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Inflation Watch

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In my view, there still is an output gap and I think that it will continue to create some downward inflation pressure, which may be offset by other things, such as (rising inflation) expectations for example or by the fall of the dollar, or other factors" – Fed Governor Bernanke during a speech to the Investment Analysts Society of Chicago, 4/15/04

On Thursday, May 13, the Bureau of Labor Statistics released the Producer Price Indexes for the month of April 2004. On Friday, May 14, the Bureau of Labor Statistics released the Consumer Price Indexes for the month of April 2004.

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 **2.29%** from April 2003 to April 2004.

Within the eight major sub-groups:

Three are growing faster than the base rate. These groups comprise **63.547%** of the index:

- Medical Care (4.76%)
- Food and Beverages (3.41%)
- Housing (2.39%)

Five are growing slower than the base rate. These groups comprise only **36.452%** of the index:

- Education and communication (1.83%)
- Other Goods and Services (1.74%)
- Transportation (1.71%)
- Recreation (1.49%)
- Apparel (0.33%)

The commonly watched special index, all items less food and energy (or "core rate"), rose **1.82%** in the April to April 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 **2.22%** April over April**.**

Two other special indices are worth notice in the April over April period. The energy index **rose 5.96%** while the energy commodities index **rose 11.04%.**

Producer Price Inflation

In the twelve months ending April 2004, the Producer Price Index for Finished Goods **increased 3.65%**, the Producer Price Index for Intermediate Goods **increased 5.02%**, the Producer Price Index for Crude materials **rose 20.34%** and the Producer Price Index for Commodities **rose 5.63%**.

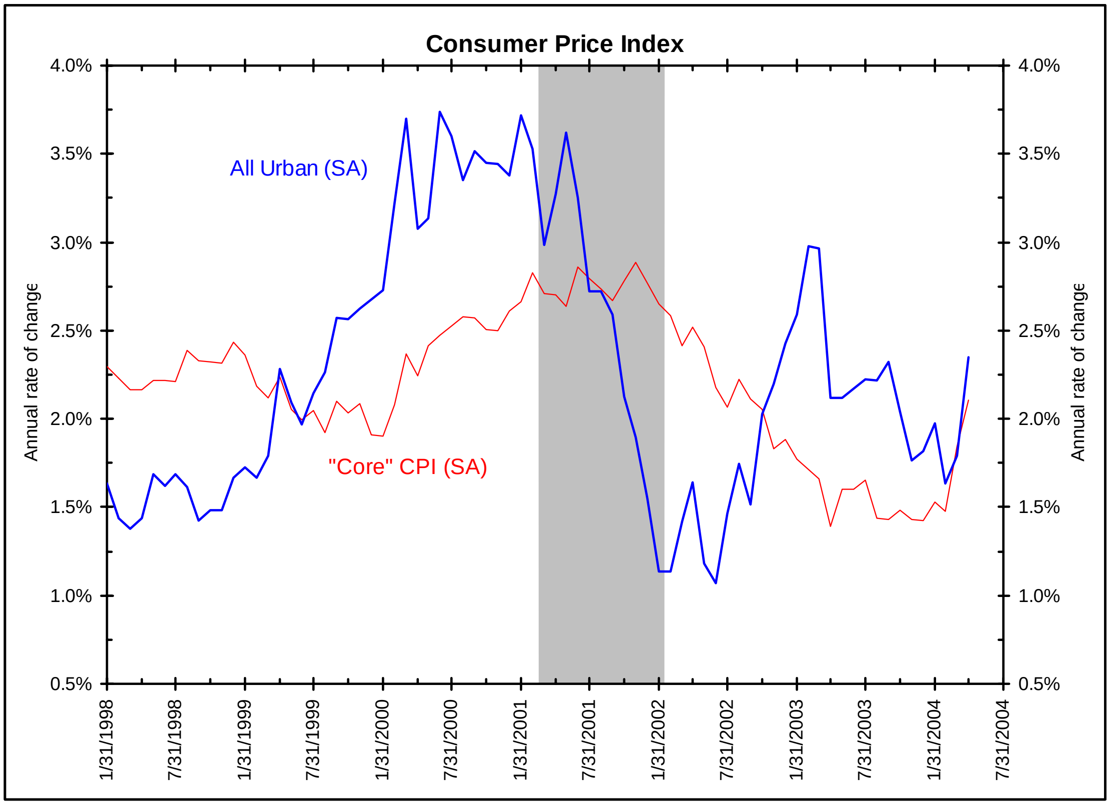
Is A Secular Change In Inflation Coming?

