth.

CPI - U *All Data Seasonally Adjusted*	Jun-13	May-13	Apr-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.5%**	0.1%	-0.4%	1.0%	1.6%	1.8%
Ex Food & Energy	**0.2%**	0.2%	0.1%	1.5%	1.8%	1.6%
Ex Energy	**0.2%**	0.1%	0.1%	1.5%	1.7%	1.6%
Energy	**3.4%**	0.4%	-4.3%	-2.7%	0.4%	3.2%
Food and Beverages	**0.2%**	-0.1%	0.2%	1.1%	1.0%	1.4%
Housing	**0.2%**	0.3%	0.2%	2.8%	2.5%	2.2%
Owners Equivalent Rent	**0.2%**	0.2%	0.2%	2.3%	2.2%	2.2%
New Vehicles	**0.3%**	0.0%	0.3%	2.3%	0.8%	1.2%
Medical Care	**0.4%**	-0.1%	0.0%	1.2%	1.8%	2.1%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.1%	1.8%	2.3%	2.3%
Real Average Hourly Earnings	**0.0%**	-0.1%	0.6%	2.0%	0.6%	0.4%

Source: U.S. Department of Labor