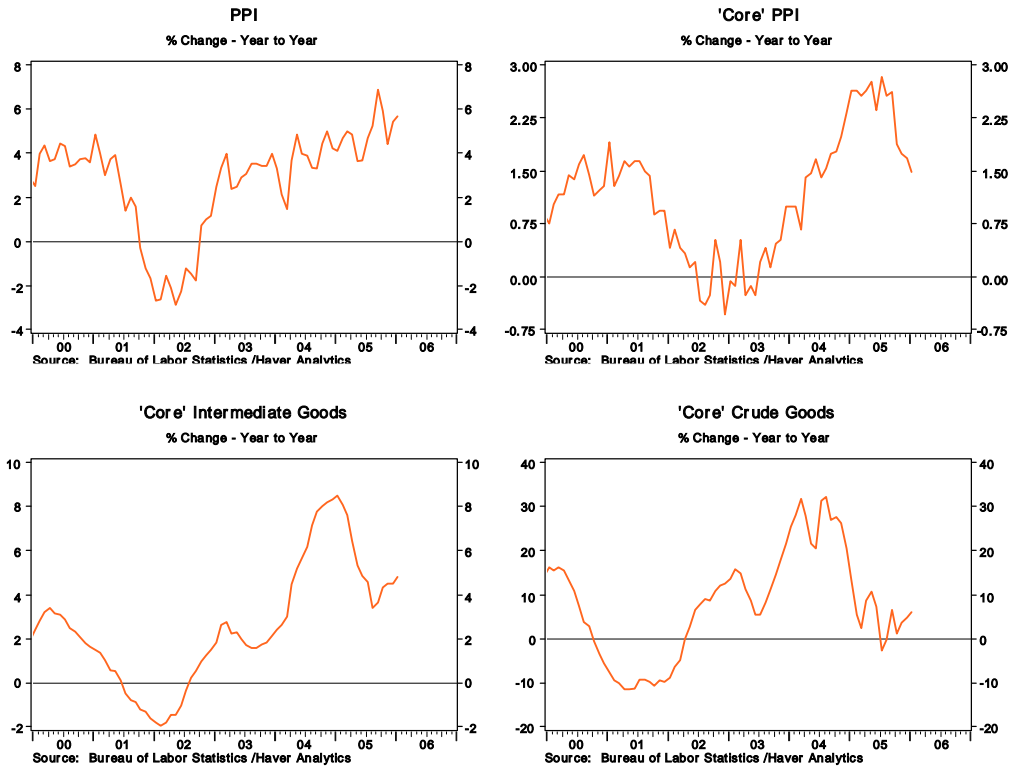


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## JANUARY PPI

- The producer price index for finished goods (PPI) rose 0.3% in January, while the “core” rate increased 0.4%. The consensus had expected both measures to rise 0.2%. The PPI is up 5.7% during the past 12 months, while the “core” PPI is up 1.5%
- Intermediate goods prices increased 1.2% and “core” intermediate prices rose 1.0%. Crude prices fell 0.5% in January, while “core” crude prices were down 0.1%.

**Implications:** Producer prices increased faster than expected in January, with the PPI up 0.3% and the “core” PPI up 0.4%. This is the largest one-month increase in the “core” PPI during the last 12 months. Despite this increase, the YOY gain in the PPI pulled back to 1.5% in January versus 1.7% in December. This continues the gradual moderation in the 12-month change during the last six months. Before this pull-back, the YOY gain in “core” producer prices had risen steadily from a deflationary low of -0.5% in December 2002 to a 14-year high of 2.7% in July 2003. This creates a dilemma: is the recent moderation just a blip or a sign that inflation is no longer a concern? We believe the pull-back is temporary. “Core” intermediate prices increased 1.0% in January and are up 8.1% at an annual rate in the past six months, suggesting that inflationary pressures remain in the pipeline. Moreover, the earliest indicators of inflation, commodity prices, remain elevated. Gold is hovering around \$550/oz and the CRB futures index is up 25.3% in the past year. Add in that nominal growth will likely be above 7% at an annual rate in Q1, and it is clear that Fed policy remains accommodative. We expect this excess liquidity to cause “core” producer prices to accelerate in the months ahead.



<b>Producer Price Index</b> <i>All data seasonally adjusted</i>	<b>Jan-06</b>	<b>Dec-05</b>	<b>Nov-05</b>	<b>3-mo % Ch</b> <i>annualized</i>	<b>6-mo % Ch.</b> <i>annualized</i>	<b>Yr over Yr</b> <i>% Ch.</i>
<b>Finished Goods</b>	<b>0.3%</b>	0.6%	-0.4%	2.0%	6.5%	5.7%
<i>Ex Food</i>	<b>0.2%</b>	0.6%	-0.6%	1.0%	6.9%	6.6%
<i>Ex Energy</i>	<b>0.3%</b>	0.3%	0.3%	3.4%	2.1%	1.6%
<b>Ex Food &amp; Energy</b>	<b>0.4%</b>	0.1%	0.1%	2.6%	1.2%	1.5%
<b>Consumer Food</b>	<b>0.2%</b>	0.8%	0.6%	6.3%	5.0%	1.9%
<b>Finished Energy Goods</b>	<b>0.0%</b>	2.0%	-2.9%	-3.7%	26.5%	25.1%
<b>Capital Equipment</b>	<b>0.3%</b>	0.1%	-0.1%	1.7%	1.0%	1.4%
<b>Intermediate Materials</b>	<b>1.2%</b>	0.1%	-1.0%	1.2%	12.1%	9.2%
<i>Ex Energy</i>	<b>1.0%</b>	0.3%	0.5%	7.4%	7.8%	4.6%
<i>Ex Food &amp; Energy</i>	<b>1.0%</b>	0.3%	0.6%	7.9%	8.1%	4.8%
<b>Crude Materials</b>	<b>-0.5%</b>	-2.3%	-1.5%	-16.0%	33.3%	23.4%
<i>Ex Energy</i>	<b>-1.9%</b>	1.8%	2.0%	7.8%	10.8%	-0.1%
<i>Ex Food &amp; Energy</i>	<b>-0.1%</b>	0.5%	3.8%	17.7%	27.4%	6.0%

Source: Bureau of Labor Statistics

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