

## Another Warm CPI Report Likely to Alter Fed Outlook

Although consumer inflation moderated a bit in February, this morning's CPI numbers were warmer than expected for the second straight month. With the March FOMC meeting now just a week away, Fed officials are likely to raise their inflation outlook and perhaps revise their dot plot to indicate fewer rate cuts this year.

The headline consumer price index climbed +0.4%, up from +0.3% in January and matching the median forecast. According to the Bureau of Labor Statistics (BLS), shelter costs and gasoline drove the increase, combining to account for over 60% of the February gain. On a year-over-year basis, overall CPI rose from +3.1% to +3.2%.

Gasoline prices rose +3.8% last month, in sharp contrast to the -3.3% January drop. Pump prices can be extremely volatile from month to month, but persistent increases can bleed into other categories. Through the first 11 days of March, gasoline prices are up about \$0.20 a gallon nationwide according to AAA. This doesn't bode well for the March report.

The service sector continues to drive overall inflation, although the downward trend in goods prices may have ended. The monthly price increase in core services moderated from +0.7% to +0.5% in February, while core goods were higher (+0.1%) for the first time in nine months.

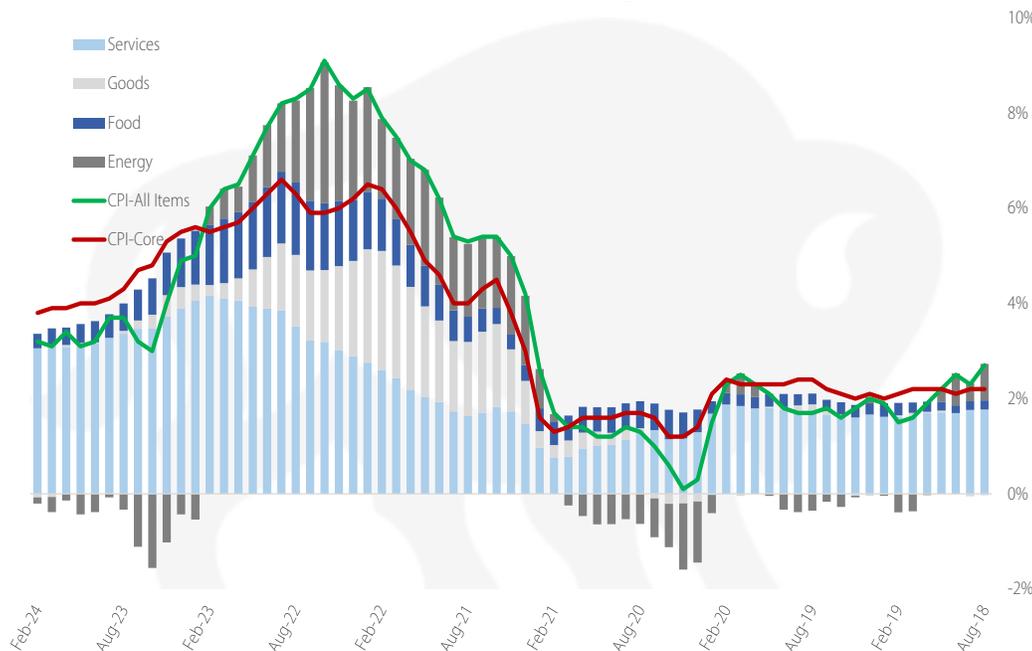
Overall shelter costs climbed +0.4% in February, down from +0.6% in the previous month as owners' equivalent rent, the largest shelter component, moderated enough during the month to counterbalance another unexpected rise in rents.

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### Consumer Price Index (Year-over-Year Percent Change)



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Source: Bureau of Labor Statistics

Please see disclosure starting on page 2

- Food prices were *unchanged* in February and are now up +2.2% on an annual basis. The food at home (grocery) subcategory was also *unchanged* last month and up just +1.0% over the past year.
- Used vehicle prices rose +0.5% in February and are down -1.8% from last year, while new auto prices fell -0.1% and are essentially flat on an annual basis.
- Auto insurance continues to climb, up another +1.4% in February and a nauseating +20.6% year-over-year.
- Non-prescription drug prices are now rising at a +9.3% year-over-year pace.

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Core CPI (ex. food and energy) rose +0.4% for the second straight month, although the year-over-year core rate declined from +3.9% to +3.8%. The so-called CPI “supercore” rate, which is core services excluding shelter costs, rose +0.5%. This Fed favorite is still much too high, but it follows a +0.85% January gain that was the highest in nearly two years.

The market’s reaction has been surprising. Stocks are actually higher in early trading, and although bond yields have risen this morning, the sell-off is mostly concentrated on the long end of the curve. The best explanation for the muted market reaction may be that investors had feared a worse report. That being said, the three-month annualized core CPI pace is now at +4.2%, double the Fed’s target. A June rate cut is still possible, but it’ll take a series of cooler inflation readings between now and then. With both January and February prices well above expectation, the outlook is less optimistic.

## Market Indications as of 9:35 A.M. Central Time

DOW	Up 226 to 38,996 (HIGH: 39,132)
NASDAQ	Up 176 to 16,195 (HIGH: 16,275)
S&P 500	Up 26 to 5,144 (HIGH: 5,157)
1-Yr T-bill	current yield 5.00%; opening yield 4.94%
2-Yr T-note	current yield 4.58%; opening yield 4.53%
3-Yr T-note	current yield 4.32%; opening yield 4.27%
5-Yr T-note	current yield 4.13%; opening yield 4.08%
10-Yr T-note	current yield 4.14%; opening yield 4.09%
30-Yr T-bond	current yield 4.30%; opening yield 4.25%

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