First Trust DATAWATCH

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October CPI

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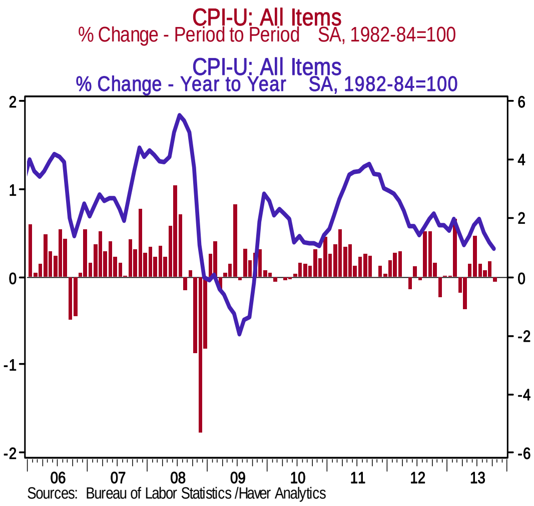
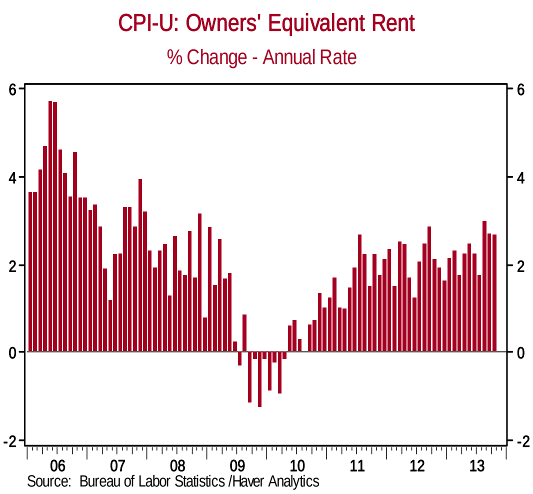
- The Consumer Price Index (CPI) declined 0.1% in October versus consensus expectations of no change. The CPI is up 1.0% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) declined 0.1% in October and is up only 0.6% in the past year.
- The decline in the CPI in October was due to energy, which fell 1.7%, led by a drop in gas prices. Food prices rose 0.1%. The "core" CPI, which excludes food and energy, was up 0.1% in October, exactly as the consensus expected. Core prices are up 1.7% versus a year ago.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – rose 0.2% in October, and are up 1.3% in the past year. Real *weekly* earnings are up 1.5% in the past year.





Implications: Consumer price inflation remains in hibernation, declining 0.1% in October and up only 1% from a year ago. Energy led prices lower in October as the gasoline index fell 2.9%. Outside of the energy sector, prices were up 0.1% in October; the gain was also 0.1% for "core" prices, which exclude food and energy. Core prices are up 1.7% in the past year. About half of the gain in the core index is due to rising rents, up 2.3% in the past year. Given recovering home prices, we expect accelerating rent prices in the years ahead. Regardless, 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%. We don't expect this to last and expect that inflation will be around the 2% target a year from now. 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. The Fed is more focused on the labor market and, we think, is willing to let inflation exceed its long-term target of 2% for a prolonged period of time until the jobless rate comes down. The best news in today's report was that "real" (inflation-adjusted) average hourly earnings rose 0.2% in October and are up 1.3% in the past year. Given today's news it looks like "real" (inflation-adjusted) consumer spending is growing at a 2.5% annual rate in Q4, which should keep real GDP growth positive even if inventory accumulation slows substantially in the quarter.

CPI - U *All Data Seasonally Adjusted*	Oct-13	Sep-13	Aug-13	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**-0.1%**	0.2%	0.1%	0.8%	2.0%	1.0%
Ex Food & Energy	**0.1%**	0.1%	0.1%	1.5%	1.7%	1.7%
Ex Energy	**0.1%**	0.1%	0.1%	1.4%	1.6%	1.6%
Energy	**-1.7%**	0.8%	-0.3%	-4.4%	5.9%	-4.8%
Food and Beverages	**0.1%**	0.0%	0.1%	1.1%	1.0%	1.3%
Housing	**0.1%**	0.3%	0.1%	1.9%	1.9%	2.1%
Owners Equivalent Rent	**0.2%**	0.2%	0.2%	2.8%	2.5%	2.3%
New Vehicles	**-0.1%**	0.2%	0.0%	0.4%	0.9%	1.0%
Medical Care	**0.0%**	0.3%	0.6%	3.7%	2.9%	2.3%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.2%	2.4%	2.3%	2.3%
Real Average Hourly Earnings	**0.2%**	-0.1%	0.2%	1.2%	-0.2%	1.3%

Source: U.S. Department of Labor