First Trust DATAWATCH

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January CPI

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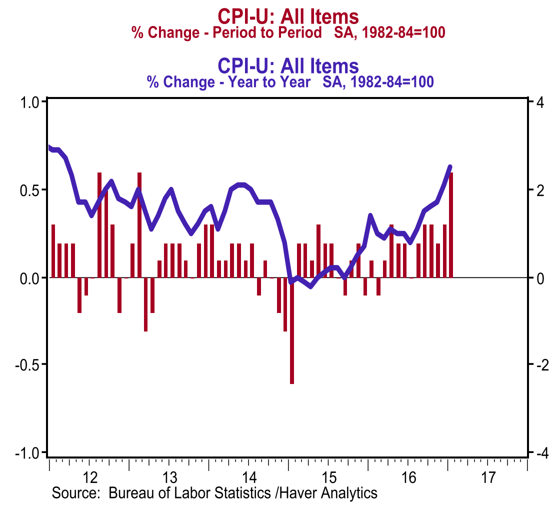
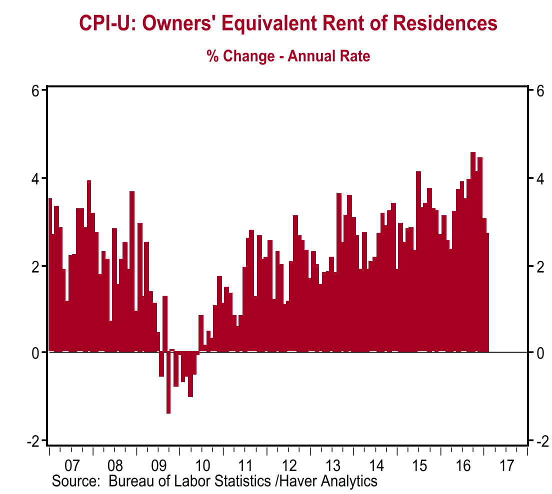
- The Consumer Price Index (CPI) increased 0.6% in January, coming in well above the consensus expected increase of 0.3%. The CPI is up 2.5% from a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) rose 0.6% in January and is up 2.2% in the past year.
- Energy prices rose 4.0% in January, while food prices increased 0.1%. The "core" CPI, which excludes food and energy, increased 0.3% in January, coming above the consensus expected rise of 0.2%. Core prices are up 2.3% versus a year ago.
- Real average hourly earnings – the cash earnings of all workers, adjusted for inflation – declined 0.5% in January and are unchanged in the past year. Real average weekly earnings are down 0.6% in the past year.

Implications: Today's inflation report was a clear sign the Federal Reserve needs to move away from the loose stance of monetary policy or risk falling behind the curve. Consumer prices jumped 0.6% in January, the largest single-month increase since 2013. The leap in prices was led by the volatile energy sector, which rose 4% in January and is up 10.8% in the past twelve months. However, "core" prices, which exclude both food and energy rose 0.3% in January, the largest gain for any month in more than a decade. Overall, consumer prices are up 2.5% in the past year while core prices are up 2.3%. Moreover, both the overall CPI and the core CPI have been rising faster in the past six months than in the past twelve months, and even faster in the past three months. The Fed's favorite measure of inflation is the PCE index. We have a model that uses the CPI to forecast the PCE and that suggests the PCE index was up 0.4% in January. If so, it would also be up 1.9% from a year ago, just a hair below the Fed's 2% target and likely to move to that target or above by March. The worst news in today's report was a 0.5% decline in real average hourly earnings. Real hourly earnings rose a modest 0.8% in 2016, a slower pace than the 1.8% gain in 2015, but given continued employment gains and a tightening labor market, this should rebound soon. With inflation heading to the Fed's 2% target and continued strength in the job market, we expect the Fed to raise rates at least three times in 2017, with four hikes a distinct possibility as well. Fed Chair Janet Yellen told the Senate Banking Committee yesterday that every meeting is "live," and investors should believe her. The odds of a rate hike in March have risen from a long-shot to over 40% and the data show action is warranted.





CPI - U All Data Seasonally Adjusted Except for Yr to Yr	Jan-17	Dec-16	Nov-16	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.6%**	0.3%	0.2%	4.1%	3.6%	2.5%
Ex Food & Energy	**0.3%**	0.2%	0.2%	2.9%	2.5%	2.3%
Ex Energy	**0.3%**	0.2%	0.1%	2.5%	2.1%	1.9%
Energy	**4.0%**	1.2%	1.0%	27.5%	24.3%	10.8%
Food and Beverages	**0.1%**	0.0%	0.0%	0.3%	0.1%	-0.1%
Housing	**0.3%**	0.3%	0.2%	3.1%	3.5%	3.1%
Owners Equivalent Rent	**0.2%**	0.3%	0.3%	3.4%	3.6%	3.5%
New Vehicles	**0.9%**	0.1%	0.0%	3.7%	2.1%	0.9%
Medical Care	**0.2%**	0.2%	0.1%	1.9%	3.4%	3.9%
Services (Excluding Energy Services)	**0.3%**	0.3%	0.3%	3.4%	3.1%	3.1%
Real Average Hourly Earnings	**-0.5%**	0.0%	-0.2%	-2.6%	-1.3%	0.0%

Source: U.S. Department of Labor