First Trust DATAWATCH

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February CPI

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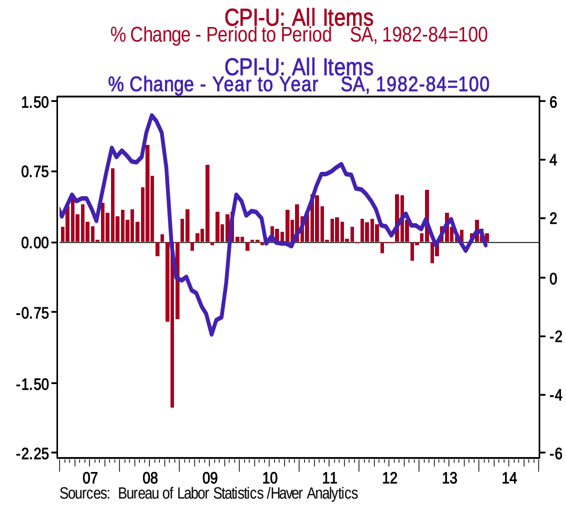
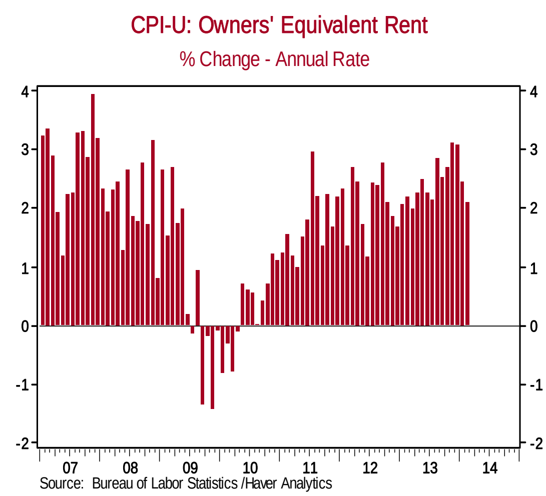
- The Consumer Price Index (CPI) increased 0.1% in February, matching consensus expectations. The CPI is up 1.1% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) rose 0.1% in February and is up 0.7% in the past year.
- The increase in the overall CPI in January was primarily due to food, which rose 0.4%, and housing, up 0.2%. Energy prices declined 0.5%. The "core" CPI, which excludes food and energy, was up 0.1% in February, 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 0.3% in February, and are up 1.1% in the past year. Real *weekly* earnings are up 0.2% in the past year.





Implications: Consumer prices continued to move higher in February, though at the same tepid 0.1% pace we saw in January. In the past year, consumer prices are up 1.1%. "Core" prices, which exclude food and energy, also rose 0.1% in February and are up 1.6% in the past year. 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, is up 2.5% from a year ago. In the prior year, it was up 2.1% and 1.8% in the year before that. 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 labor market. 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%. The minutes from the Fed meeting in January suggest we'll see a change to the 6.5% threshold announced at tomorrow's Fed statement, with either a drop to 6% or movement to more qualitative (and subjective) measures. In other words, the Fed will give itself more wiggle room to keep policy loose.

CPI - U *All Data Seasonally Adjusted*	Feb-14	Jan-14	Dec-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	0.1%	0.2%	2.0%	1.5%	1.1%
Ex Food & Energy	**0.1%**	0.1%	0.1%	1.4%	1.6%	1.6%
Ex Energy	**0.2%**	0.1%	0.1%	1.5%	1.6%	1.5%
Energy	**-0.5%**	0.6%	1.6%	6.9%	1.2%	-2.5%
Food and Beverages	**0.4%**	0.1%	0.1%	1.9%	1.5%	1.4%
Housing	**0.2%**	0.4%	0.2%	3.6%	3.0%	2.5%
Owners Equivalent Rent	**0.2%**	0.2%	0.3%	2.6%	2.7%	2.5%
New Vehicles	**0.1%**	-0.3%	0.0%	-0.8%	-0.5%	0.3%
Medical Care	**0.3%**	0.3%	0.0%	2.5%	2.0%	2.3%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.1%	2.3%	2.4%	2.2%
Real Average Hourly Earnings	**0.3%**	0.1%	-0.2%	0.8%	1.0%	1.1%

Source: U.S. Department of Labor