First Trust DATAWATCH

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February CPI

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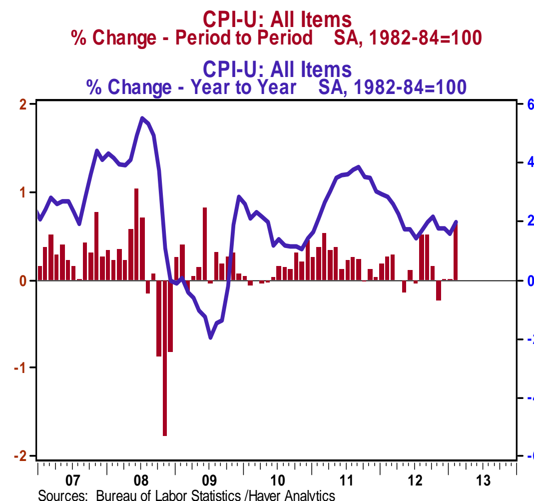
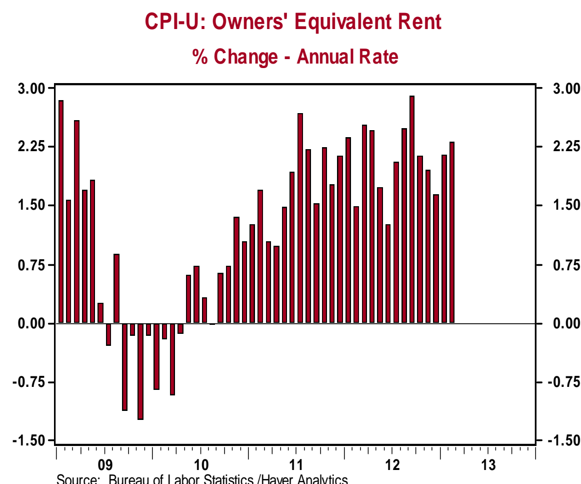
- The Consumer Price Index (CPI) increased 0.7% in February, coming in above the consensus expected gain of 0.5%. The CPI is up 2.0% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was up 0.8% in February and is up 1.9% in the past year.
- The rise in the CPI in February was mainly due to a 5.4% gain in energy prices. Most other major categories saw small gains. The "core" CPI, which excludes food and energy, was up 0.2% in February, matching consensus expectations, and is up 2.0% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were down 0.6% in February but are up 0.1% in the past year. Real *weekly* earnings are down 0.2% in the past year.



Implications: Loose monetary policy is starting to push up inflation. Consumer prices rose 0.7% in February, the biggest monthly gain since 2009. In the first two months of the year, consumer prices are up at a 4.3% annual rate. However, the gain in February was mostly due to energy prices, which rose 5.4%, and overall prices are still up only 2% from a year ago. Energy prices may go up further in March, but not nearly as fast. The underlying inflation trend is rising, but it will not be as fast as we have been seeing recently. "Core" prices, which exclude food and energy, were up 0.2% in February, and are up 2% from a year ago. Neither overall nor core price gains in the past year set 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) remains below the Fed's target of 2%. We don't expect this to last. However, for the Fed, the key measure of inflation is its *own forecast of future inflation.* So even if inflation goes to roughly 3% within the next year (which we expect), as long as the Fed projects the rise to be temporary it will not react 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 fell 0.6% in February. Given today's news it looks like "real" (inflation-adjusted) consumer spending is growing at a 2 - 2.5% annual rate in Q1, consistent with our forecast of 2.5% real GDP growth.



CPI - U *All Data Seasonally Adjusted*	Feb-13	Jan-13	Dec-12	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.7%**	0.0%	0.0%	3.0%	2.4%	2.0%
Ex Food & Energy	**0.2%**	0.3%	0.1%	2.2%	2.0%	2.0%
Ex Energy	**0.2%**	0.2%	0.1%	2.0%	1.9%	1.9%
Energy	**5.4%**	-1.7%	-0.8%	11.6%	6.7%	2.3%
Food and Beverages	**0.1%**	0.0%	0.2%	1.3%	1.6%	1.6%
Housing	**0.2%**	0.2%	0.1%	2.3%	2.5%	1.9%
Owners Equivalent Rent	**0.2%**	0.2%	0.1%	2.1%	2.2%	2.1%
New Vehicles	**-0.3%**	0.1%	0.2%	-0.2%	0.7%	1.1%
Medical Care	**0.2%**	0.1%	0.2%	1.9%	1.8%	3.1%
Services (Excluding Energy Services)	**0.2%**	0.3%	0.2%	2.9%	2.8%	2.6%
Real Average Hourly Earnings	**-0.6%**	0.1%	0.4%	-0.4%	0.0%	0.1%

Source: U.S. Department of Labor

This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.