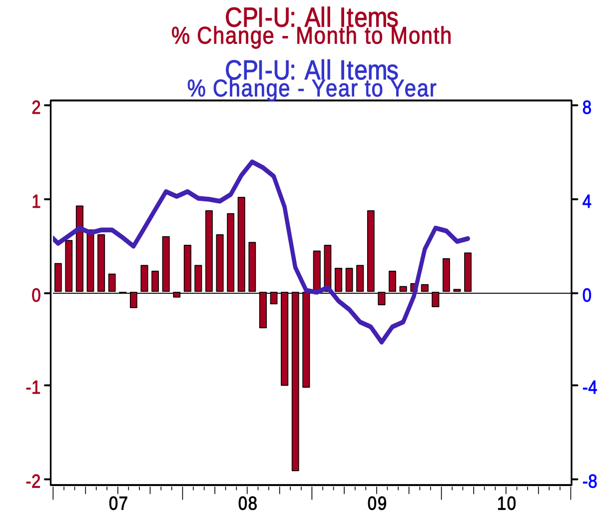
First Trust Data Watch

April 14, 2010 • 630.517.7756 • http://www.ftportfolios.com

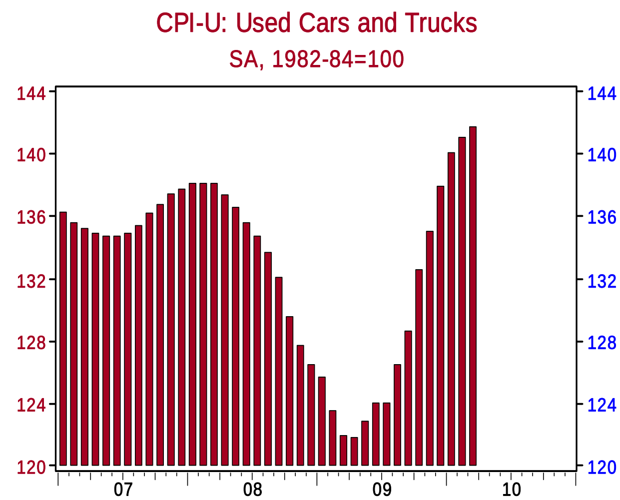
MARCH CPI

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

- The Consumer Price Index (CPI) increased 0.1% in March, matching consensus expectations. The CPI is up 2.3% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what a homeowner would charge himself for rent) was up 0.1% in March and is up 3.2% in the past year.
- Energy prices were unchanged in March. Food prices increased 0.2% and made the largest contribution to the increase in the overall CPI. Excluding food and energy, the "core" CPI was unchanged in March and is up 1.1% versus a year ago.
- Real average hourly earnings – the cash earnings of production workers, adjusted for inflation – fell 0.2% in March and are down 1.0% versus a year ago.



Sources: Bureau of Labor Statistics /Haver Analytics



Source: Bureau of Labor Statistics /Haver Analytics

Implications: Headline figures on consumer prices remain benign, but trouble is brewing deeper inside the inflation report. Overall consumer prices are up 2.3% in the past year. Even better, according to the inflation "doves," is that "core" prices, which exclude food and energy, are up only 1.1% versus a year ago. But we do not believe this is the important part of the report. Instead, we think "cash" inflation better gauges the 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 pay if they rented their own homes. 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 are up 3.2% versus a year ago, higher than the overall index or "core" CPI would have you believe. The financial and economic panic of late 2008 and early 2009 got the Federal Reserve to cut short-term interest rates to, effectively, zero percent. As the economy recovers, that policy stance is becoming more and more inappropriate. Loose money from the Federal Reserve will eventually cause all these measures of inflation to increase substantially.

CPI - U *All Data Seasonally Adjusted*	Mar-10	Feb-10	Jan-10	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	0.0%	0.2%	0.9%	1.7%	2.3%
Ex Food & Energy	**0.0%**	0.1%	-0.1%	-0.2%	0.6%	1.1%
Ex Energy	**0.1%**	0.1%	-0.1%	0.2%	0.7%	1.0%
Energy	**0.0%**	-0.5%	2.8%	9.2%	12.2%	18.3%
Food and Beverages	**0.2%**	0.0%	0.2%	2.0%	1.5%	0.3%
Housing	**0.0%**	0.0%	-0.3%	-1.1%	-0.4%	-0.6%
Owners Equivalent Rent	**-0.1%**	0.0%	-0.1%	-0.8%	-0.6%	0.0%
New Vehicles	**0.1%**	0.1%	-0.5%	-1.2%	2.8%	3.0%
Medical Care	**0.3%**	0.5%	0.5%	5.7%	4.1%	3.7%
Services (Excluding Energy Services)	**0.1%**	0.1%	-0.2%	-0.2%	0.3%	0.8%
Real Average Hourly Earnings	**-0.2%**	0.1%	0.0%	-0.5%	-0.2%	-1.0%

Source: U.S. Department of Labor