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Inflation Watch

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On Friday, April 11, the Bureau of Labor Statistics released the Producer Price Indexes for the month of March 2003. On Wednesday, April 16, the Bureau of Labor Statistics released the Consumer Price Indexes for the month of March 2003, and the Federal Reserve Bank of Cleveland released the Median CPI for the month of March 2003.

The following tables contain statistics on the Consumer Price Index (including the Median CPI), the Producer Price Index, and various sub-indexes and special indexes of both.

Additional Information

To see charts for all the indexes shown in the attached tables, go to the subscriber area of our web site (<http://www.biancoresearch.com>) and click on "Inflation Watch."

Consumer Price Inflation

The Consumer Price Index rose 2.97% from March 2002 to March 2003.

Within the eight major sub-groups:

Two are growing faster than the base rate. These groups comprise 22.87% of the index:

- Transportation (6.77%)
- Medical Care (4.30%)

Four are growing slower than the base rate. These groups comprise only 77.13% of the index:

- Housing (2.91%)
- Other goods and services (3.05%)
- Education and communication (2.72%)
- Food and beverages (1.42%)
- Recreation (1.13%)
- Apparel (-3.97%)

For those wondering about deflation, note that only 4.399% of the CPI has declined in the last 12-month period (apparel). The other 95.76% of the CPI is higher.

The commonly watched special index, all items less food and energy (or "core rate"), rose 1.69% in the March to March period.

Many prefer to watch the Federal Reserve Bank of Cleveland's Median CPI as a better measure of the "core rate." This index rose 2.62% March over March.

Of special interest is the all items less energy index, which accounts for 93.782% of the all items index. It rose 1.66% March over March.

Two other special indices are worth notice in the March over March period. The energy index **rose 22.62%** while the energy commodities index **rose 36.48%**.

Producer Price Inflation

In the twelve months ending March 2003, the Producer Price Index for Finished Goods **increased 4.16%**, the Producer Price Index for Intermediate Goods **increased 7.98%**, the Producer Price Index for Crude materials **rose 47.68%** and the Producer Price Index for Commodities **rose 8.94%**.

A Negative Real Funds Rate = Free Money

The targeted Fed Funds rate is currently lower than the annual rate of change of the All Urban CPI Index by a margin not seen since September 1980. This spread, also known as the "real" funds rate, has only been negative during one other period since 1980 (it was negative for a period ending in May 1993).

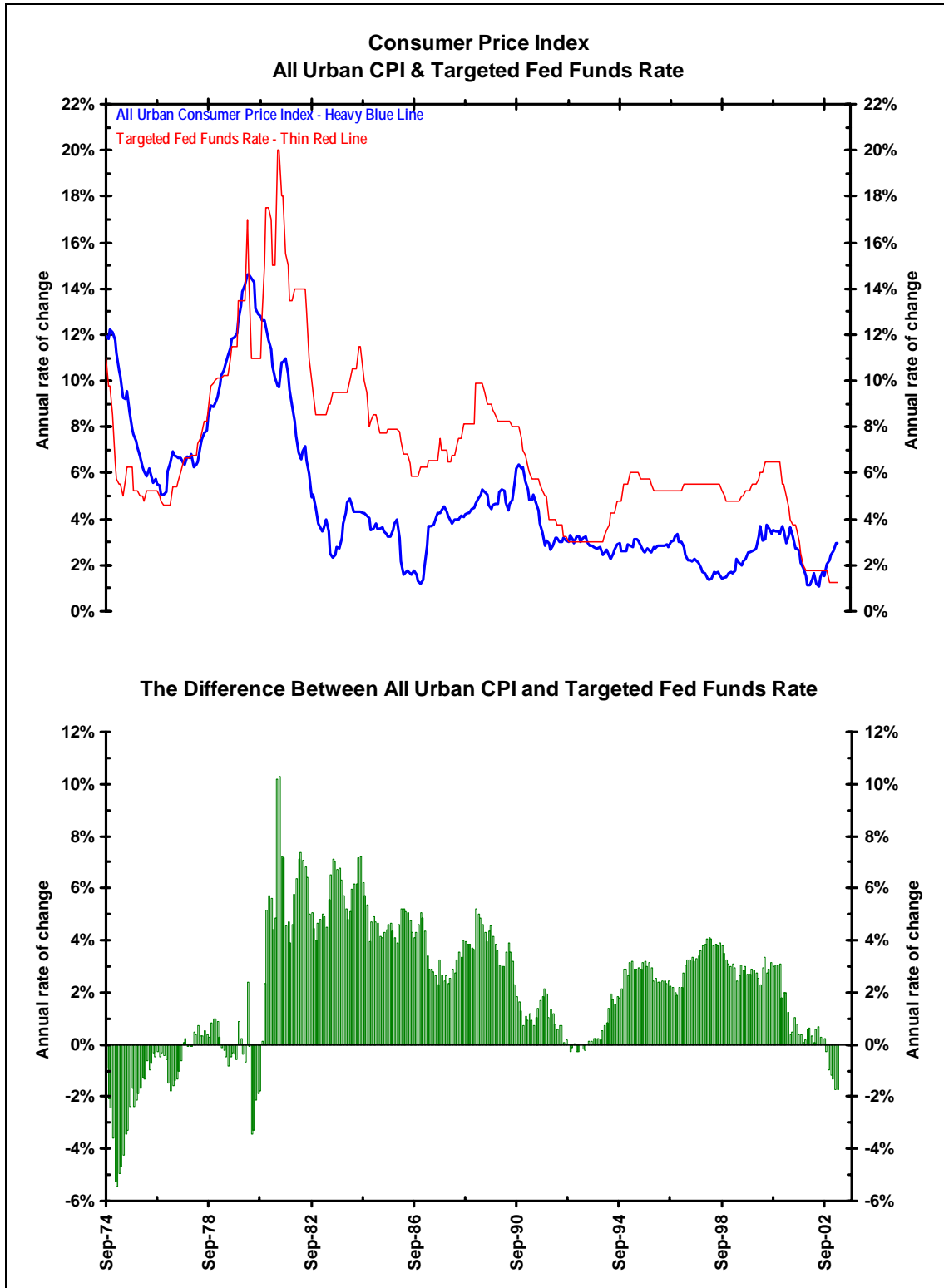
To show just how rare a negative "real" funds rate is, we constructed the chart on the next page. Whenever such a negative "real" funds rate occurs (as shown by a negative reading in the bottom panel), it is extremely stimulative for the economy. After factoring for inflation, a negative "real" funds rate can be considered "free money" and encourages borrowing.