As the quote above states, Fed governor Bernanke believes that multiple factors continue to exert a downward pressure on inflation. While this may be true, the charts on the next page argue otherwise.

The first chart shows the annual rate of change in both "All Urban" CPI (blue line) and "Core" CPI (red line). Notice that, since the beginning of the year, both of these indices have turned sharply higher. This marks the first time since the end of the recession (November 2001) that inflation is trending higher.

The second chart below shows the 10-year TIPS breakeven rate and the **10-year** annualized rate of change in All Urban CPI. The 10-year TIPS breakeven signals what the market believes inflation will average over the **next** 10 years. The 10-year annualized rate of change in All Urban CPI shows what inflation has been over the **past** 10 years. Notice that, for the first time the marketplace believes inflation will be greater over the next ten years than it was over the previous ten.

Add these factors up and one could make the case that the recent uptrend in year-over-year inflation represents the market's belief that the secular trend of inflation is turning higher.


Consumer Price Index
All Urban (SA)
"Core" CPI (SA)
Annual rate of change
4.0%
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
1/31/1998
7/31/1998
1/31/1999
7/31/1999
1/31/2000
7/31/2000
1/31/2001
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1/31/2002
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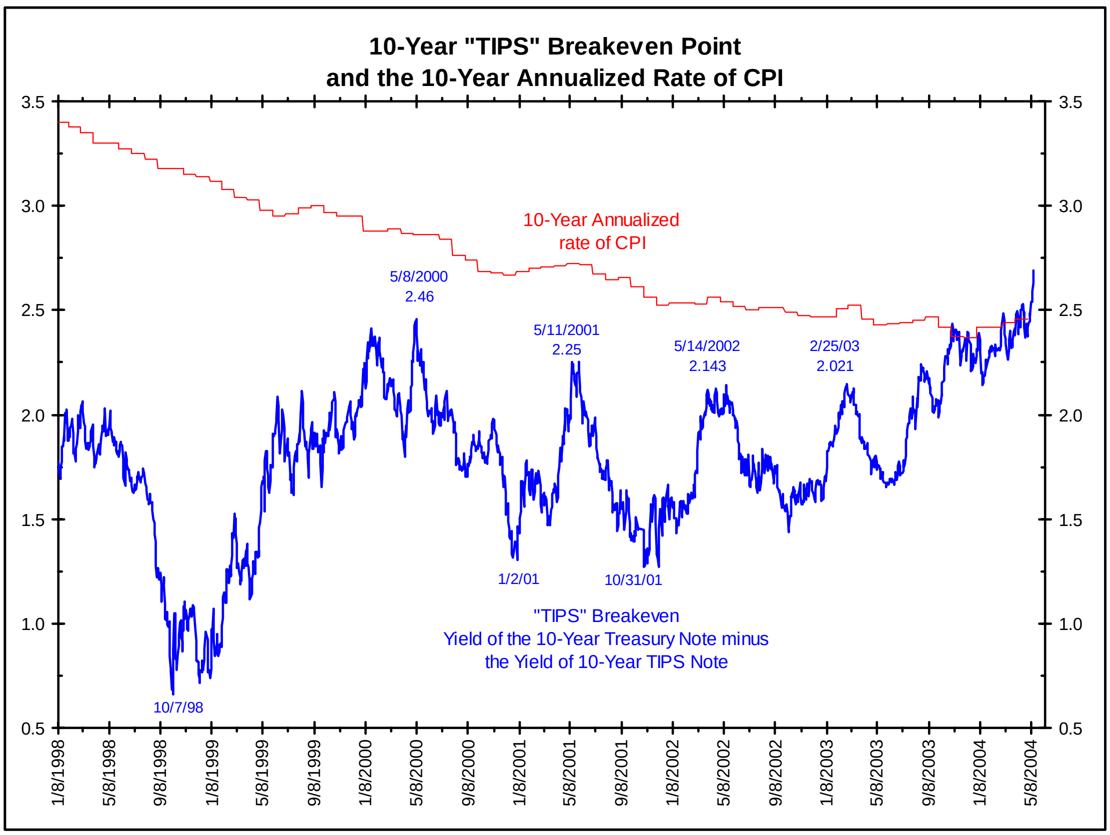
1/31/2004
7/31/2004


