First Trust DATAWATCH

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January CPI

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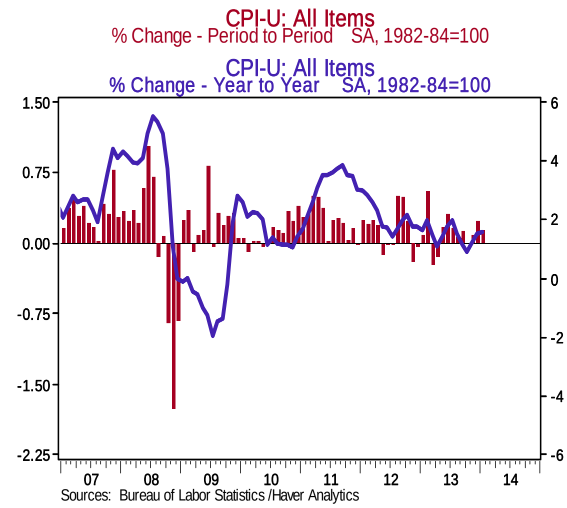
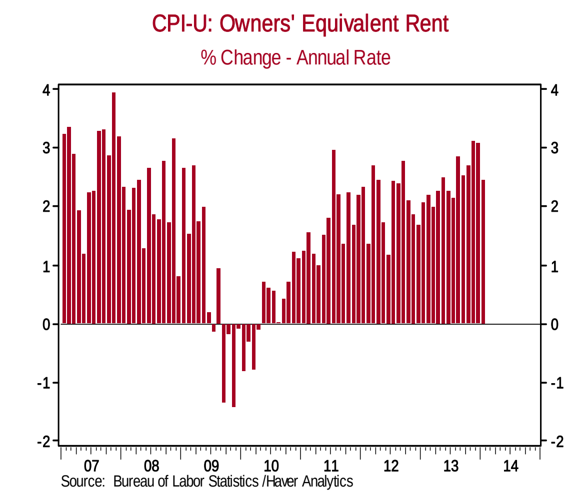
- The Consumer Price Index (CPI) increased 0.1% in January, matching consensus expectations. The CPI is up 1.6% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) rose 0.1% in January and is up 1.3% in the past year.
- More than half of the increase in the overall CPI in January was due to energy, which rose 0.6%. Food prices rose 0.1%. The "core" CPI, which excludes food and energy, was up 0.1% in January, matching consensus estimates. Core prices are up 1.6% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – rose 0.1% in January, and are up 0.4% in the past year. Real *weekly* earnings are also up 0.4% in the past year.





Implications: Consumer prices continued to move higher in January, although only at the tepid 0.1% pace the consensus expected. In the past year, consumer prices are up 1.6%, both including and excluding food and energy. So, for the time being, neither overall inflation nor core inflation is setting off alarm bells. Instead, they suggest the Fed's preferred measure of inflation, the PCE deflator (which usually runs a ¼ point below the overall CPI) will remain well below the Fed's target of 2%. Given loose monetary policy, we don't expect this to last; inflation should reach the 2% target by late 2014. Notice that despite generally quiet inflation in 2013, there is a rising trend in housing inflation. Owners equivalent rent (the government's estimate of what homeowners would charge themselves for rent), which makes up about ¼ of the overall CPI, has increased at a 2.8% annual rate in the past six months versus a 2.5% gain in the past year. This measure will be a key source of the acceleration in inflation in the year ahead. However, for the Fed, the key measure of inflation is its own forecast of future inflation. So, even if inflation moves higher, as long as the Fed projects the rise to be temporary it will not react by raising short-term interest rates. At this point, the Fed is much more focused on the unemployment rate. The jobless rate is now very close to the 6.5% level the Fed has said would start discussions about raising short-term rates. But the Fed has also said short-term rates would remain low "well past" the unemployment rate reaching 6.5%. Yesterday's minutes from the Fed's January meeting suggest it may change the 6.5% threshold at its next meeting in March. In other news this morning, new claims for unemployment insurance declined 3,000 last week to 336,000. Continuing claims for regular state benefits increased 37,000 to 2.981 million. It's still early, and the forecast may change, but our payroll models are now projecting February gains of 175,000 nonfarm, 165,000 for the private sector. In other news this morning, the Philadelphia Fed index, a measure of manufacturing activity in that area fell to -6.3 in February from +9.4 in January. The extreme winter weather that blanketed the region was cited by many respondents as the driver of the slowdown.

CPI - U *All Data Seasonally Adjusted*	Jan-14	Dec-13	Nov-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	0.2%	0.1%	2.0%	1.4%	1.6%
Ex Food & Energy	**0.1%**	0.1%	0.2%	1.6%	1.6%	1.6%
Ex Energy	**0.1%**	0.1%	0.2%	1.5%	1.5%	1.5%
Energy	**0.6%**	1.6%	-0.4%	7.1%	1.3%	2.1%
Food and Beverages	**0.1%**	0.1%	0.1%	1.0%	1.0%	1.1%
Housing	**0.4%**	0.2%	0.2%	3.6%	2.8%	2.4%
Owners Equivalent Rent	**0.2%**	0.3%	0.3%	2.9%	2.8%	2.5%
New Vehicles	**-0.3%**	0.0%	-0.1%	-1.5%	-0.6%	0.0%
Medical Care	**0.3%**	0.0%	0.0%	1.4%	2.4%	2.1%
Services (Excluding Energy Services)	**0.2%**	0.1%	0.3%	2.5%	2.4%	2.3%
Real Average Hourly Earnings	**0.1%**	-0.2%	0.2%	0.4%	0.6%	0.4%

Source: U.S. Department of Labor