In the two other instances we mentioned above (September 1980 and May 1993), the negative "real" funds rate actually overstimulated portions of the financial markets. In 1980, the vast amounts of borrowing spurred by the negative "real" rates encouraged inflation. In 1993, the negative "real" funds rate helped induce "The Carry Trade".

Both of these instances ended badly for the bond market. Once inflation picked up in the 1980's, the Fed had to raise rates to keep the economy in check. This led to higher yields for bonds, and prices plummeted. Once the Fed raised rates in 1994, investors caught in "The Carry Trade" quickly

deleveraged, selling bonds and causing one of the worst total return years in the history of bonds.

Will the negative "real" funds rate we currently have lead to a similar scenario in which bonds will get hammered in the near future? This is an interesting thought given that rates are near 40-year lows.



Inflation Watch

	Annualized through March 2003							Index Weights as of 1/31/2003
	Mar 2003	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Consumer Price Index								
All Urban Consumers								
All Items (NSA)	0.60%	3.57%	3.14%	2.47%	2.58%	2.52%	3.21%	100.000
All Items (SA)	0.33%	3.46%	2.97%	2.45%	2.57%	2.53%	3.19%	100.000
Food and beverages (SA)	0.17%	2.39%	1.42%	2.34%	2.27%	2.46%	3.02%	15.719
Housing (SA)	0.38%	3.34%	2.91%	3.18%	2.96%	2.78%	3.19%	40.873
Apparel-SA	-0.41%	-4.31%	-3.97%	-2.49%	-1.84%	-1.01%	1.01%	4.399
Transportation (SA)	1.00%	8.74%	6.77%	1.52%	2.59%	2.20%	2.59%	17.055
Medical care (SA)	0.17%	3.86%	4.30%	4.43%	4.16%	4.01%	5.58%	5.810
Recreation (SA)	0.09%	2.08%	1.13%	1.44%	1.22%	1.73%	N/A	6.019
Education and communication (SA)	-0.09%	1.48%	2.72%	2.39%	1.85%	2.62%	N/A	5.813
Other goods and services (SA)	-0.07%	0.20%	3.05%	3.52%	5.05%	4.46%	5.65%	4.312
Special indexes								
All items less food (SA)	0.38%	3.67%	3.30%	2.46%	2.62%	2.53%	3.23%	85.312
All items less energy (SA)	0.00%	1.38%	1.66%	2.26%	2.25%	2.47%	3.34%	93.782
All items less food and energy (SA)	0.00%	1.26%	1.69%	2.26%	2.25%	2.47%	3.42%	79.094
Energy (SA)	4.64%	35.02%	22.62%	5.10%	6.90%	3.23%	2.01%	6.218
Energy commodities (SA)	4.30%	53.48%	36.48%	4.03%	10.14%	4.18%	2.36%	2.752
Median CPI	0.10%	2.25%	2.62%	3.29%	3.03%	3.01%	3.52%	100.000
Producer Price Index								
Commodities								
All (NSA)	2.61%	14.75%	8.94%	2.63%	2.55%	1.77%	1.73%	100.000
Industrial (NSA)	3.01%	16.04%	10.11%	2.72%	2.83%	1.90%	1.81%	86.213
Farm Products (NSA)	-0.16%	6.56%	1.67%	1.70%	0.77%	0.86%	1.21%	13.787
Finished Goods								
All (SA)	1.47%	8.97%	4.16%	1.81%	2.14%	1.50%	1.83%	100.000
Finished consumer goods (SA)	1.58%	11.64%	5.43%	2.34%	2.76%	1.80%	1.93%	72.948
Capital equipment (SA)	0.79%	1.44%	0.36%	0.41%	0.33%	0.67%	1.59%	27.052
Intermediate Goods								
All (SA)	2.02%	12.30%	7.98%	2.06%	2.00%	1.62%	1.59%	100.000
Manufacturing (SA)	0.23%	4.78%	3.84%	0.60%	0.47%	0.90%	1.31%	47.040
Construction (SA)	-0.07%	0.40%	1.06%	0.20%	0.75%	1.41%	2.03%	13.085
Processed fuels and lubricants (SA)	10.31%	66.01%	36.30%	8.16%	9.22%	4.00%	1.47%	15.060
Containers (SA)	0.13%	2.11%	1.58%	1.31%	1.69%	1.99%	2.21%	3.421
Supplies (SA)	0.43%	2.31%	2.10%	1.26%	0.84%	1.29%	1.70%	21.395
Crude materials								
All (SA)	13.33%	92.76%	47.68%	10.66%	9.03%	4.17%	2.12%	100.000
Foodstuffs and feedstuffs (SA)	-2.31%	13.29%	3.02%	1.33%	-0.09%	-0.07%	0.26%	46.173
Nonfood except fuel (SA)	2.07%	30.79%	28.41%	0.55%	7.17%	2.39%	1.24%	32.578
Fuel (SA)	44.17%	456.37%	177.76%	39.25%	25.20%	12.83%	N/A	21.249