10-Year "TIPS" Breakeven Point
and the 10-Year Annualized Rate of CPI
10-Year Annualized
rate of CPI
5/8/2000
2.46
5/11/2001
2.25
5/14/2002
2.143
2/25/03
2.021
1/2/01
10/31/01
10/7/98
"TIPS" Breakeven
Yield of the 10-Year Treasury Note minus
the Yield of 10-Year TIPS Note
3.5
3.0
2.5
2.0
1.5
1.0
0.5
1/8/1998
5/8/1998
9/8/1998
1/8/1999
5/8/1999
9/8/1999
1/8/2000
5/8/2000
9/8/2000
1/8/2001
5/8/2001
9/8/2001
1/8/2002
5/8/2002
9/8/2002
1/8/2003
5/8/2003
9/8/2003
1/8/2004
5/8/2004

Inflation Watch

		Annualized through April 2004							Index Weights as of
	Apr 2004	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	12/31/2003
Consumer Price Index									
All Urban Consumers									
All Items (NSA)	0.32%	6.19%	3.27%	2.29%	2.05%	2.50%	2.46%	3.05%	100.000
All Items (SA)	0.21%	3.93%	2.94%	2.35%	2.03%	2.49%	2.45%	3.03%	100.000
Food and beverages (SA)	0.16%	2.41%	2.98%	3.41%	2.38%	2.46%	2.56%	2.98%	15.384
Housing (SA)	0.37%	3.47%	2.82%	2.39%	2.43%	2.93%	2.72%	3.07%	42.089
Apparel-SA	0.00%	3.38%	-0.66%	0.33%	-2.04%	-1.73%	-0.99%	0.89%	3.975
Transportation (SA)	0.06%	7.82%	4.10%	1.71%	1.12%	2.26%	1.94%	2.24%	16.881
Medical care (SA)	0.36%	6.34%	5.26%	4.76%	4.46%	4.38%	3.96%	5.49%	6.074
Recreation (SA)	0.18%	3.00%	2.05%	1.49%	1.19%	1.30%	1.61%	N/A	5.872
Education and communication (SA)	0.27%	2.55%	2.19%	1.83%	2.19%	2.00%	2.35%	N/A	5.948
Other goods and services (SA)	0.13%	2.14%	2.08%	1.74%	2.54%	3.44%	4.42%	5.37%	3.776
Special indexes									
All items less food (SA)	0.27%	4.37%	2.93%	2.17%	1.99%	2.49%	2.43%	3.04%	85.617
All items less energy (SA)	0.26%	3.16%	2.31%	2.11%	2.01%	2.19%	2.38%	3.18%	92.92
All items less food and energy (SA)	0.26%	3.33%	2.07%	1.82%	1.93%	2.13%	2.34%	3.23%	78.537
Energy (SA)	0.14%	15.98%	11.79%	5.96%	2.88%	6.61%	3.46%	1.81%	7.08
Energy commodities (SA)	-0.26%	32.92%	21.88%	11.04%	4.84%	9.06%	4.82%	2.14%	3.48
Median CPI	0.30%	3.25%	2.22%	2.22%	2.77%	2.87%	2.91%	3.40%	100.000
Producer Price Index									
Commodities									
All (NSA)	1.26%	4.26%	7.45%	5.63%	1.94%	3.17%	1.90%	1.66%	100.000
Industrial (NSA)	1.05%	0.00%	7.46%	4.49%	1.47%	2.99%	1.92%	1.69%	86.213
Farm Products (NSA)	2.25%	30.67%	6.04%	12.64%	4.64%	4.20%	1.80%	1.52%	13.787
Finished Goods									
All (SA)	0.68%	5.32%	4.05%	3.65%	1.23%	2.23%	1.67%	1.77%	100.000
Finished consumer goods (SA)	0.94%	6.92%	4.95%	4.51%	1.65%	2.86%	2.06%	1.90%	74.351
Capital equipment (SA)	0.00%	1.14%	1.29%	1.37%	0.26%	0.48%	0.53%	1.47%	25.649
Intermediate Goods									
All (SA)	1.37%	12.62%	8.66%	5.02%	2.21%	2.82%	1.81%	1.54%	100.000
Manufacturing (SA)	1.34%	13.04%	8.45%	5.10%	1.86%	1.98%	1.23%	1.33%	46.863
Construction (SA)	1.74%	19.74%	10.70%	7.00%	2.85%	2.03%	1.93%	2.22%	12.896
Processed fuels and lubricants (SA)	1.79%	13.03%	12.24%	5.76%	3.08%	7.62%	3.79%	1.09%	16.959
Containers (SA)	0.13%	1.04%	1.44%	0.19%	0.09%	1.89%	2.02%	1.96%	3.160
Supplies (SA)	1.10%	8.94%	6.44%	3.61%	1.77%	1.82%	1.47%	1.71%	20.122
Crude materials									
All (SA)	3.00%	27.50%	25.36%	20.34%	5.10%	11.15%	4.05%	1.94%	100.000
Foodstuffs and feedstuffs (SA)	3.65%	75.11%	13.76%	26.58%	7.71%	7.40%	1.85%	1.21%	40.157
Nonfood except fuel (SA)	-0.50%	30.47%	36.60%	26.72%	9.83%	10.93%	4.29%	1.52%	33.319
Fuel (SA)	6.86%	-20.13%	30.85%	5.60%	0.00%	18.48%	7.73%	N/A	26.524

