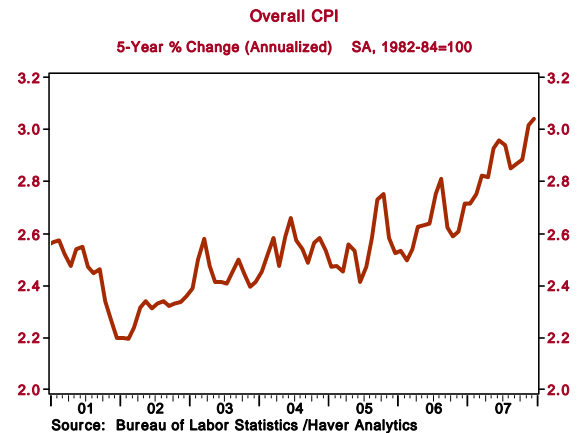
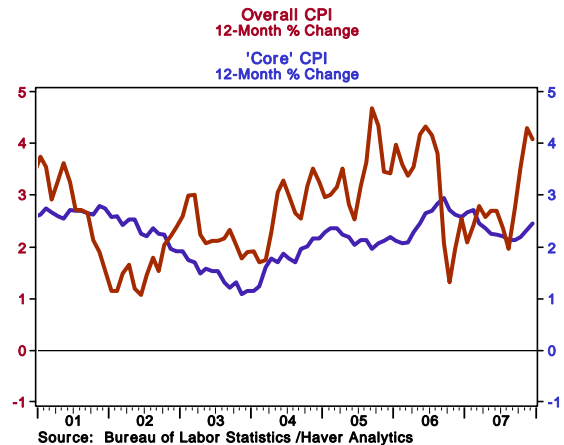


## DECEMBER CPI

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- The Consumer Price Index (CPI) increased 0.3% in December versus a consensus expected 0.2%. The CPI is up 4.1% versus a year ago.
- Energy prices increased 0.9% in December, following November's outsized gain of 5.7%. Energy prices are up 17.4% versus last year. Food and beverage prices were unchanged in December but are up 4.8% versus last year.
- Excluding food and energy, the core CPI was up 0.2% in December (0.242% unrounded), equaling consensus expectations. The core CPI is up 2.4% versus a year ago. Excluding just energy, the CPI was up 0.2% in December and is up 2.8% versus a year ago.
- Real average hourly earnings – the cash earnings of production workers – were up 0.1% in December but are down 0.7% versus a year ago. However, year-to-year wage comparisons should improve substantially over the next several months.

**Implications:** The Federal Reserve cannot afford to treat inflation as a back-page story. Consumer prices rose 0.3% in December, bringing the total 2007 increase to 4.1%, more than any calendar year since 1990. At 4.1% consumer inflation is higher than the yield on the 10-year Treasury, and that's before investors pay taxes on the interest. Since 1960, and with the exception of Hurricanes Katrina/Rita, a negative real *pre-tax* interest rate on the 10-year Treasury has only happened in 1973-80, not a model period for fighting inflation. Even core consumer prices are accelerating, with ex-food/energy prices up at a 2.7% annual rate in the past three months. Investors should not be complacent about inflation, despite the low inflation expectations built into Treasury yields (calculated by comparing regular Treasury yields to the yield on inflation-indexed Treasuries). In the past several years inflation has persistently exceeded these expectations.



CPI - U <i>All Data Seasonally Adjusted</i>	Dec-07	Nov-07	Oct-07	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
<b>Consumer Price Index</b>	<b>0.3%</b>	0.8%	0.3%	5.6%	3.3%	4.1%
<i>Ex Food &amp; Energy</i>	<b>0.2%</b>	0.3%	0.2%	2.7%	2.6%	2.4%
<i>Ex Energy</i>	<b>0.2%</b>	0.3%	0.2%	2.7%	2.8%	2.8%
<b>Energy</b>	<b>0.9%</b>	5.7%	1.4%	37.1%	8.1%	17.4%
<b>Food and Beverages</b>	<b>0.0%</b>	0.3%	0.3%	2.3%	3.5%	4.8%
<b>Housing</b>	<b>0.3%</b>	0.4%	0.2%	3.8%	2.7%	3.0%
<b>Owners Equivalent Rent</b>	<b>0.3%</b>	0.3%	0.2%	3.4%	3.1%	2.8%
<b>New Vehicles</b>	<b>0.0%</b>	0.1%	-0.2%	-0.5%	-0.6%	-0.3%
<b>Medical Care</b>	<b>0.3%</b>	0.4%	0.6%	5.1%	5.6%	5.2%
<b>Services (Excluding Energy Services)</b>	<b>0.3%</b>	0.3%	0.2%	3.5%	3.4%	3.3%
<b>Real Average Hourly Earnings</b>	<b>0.1%</b>	-0.5%	-0.2%	-2.4%	0.2%	-0.7%

Source: U.S. Department of Labor