First Trust DATAWATCH

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February CPI

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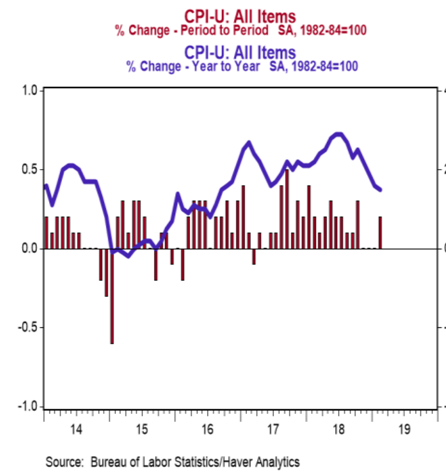
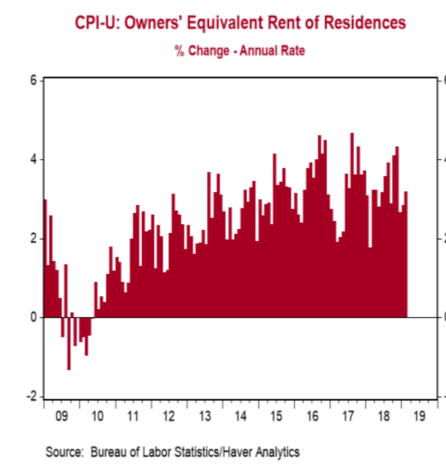
- The Consumer Price Index (CPI) rose 0.2% in February, matching consensus expectations. The CPI is up 1.5% from a year ago.
- Food and energy prices both rose 0.4% in February. The "core" CPI, which excludes food and energy, increased 0.1% in February, coming in below the consensus expected rise of 0.2%. Core prices are up 2.1% versus a year ago.
- Real average hourly earnings – the cash earnings of all workers, adjusted for inflation – rose 0.3% in February and are up 1.9% in the past year. Real average weekly earnings are up 1.6% in the past year.





Implications: Following three consecutive months of no change, consumer prices moved higher in February, rising 0.2%. That may sound like inflation has been virtually non-existent as of late, but rather, it's a textbook case of how volatile categories can distort readings. Energy prices fell 2.8% in November, 2.6% in December, and 3.1% in January. So while the consumer price index showed no change in overall prices during that period, "core" inflation (which excludes the volatile food and energy categories) rose a steady 0.2% in all three months. Now February saw both food and energy prices rise 0.4%, while "core" inflation rose 0.1%. The distortion becomes increasingly clear when you look at the trend. The consumer price index is up 1.5% in the past year, but decelerating, up 1.0% annualized over the past six months and 0.6% annualized over the last three. On the other hand, "core" prices are up 2.1% in the past year and that pace has remained steady, up 2.3% annualized over the past six months and 2.1% annualized over the last three. In other words, the Fed (which understands the short-term volatility coming primarily from the energy sector) continues to have ample support for a path of continued rate hikes. What's restraining the Fed from raising rates is the low level of the yield on the 10-year Treasury Note, which doesn't yet reflect the underlying strength of the economy, and the fear that raising rates would invert the yield curve. We think continued solid economic growth and further resolution of trade tensions will bring more confidence to the financial markets and a return to a more "risk on" environment will put upward pressure on interest rates. Looking at the details of the February report shows housing led the rise in "core" prices, up 0.2%, while higher prices for apparel, education, and personal care (think cosmetics, toothpaste, and hair products) offset declining costs for medical care and motor vehicles. Arguably the best news in today's report was that real average hourly earnings rose 0.3% in February and are accelerating. These real wages are up 1.9% in the past year, up 2.2% at an annual rate over the past six months, and up 3.0% at an annual rate in the past three-months. Remember, "real" wage growth represents increases in earnings above the pace of inflation, so these are direct gains to consumer purchasing power. And these earnings do not include irregular bonuses – like the ones paid by companies after the tax cut or to attract new hires – or the value of benefits. Strong employment growth (don't let February's weak headline payrolls shade your vision), healthy corporate earnings, and continued growth in orders suggest this trend will hold through 2019. The data show pretty much exactly what you would expect from an economy growing at a healthy pace.

CPI - U *All Data Seasonally Adjusted Except for Yr to Yr*	Feb-19	Jan-19	Dec-18	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.2%**	0.0%	0.0%	0.6%	1.0%	1.5%
Ex Food & Energy	**0.1%**	0.2%	0.2%	2.1%	2.3%	2.1%
Ex Energy	**0.2%**	0.2%	0.2%	2.4%	2.3%	2.1%
Energy	**0.4%**	-3.1%	-2.6%	-19.4%	-13.5%	-5.0%
Food	**0.4%**	0.2%	0.3%	4.0%	2.4%	2.0%
Housing	**0.2%**	0.2%	0.3%	3.1%	2.9%	2.9%
Owners Equivalent Rent	**0.3%**	0.3%	0.2%	3.4%	3.2%	3.3%
New Vehicles	**-0.2%**	0.2%	0.0%	-0.1%	-0.3%	0.3%
Medical Care	**-0.2%**	0.2%	0.3%	1.1%	2.0%	1.7%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.2%	2.6%	2.6%	2.7%
Real Average Hourly Earnings	**0.3%**	0.1%	0.4%	3.0%	2.2%	1.9%

Source: U.S. Department of Labor