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 April 2004	10 Year High [1]	Date	10 Year Low [1]	Date
Consumer Price Index					
All Urban Consumers					
All Items (NSA)	2.29%	3.76%	Mar 2000	1.07%	Jun 2002
All Items (SA)	2.35%	3.73%	Jun 2000	1.07%	Jun 2002
Food and beverages (SA)	3.41%	4.27%	Nov 1996	1.02%	Jan 2003
Housing (SA)	2.39%	4.80%	Jan 2001	1.87%	Jun 2002
Apparel-SA	0.33%	1.66%	Aug 1998	-3.99%	Apr 2003
Transportation (SA)	1.71%	9.23%	Mar 2000	-4.31%	Feb 2002
Medical care (SA)	4.76%	4.99%	Dec 2002	2.52%	Oct 1997
Recreation (SA)	1.49%	3.39%	Jul 1996	0.30%	Sep 1999
Education and communication (SA)	1.83%	4.35%	Jan 1995	0.30%	Jun 1999
Other goods and services (SA)	1.74%	10.42%	Jan 1999	0.98%	Sep 2003
Special indexes					
All items less food (SA)	2.17%	4.06%	Mar 2000	0.85%	Feb 2002
All items less energy (SA)	2.11%	3.14%	Apr 1995	1.39%	Apr 2003
All items less food and energy (SA)	1.82%	3.15%	Apr 1995	1.04%	Dec 2003
Energy (SA)	5.96%	24.08%	Mar 2000	-15.57%	Feb 2002
Energy commodities (SA)	11.04%	52.34%	Mar 2000	-24.49%	Dec 2001
Median CPI	2.22%	4.01%	Nov 2001	1.71%	Jan 2004
Producer Price Index					
Commodities					
All (NSA)	5.63%	9.12%	Jan 2001	-8.21%	Jan 2002
Industrial (NSA)	4.49%	10.04%	Mar 2003	-9.45%	Jan 2002
Farm Products (NSA)	12.64%	25.43%	Dec 2003	-14.09%	Jul 1997
Finished Goods					
All (SA)	3.65%	4.81%	Jan 2001	-2.74%	May 2002
Finished consumer goods (SA)	4.51%	6.10%	Jan 2001	-3.48%	May 2002
Capital equipment (SA)	1.37%	2.60%	Nov 1995	-1.00%	Aug 2002
Intermediate Goods					
All (SA)	5.02%	7.98%	Mar 2003	-4.86%	Feb 2002
Manufacturing (SA)	5.10%	8.65%	Apr 1995	-3.26%	Feb 2002
Construction (SA)	7.00%	7.00%	Apr 2004	-0.73%	Mar 2001
Processed fuels and lubricants (SA)	5.76%	35.65%	Mar 2003	-20.56%	Jan 2002
Containers (SA)	0.19%	18.56%	Jul 1995	-9.00%	Nov 1996
Supplies (SA)	3.61%	4.98%	Dec 1995	-1.40%	Sep 1998
Crude materials					
All (SA)	20.34%	55.10%	Jan 2001	-39.75%	Jan 2002
Foodstuffs and feedstuffs (SA)	26.58%	28.21%	Oct 2003	-14.54%	Jul 1997
Nonfood except fuel SA)	26.72%	62.59%	Feb 2000	-29.01%	Nov 2001
Fuel (SA)	5.60%	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#cpi)
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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