First Trust

Data Watch

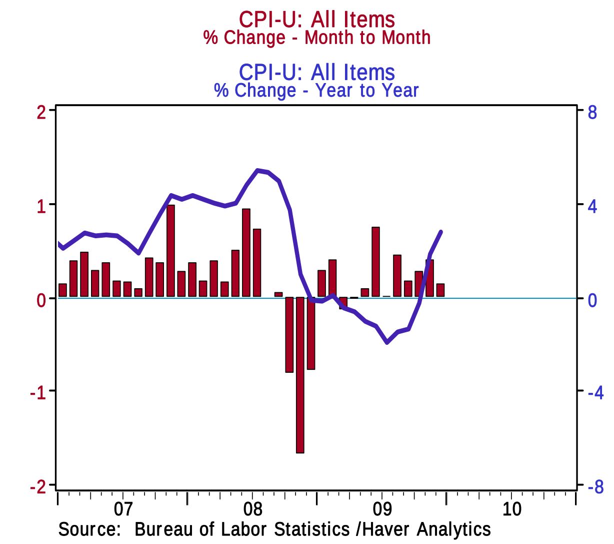
January 15, 2010 • 630.517.7756 • http://www.ftportfolios.com

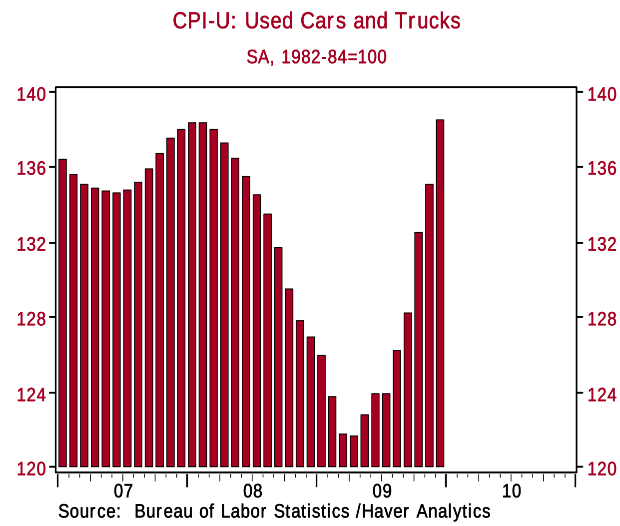
DECEMBER CPI

Chief Economist – Brian S. Wesbury
Senior Economist – Robert Stein, CFA

- The Consumer Price Index (CPI) was up 0.1% in December, slightly below consensus expectations. The CPI is up 2.7% versus a year ago, and is up at a 3.3% annual rate in the past three months.
- "Cash" inflation (which excludes the government's estimate of what a homeowner would charge himself for rent) increased 0.2% in December, is up 3.5% versus a year ago, and is up at a 4.5% annual rate in the past three months.
- Energy prices and food prices were each up 0.2% in December. Excluding food and energy, the "core" CPI was up 0.1% in December and is up 1.8% versus last year.
- Real average hourly earnings – the cash earnings of production workers, adjusted for inflation – were unchanged in December and are down 1.3% versus a year ago.

Implications: Investors and the Fed need to stop worrying so much about economic growth and start to show more concern about inflation. Consumer prices were 2.7% higher in December than they were a year ago and prices have risen at a 3.3% annual rate in the past three months. While some analysts focus on "core" inflation, which excludes food and energy and is up only 1.8% in the past year, we think our measure of "cash" inflation is a better gauge of the true pain consumers are feeling. Cash inflation counts everything, including food and energy, but takes out something called "owners' equivalent rent" or OER – the government's estimate of what homeowners would get for their homes if they rented them out. Remember, OER does not reflect an actual transaction; if OER goes up no one has to pay anyone else any more money. Excluding OER, consumer prices were up 3.5% in 2009 and are accelerating. Cash inflation is up at a 4% annual rate in the past six months and up at a 4.5% rate in the past three months. Some analysts are focusing on the *average* level of prices in 2009 versus the *average* level of prices in 2008 and are saying that the decline of 0.3% indicates deflation. But that decline is due to the steep drop in prices in late 2008 during the panic. Focusing on that measure is like awarding a playoff win to the team that averages the most points over the last four games, instead of to the team that wins in a head-to-head battle.





CPI - U *All Data Seasonally Adjusted*	Dec-09	Nov-09	Oct-09	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	0.4%	0.3%	3.3%	2.9%	2.7%
Ex Food & Energy	**0.1%**	0.0%	0.2%	1.3%	1.3%	1.8%
Ex Energy	**0.1%**	0.0%	0.2%	1.3%	1.1%	1.4%
Energy	**0.2%**	4.1%	1.5%	25.8%	23.4%	18.2%
Food and Beverages	**0.2%**	0.1%	0.1%	1.3%	0.3%	-0.4%
Housing	**0.0%**	0.0%	0.1%	0.4%	0.0%	-0.3%
Owners Equivalent Rent	**0.0%**	-0.1%	0.0%	-0.6%	-0.5%	0.7%
New Vehicles	**-0.3%**	0.6%	1.6%	8.3%	3.1%	4.9%
Medical Care	**0.1%**	0.3%	0.2%	2.3%	3.0%	3.4%
Services (Excluding Energy Services)	**0.1%**	0.0%	0.1%	0.6%	1.0%	1.4%
Real Average Hourly Earnings	**0.0%**	-0.4%	0.0%	-1.4%	-0.7%	-1.3%

Source: U.S. Department of Labor