First Trust DATAWATCH

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December CPI

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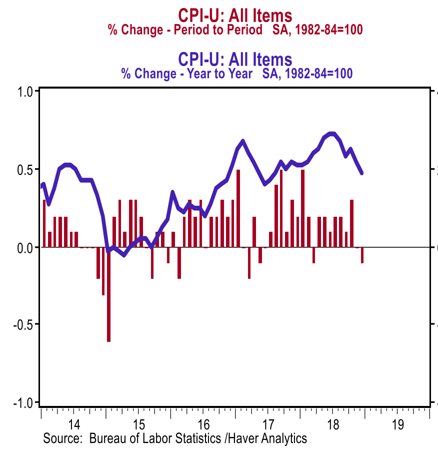
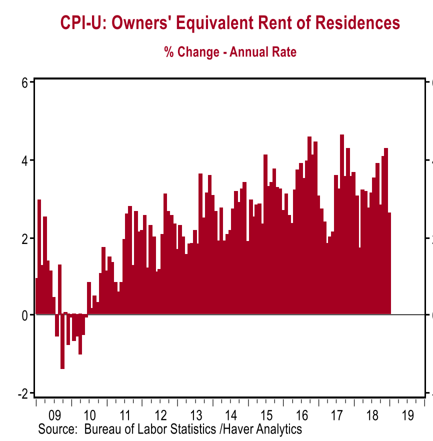
- The Consumer Price Index (CPI) declined 0.1% in December, matching consensus expectations. The CPI is up 1.9% from a year ago.
- Energy prices declined 3.5% in December, while food rose 0.4%. The "core" CPI, which excludes food and energy, increased 0.2% in December, also matching consensus expectations. Core prices are up 2.2% versus a year ago.
- Real average hourly earnings – the cash earnings of all workers, adjusted for inflation – rose 0.5% in December and are up 1.1% in the past year. Real average weekly earnings are up 1.2% in the past year.





Implications: Feel free to completely ignore the headline decline in consumer prices in December, as a sharp decline in gas prices masked inflation in nearly every other category. Sure, some pouting pundits will grasp on to the first decline in nine months or the fact that consumer prices dipped below the Fed's 2% inflation target on a twelve-month basis for the first time in over a year, but the Fed won't be fooled; the expectation among some market participants of a rate cut in 2019 is way off-base. Recent months are a textbook example of how volatility distorts the headline reading. Energy prices rose 2.4% in October before falling 2.2% in November and 3.5% in December. Meanwhile, "core" inflation (which excludes the typically volatile food and energy categories) has risen a steady 0.2% in each of those months. Over the past three months, overall inflation has risen at a modest 1.2% annualized, while "core" prices are up at a 2.5% annual rate. In other words, the Fed (which understands the short-term volatility coming from the energy sectors) will feel there is ample data to support a path of continued rate hikes if – and this is important – we see longer term interest rates begin to rise. The Fed does not want to force a yield curve inversion, but we believe continued solid economic growth and further resolution of trade tensions will bring confidence back to the markets and a return to a more "risk on" environment will put upward pressure on interest rates. As we stated in our annual forecasts release, we expect the 10-year Treasury to end the year at 3.4%, giving the Fed room for two, maybe three hikes in 2019. Looking at the details of the November report shows housing and medical care led the rise in "core" prices, up 0.4% and 0.3%, respectively. Arguably the best news in today's report was that real average hourly earnings rose 0.5% in December – meaning wages rose 0.5% faster than inflation. These real wages are up just 1.1% in the past year but have been accelerating, with wages up 2.2% at an annual rate over the past three months and up 2.1% at an annual rate in the past six-months. And importantly, 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. It's an imperfect measure (to say the least), but this looks like it could be the long-awaited start to rising wage pressures that have been stubbornly slow over recent years. The labor market remains strong and companies continue to report that finding available qualified labor remains a top headwind to even faster growth. In recent employment news, initial jobless claims fell 17,000 last week to 216,000. Meanwhile, continuing claims declined 28,000 to 1.72 million. These figures are consistent with continued robust job gains in January, though expect a slowdown from December's blistering jobs report and the lack of a resolution in the partial government shutdown may temporarily roil the January jobs report. Put it all together, and the data show pretty much exactly what you would expect from an economy growing at a healthy clip, and we expect more of the same in 2019.

CPI - U *All Data Seasonally Adjusted Except for Yr to Yr*	Dec-18	Nov-18	Oct-18	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**-0.1%**	0.0%	0.3%	1.2%	1.5%	1.9%
Ex Food & Energy	**0.2%**	0.2%	0.2%	2.5%	2.1%	2.2%
Ex Energy	**0.2%**	0.2%	0.2%	2.4%	2.0%	2.1%
Energy	**-3.5%**	-2.2%	2.4%	-12.5%	-4.8%	-0.3%
Food	**0.4%**	0.2%	-0.1%	2.1%	1.6%	1.6%
Housing	**0.4%**	0.3%	0.3%	4.2%	3.3%	3.0%
Owners Equivalent Rent	**0.2%**	0.3%	0.3%	3.3%	3.2%	3.2%
New Vehicles	**0.0%**	0.0%	-0.2%	-0.8%	0.0%	-0.3%
Medical Care	**0.3%**	0.4%	0.2%	3.3%	1.1%	2.0%
Services (Excluding Energy Services)	**0.3%**	0.2%	0.2%	2.6%	2.8%	2.9%
Real Average Hourly Earnings	**0.5%**	0.2%	-0.1%	2.2%	2.1%	1.1%

Source: U.S. Department of Labor