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

Federal Reserve Bank of Cleveland (<http://www.clev.frb.org/Research/index.htm#cpi>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

Inflation Watch

	12 Months through March 2003	10 Year High ¹	Date	10 Year Low ¹	Date
Consumer Price Index					
All Urban Consumers					
All Items (NSA)	3.14%	3.76%	Mar 2000	1.07%	Jun 2002
All Items (SA)	2.97%	3.73%	Jun 2000	1.07%	Jun 2002
Food and beverages (SA)	1.42%	4.27%	Nov 1996	1.02%	Jan 2003
Housing (SA)	2.91%	4.80%	Jan 2001	1.87%	Jun 2002
Apparel-SA	-3.97%	2.52%	Apr 1993	-3.97%	Mar 2003
Transportation (SA)	6.77%	9.23%	Mar 2000	-4.31%	Feb 2002
Medical care (SA)	4.30%	6.25%	May 1993	2.52%	Oct 1997
Recreation (SA)	1.13%	3.39%	Jul 1996	0.30%	Sep 1999
Education and communication (SA)	2.72%	4.35%	Jan 1995	0.30%	Jun 1999
Other goods and services (SA)	3.05%	10.42%	Jan 1999	1.77%	Mar 1994
Special indexes					
All items less food (SA)	3.30%	4.06%	Mar 2000	0.85%	Feb 2002
All items less energy (SA)	1.66%	3.24%	May 1993	1.66%	Mar 2003
All items less food and energy (SA)	1.69%	3.49%	Apr 1993	1.69%	Mar 2003
Energy (SA)	22.62%	24.08%	Mar 2000	-15.57%	Feb 2002
Energy commodities (SA)	36.48%	52.34%	Mar 2000	-24.49%	Dec 2001
Median CPI	2.62%	4.01%	Nov 2001	2.21%	Dec 1999
Producer Price Index					
Commodities					
All (NSA)	8.94%	9.12%	Jan 2001	-8.21%	Jan 2002
Industrial (NSA)	10.11%	10.11%	Mar 2003	-9.45%	Jan 2002
Farm Products (NSA)	1.67%	24.85%	May 1996	-14.09%	Jul 1997
Finished Goods					
All (SA)	4.16%	4.81%	Jan 2001	-2.74%	May 2002
Finished consumer goods (SA)	5.43%	6.10%	Jan 2001	-3.48%	May 2002
Capital equipment (SA)	0.36%	2.60%	Nov 1995	-1.00%	Aug 2002
Intermediate Goods					
All (SA)	7.98%	7.98%	Mar 2003	-4.86%	Feb 2002
Manufacturing (SA)	3.84%	8.65%	Apr 1995	-3.26%	Feb 2002
Construction (SA)	1.06%	5.33%	Apr 1995	-0.73%	Mar 2001
Processed fuels and lubricants (SA)	36.30%	36.30%	Mar 2003	-20.56%	Jan 2002
Containers (SA)	1.58%	18.56%	Jul 1995	-9.00%	Nov 1996
Supplies (SA)	2.10%	4.98%	Dec 1995	-1.40%	Sep 1998
Crude materials					
All (SA)	47.68%	55.10%	Jan 2001	-39.75%	Jan 2002
Foodstuffs and feedstuffs (SA)	3.02%	26.06%	May 1996	-14.54%	Jul 1997
Nonfood except fuel SA)	28.41%	62.59%	Feb 2000	-29.01%	Nov 2001
Fuel (SA)	177.76%	223.46%	Jan 2001	-67.47%	Jan 2002

Data Sources: Bureau of Labor Statistics (<http://stats.bls.gov/datahome.htm>)

Federal Reserve Bank of Cleveland (<http://www.clev.frb.org/Research/index.htm#cp>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

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