

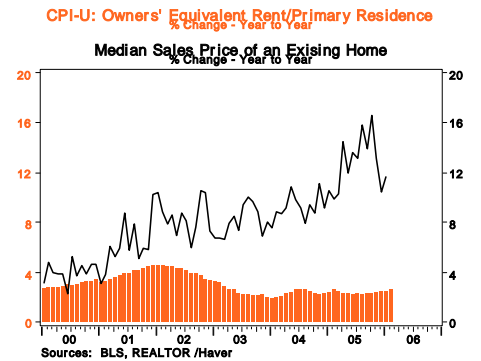
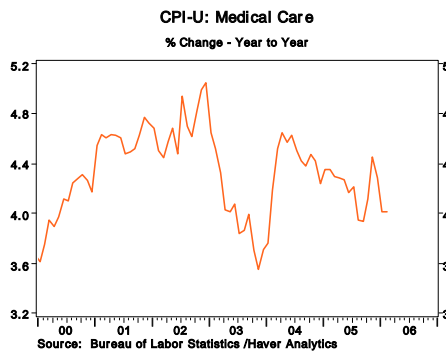
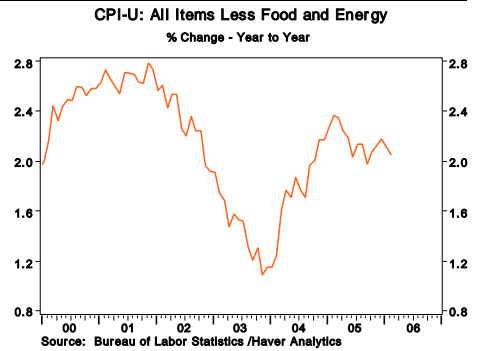
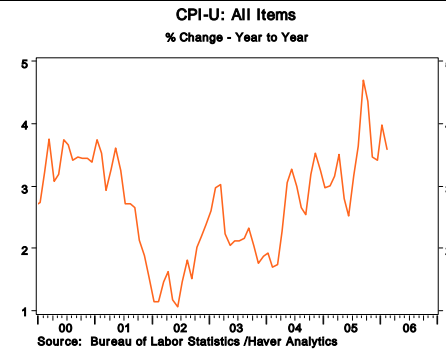
**Brian S. Wesbury**  
*Chief Economist*  
**Bill Mulvihill**  
*Senior Economist*

## FEBRUARY CPI

- The Consumer Price Index (CPI) rose a modest 0.1% in February versus a 0.7% increase in January. The small gain was in-line with consensus expectations. The 12-month change in the CPI decelerated to 3.6% last month from 4.0% in January.
- Energy prices fell 1.2% in February after increasing 5.0% in January. Food and beverage prices rose 0.2%. Excluding food and energy, the “core” CPI was up 0.1% last month, slightly less than consensus estimates of a 0.2% gain. “Core” consumer prices are up 2.1% in the past year.

**Implications:** Once again, inflationary pressures failed to show up in the CPI data. This is in sharp contrast with market measures (gold and commodity prices) and anecdotal evidence (ISM Index) which indicate that inflationary pressures remain elevated. While gains in productivity and cheap goods from overseas are helping to hold prices down, we continue to believe that the CPI understates actual inflation.

For example, the CPI’s measure owner’s equivalency rent is up just 2.5% in the past year and has averaged only 2.9% annualized gains over the past five years. If this measure was accurate, talk of a housing “bubble” would be hard to sustain. Most anecdotal evidence points to much more rapid growth in home prices. The median price of an existing home is up 11.6% in the past year, while the median price of a new home is up 6.7%. Other measures of healthcare and education costs are rising faster than official CPI estimate. As a result, it could be that inflation is being understated by as much as 1% on an annual basis. Even with this underestimation services prices, excluding energy services have climbed 3% at an annual rate in the past three months and we believe this is much more indicative of true inflation. As a result, a neutral federal funds rate is likely near 5.5%.



<b>CPI - U</b> <i>all data seasonally adjusted</i>	<b>Feb-06</b>	<b>Jan-06</b>	<b>Dec-05</b>	<b>3-mo % Ch.</b> <b>annualized</b>	<b>6-mo % Ch.</b> <b>annualized</b>	<b>Yr over Yr</b> <b>% Ch.</b>
<b>Consumer Price Index</b>	<b>0.1%</b>	0.7%	-0.1%	2.7%	3.0%	3.6%
<b>X Food &amp; Energy</b>	<b>0.1%</b>	0.2%	0.1%	2.0%	2.3%	2.1%
<b>X Energy</b>	<b>0.2%</b>	0.2%	0.2%	2.4%	2.4%	2.2%
<b>Energy</b>	<b>-1.2%</b>	5.0%	-2.1%	6.3%	8.8%	20.1%
<b>Food and Beverages</b>	<b>0.2%</b>	0.5%	0.1%	2.9%	2.9%	2.7%
<b>Housing</b>	<b>0.1%</b>	0.5%	0.2%	2.8%	5.2%	4.0%
<b>Apparel</b>	<b>-1.0%</b>	0.3%	-0.3%	-3.6%	-2.5%	-1.8%
<b>Transportation</b>	<b>-0.2%</b>	1.8%	-0.7%	3.5%	-0.9%	5.8%
<b>- New Vehicles</b>	<b>0.1%</b>	0.6%	-0.1%	2.1%	3.0%	-0.4%
<b>Medical Care</b>	<b>0.5%</b>	0.1%	0.2%	3.3%	4.5%	4.0%
<b>Recreation</b>	<b>0.1%</b>	0.0%	0.1%	0.7%	1.3%	1.1%
<b>Education &amp; Communication</b>	<b>0.2%</b>	0.4%	0.2%	3.2%	3.7%	2.6%
<b>Commodities</b>	<b>-0.1%</b>	0.9%	-0.3%	1.7%	0.2%	3.1%
<b>Commodities x Food &amp; Beverages</b>	<b>-0.3%</b>	1.1%	-0.6%	1.1%	-1.4%	3.4%
<b>Services</b>	<b>0.2%</b>	0.5%	0.1%	3.3%	4.9%	3.9%
<b>Services x Energy Services</b>	<b>0.3%</b>	0.2%	0.3%	3.0%	3.2%	2.9%
<b>Other Goods &amp; Services</b>	<b>0.1%</b>	0.3%	0.4%	2.9%	2.7%	2.7%

Source: U.S. Department of Labor

This report was prepared by First Trust Advisors, L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.