First Trust DATAWATCH

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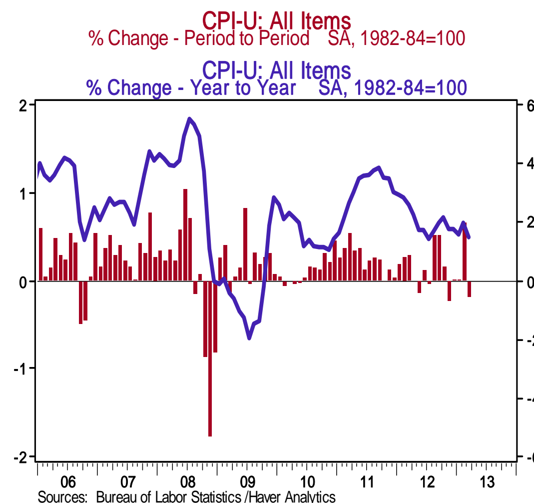
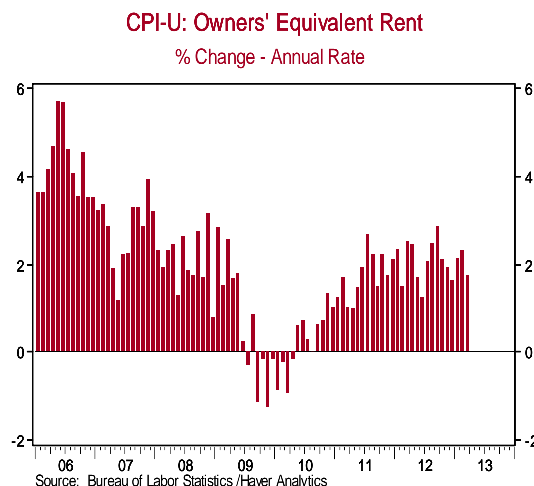
March CPI

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Senior Economist
Strider Elass – Economic Analyst

- The Consumer Price Index (CPI) declined 0.2% in March, coming in below consensus expectations of no change. The CPI is up 1.5% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) was down 0.3% in March but is up 1.3% in the past year.
- The decline in the CPI in March was due to a 2.6% drop in energy prices. Food prices were unchanged. Most other major categories saw small gains. The "core" CPI, which excludes food and energy, was up 0.1% in March, coming in just below the consensus expected gain of 0.2%. Core prices are up 1.9% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were up 0.2% in March and are up 0.3% in the past year. Real *weekly* earnings are up 0.6% in the past year.





Implications: Despite the headline number of a 0.2% decline in the CPI, it looks like loose monetary policy is starting to nudge up underlying inflation. In the first three months of the year, consumer prices have accelerated, up at a 2.1% annual rate compared to up only 1.5% in the past year. The decline in CPI in March was due to energy prices, which are obviously volatile and which fell 2.6%. "Core" prices, which exclude food and energy, were up 0.1% in March and are up 1.9% 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 well 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 best news in today's report was that "real" (inflation-adjusted) average hourly earnings rose 0.2% in March. Given today's news it looks like "real" (inflation-adjusted) consumer spending grew at a 2.5 – 3.0% annual rate in Q1, consistent with our forecast of 3% real GDP growth.

CPI - U *All Data Seasonally Adjusted*	Mar-13	Feb-13	Jan-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**-0.2%**	0.7%	0.0%	2.1%	1.0%	1.5%
Ex Food & Energy	**0.1%**	0.2%	0.3%	2.1%	1.9%	1.9%
Ex Energy	**0.1%**	0.2%	0.2%	1.9%	1.8%	1.8%
Energy	**-2.6%**	5.4%	-1.7%	3.7%	-6.4%	-1.6%
Food and Beverages	**0.1%**	0.1%	0.0%	0.9%	1.6%	1.5%
Housing	**0.1%**	0.2%	0.2%	2.1%	2.2%	1.9%
Owners Equivalent Rent	**0.1%**	0.2%	0.2%	2.1%	2.0%	2.1%
New Vehicles	**0.1%**	-0.3%	0.1%	-0.7%	0.7%	1.1%
Medical Care	**0.3%**	0.2%	0.1%	2.4%	2.0%	3.1%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.3%	2.8%	2.7%	2.5%
Real Average Hourly Earnings	**0.2%**	-0.6%	0.1%	-1.2%	0.8%	0.3%

Source: U.S. Department of Labor

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