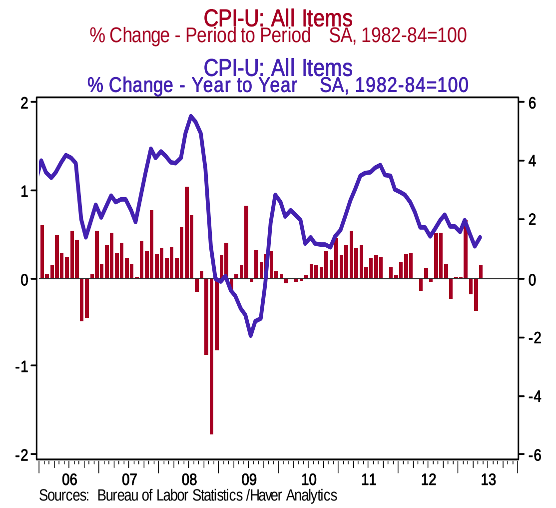
First Trust DATAWATCH

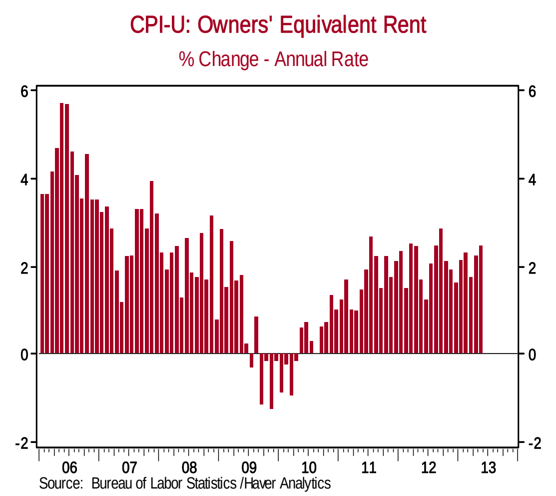
June 18, 2013 • 630.517.7756 • www.ftportfolios.com

May CPI

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

- The Consumer Price Index (CPI) increased 0.1% in May, coming in below the consensus expected gain of 0.2%. The CPI is up 1.4% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was up 0.1% in May and is up 1.2% in the past year.
- The gain in the CPI in May was led by rent (+0.2%) and energy (+0.4%). Food prices were down 0.1%. The "core" CPI, which excludes food and energy, was up 0.2% in May, exactly as the consensus expected. Core prices are up 1.7% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were down 0.2% in May, but are up 0.5% in the past year. Real *weekly* earnings are up 0.9% in the past year.





Implications: For now, all continues to be quiet on the inflation front. Consumer prices rose a tepid 0.1% in May and are only up 1.4% from a year ago. The slight rise in May was due to rent (both actual rent and owners' equivalent rent) as well as energy costs. Food and medical care each declined 0.1%. "Core" prices, which exclude food and energy, were up 0.2% in May and are up 1.7% 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) 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, which we see released tomorrow with the FOMC statement. 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 declined 0.2% in May, although they are still up 0.5% in the past year. Given today's news it looks like "real" (inflation-adjusted) consumer spending is growing at a 2.5% annual rate in Q2, consistent with our forecast of 2.5% real GDP growth.

CPI - U *All Data Seasonally Adjusted*	May-13	Apr-13	Mar-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	-0.4%	-0.2%	-1.6%	0.7%	1.4%
Ex Food & Energy	**0.2%**	0.1%	0.1%	1.3%	1.7%	1.7%
Ex Energy	**0.1%**	0.1%	0.1%	1.2%	1.6%	1.6%
Energy	**0.4%**	-4.3%	-2.6%	-23.6%	-7.7%	-1.0%
Food and Beverages	**-0.1%**	0.2%	0.1%	0.6%	1.0%	1.4%
Housing	**0.3%**	0.2%	0.1%	2.5%	2.4%	2.2%
Owners Equivalent Rent	**0.2%**	0.2%	0.1%	2.2%	2.1%	2.1%
New Vehicles	**0.0%**	0.3%	0.1%	1.3%	0.5%	1.1%
Medical Care	**-0.1%**	0.0%	0.3%	0.5%	1.2%	2.2%
Services (Excluding Energy Services)	**0.2%**	0.1%	0.2%	1.9%	2.4%	2.3%
Real Average Hourly Earnings	**-0.2%**	0.6%	0.3%	2.8%	1.2%	0.5%

Source: U.S. Department of Labor