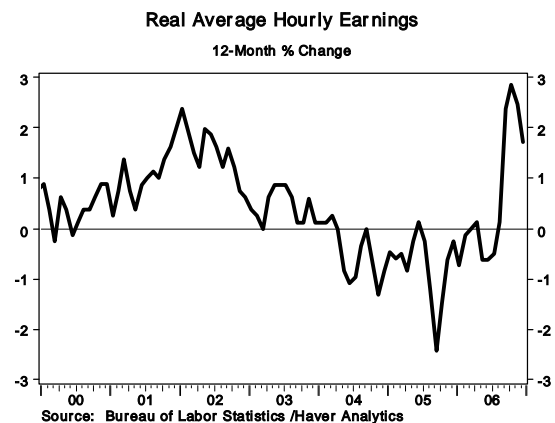
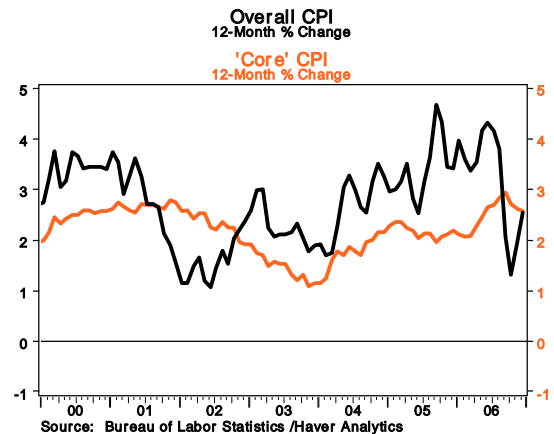


DECEMBER CPI

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- The Consumer Price Index (CPI) increased 0.5% in December, more than the consensus expectation of 0.4%. The CPI is up 2.5% versus a year ago.
- Energy prices increased 4.6% in December, accounting for most of the increase in the CPI. Excluding energy, the CPI was up 0.1%. The “core” CPI, which excludes both food and energy, was up 0.2%, the largest increase in three months. The “core” CPI is up 2.6% versus a year ago.
- Medical care inflation increased only 0.1% in December, tying the record for the smallest monthly increase in the sector since 1975. Prescription drug prices dropped 0.5% in December.
- Real average hourly earnings dropped 0.1% in December, the first decline in four months. Real average hourly earnings are up 1.7% versus a year ago.

Implications: Today’s data shows that inflation remains a threat. The 2.6% increase in the core CPI in 2006 was the largest in five calendar years. Core inflation is already above the Fed’s comfort-zone and, with monetary policy having been too loose for too long, we expect core inflation to trend upward over the course of 2007. Note that the 0.2% increase in the core in December was the largest increase for any December since 1998. Expectations of rate cuts in early 2007 used to be widespread. We resisted that consensus and it has moved in our direction, with the market consensus now signaling no rate cuts in the near future. In the weeks ahead we expect the market to start pricing in greater odds that the next move by the Fed will be to increase rates, not cut them.



CPI - U <i>All Data Seasonally Adjusted</i>	Dec-06	Nov-06	Oct-06	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	0.5%	0.0%	-0.5%	0.2%	0.5%	2.5%
Ex Food & Energy	0.2%	0.0%	0.1%	1.4%	2.0%	2.6%
Ex Energy	0.1%	0.0%	0.1%	1.2%	2.0%	2.5%
Energy	4.6%	-0.2%	-7.0%	-11.2%	-13.4%	2.9%
Food and Beverages	0.0%	-0.1%	0.3%	0.8%	2.1%	2.2%
Housing	0.4%	0.4%	0.0%	3.2%	3.5%	3.3%
Owners Equivalent Rent	0.3%	0.3%	0.4%	4.1%	4.0%	4.3%
New Vehicles	-0.2%	-0.7%	-0.1%	-4.0%	-2.2%	-0.9%
Medical Care	0.1%	0.2%	0.3%	2.3%	3.0%	3.6%
Services (Excluding Energy Services)	0.2%	0.2%	0.3%	2.9%	3.4%	3.7%
Real Average Hourly Earnings	-0.1%	0.4%	1.0%	4.9%	4.2%	1.7%
Real Average Weekly Earnings	-0.1%	0.3%	1.3%	6.2%	4.2%	2.3%

Source: U.S. Department of Labor