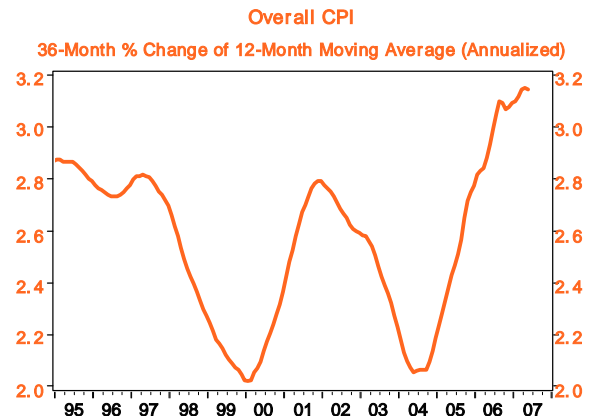
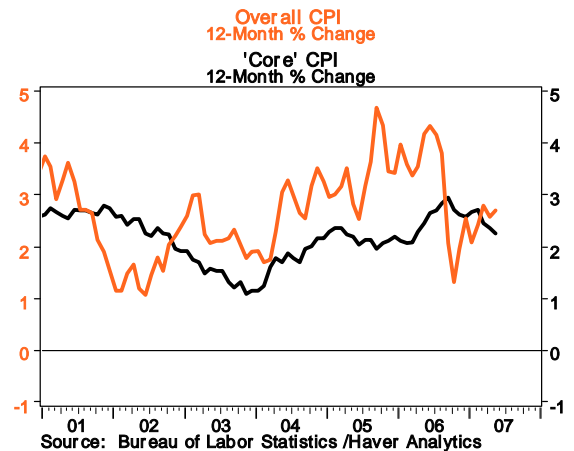


MAY CPI

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- The Consumer Price Index (CPI) increased 0.7% in May, slightly more than the consensus expected. The CPI is up 2.7% versus a year ago.
- Energy prices increased 5.4% in May. Excluding food and energy, the core CPI was up 0.1% (0.149% un-rounded), slightly less than the consensus expected. The core CPI is up 2.2% versus a year ago.

Implications: As with yesterday's producer price report, despite a relatively low reading on core inflation (which excludes food and energy prices), inflation is not benign. The overall CPI was up 0.7% in May, pushing the three-month annualized change to a huge 7%. Excluding the months affected by Hurricanes Katrina and Rita in 2005, it has been more than 16 years since we had a single month or a three-month period with as rapid an increase in the CPI. Core inflation is not a useful measure of the underlying inflation trend when food and energy prices consistently move in one direction. In this situation, consistently ignoring food and energy hides the underlying inflation trend. The chart to the right presents an alternative measure of the underlying inflation trend and it is not a pretty picture. This chart looks at the 3-year change in the 12-month moving average of the CPI. This process counts food and energy (unlike the core) but smoothes out the data to reveal an underlying trend. By this measure, CPI inflation is up at a 3.1% annual rate, well above the inflation rate of 1999-2000 when the Greenspan Federal Reserve raised short-term rates up to 6.5%. In other news today, the Empire State Manufacturing Index soared to 25.8 in June, the highest in a year. The report adds to the case that the economy is strong. Options on federal funds futures now suggest a larger risk of a rate hike by year-end than a rate cut. Expect the odds of a rate hike to increase further in the months ahead.



CPI - U <i>All Data Seasonally Adjusted</i>	May-07	Apr-07	Mar-07	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	0.7%	0.4%	0.6%	7.0%	5.5%	2.7%
<i>Ex Food & Energy</i>	0.1%	0.2%	0.1%	1.6%	2.1%	2.2%
<i>Ex Energy</i>	0.2%	0.2%	0.1%	2.0%	2.5%	2.5%
Energy	5.4%	2.4%	5.9%	71.0%	40.2%	4.7%
<i>Food and Beverages</i>	0.3%	0.4%	0.3%	4.2%	5.1%	3.9%
<i>Housing</i>	0.2%	0.2%	0.2%	2.5%	3.3%	3.3%
<i>Owners Equivalent Rent</i>	0.1%	0.2%	0.3%	2.1%	2.6%	3.5%
<i>New Vehicles</i>	-0.2%	0.0%	0.3%	0.3%	-0.3%	-1.0%
<i>Medical Care</i>	0.3%	0.4%	0.1%	3.3%	4.6%	4.0%
<i>Services (Excluding Energy Services)</i>	0.3%	0.3%	0.1%	2.7%	3.1%	3.4%
Real Average Hourly Earnings	-0.2%	-0.4%	-0.5%	-2.8%	-1.4%	1.6%
Real Average Weekly Earnings	-0.5%	-0.6%	0.1%	-1.6%	-1.4%	1.6%

Source: U.S. Department of Labor

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