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Inflation Watch

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The Bureau of Labor Statistics released the December 2006 Producer and Consumer Price Index reports on Wednesday, January 17th and Thursday, January 18th, 2006, respectively.

The following tables contain statistics on the Consumer Price Index (including the Median CPI), the Producer Price Index, the Personal Consumption Expenditure Index, and various sub-indices and special indices for all three.

Additional Information

To see charts for all the indices 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 **2.54%** from December 2005 to December 2006.

Within the eight major sub-groups:

Three groups are growing faster than the base rate. They comprise **52.06%** of the index:

- Medical Care (3.52%)
- Housing (3.30%)
- Other Goods and Services (3.02%)

Five are growing slower than the base rate. These groups comprise **47.94%** of the index:

- Education and communication (2.35%)
- Food and Beverages (2.18%)
- Transportation (1.55%)
- Apparel (1.01%)
- Recreation (1.00%)

The commonly watched special index, all items less food and energy (or "core rate"), rose 2.61% in the December to December 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 **3.87%** on a year-over-year basis.

Two other special indices are notable on a year-over-year basis. The energy index **rose 3.09%** while the energy commodities index **rose 6.08%**.

Personal Consumption Expenditures

In the year ending **December** 2006, the PCE Index increased 2.29%. The "core" PCE Index (less food and energy) increased by 2.22%.

Producer Price Inflation

In the twelve months ending December 2006, the Producer Price Index for Finished Goods **increased 1.19%**, the Producer Price Index for Intermediate Goods **increased 2.81%**, the Producer Price Index for Crude materials **fell 2.38%** and the Producer Price Index for Commodities **rose 1.84%**.

Rents, OER and the Outlook For Core Inflation

As Owners' Equivalent Rent (OER) constitutes nearly 30% of core CPI, apartment rental data have become critical for CPI analysis. Data published by the real estate company REIS are useful in this regard. The table below depicts effective apartment rents and their quarterly and annual growth rates.

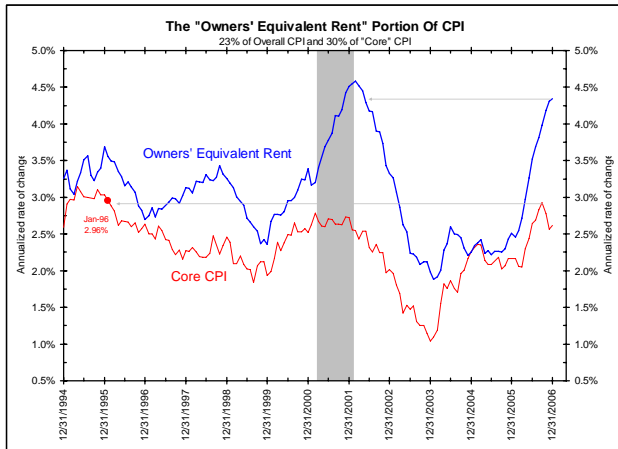
**U.S. Apartment Market
Effective Rents**

Date	Effective Rent	Quarterly Percent Change	Annual Percent Change
Mar-03	\$ 845	-0.2%	
Jun-03	\$ 845	0.0%	
Sep-03	\$ 849	0.5%	
Dec-03	\$ 851	0.2%	
Mar-04	\$ 851	0.0%	0.7%
Jun-04	\$ 857	0.7%	1.4%
Sep-04	\$ 866	1.1%	2.0%
Dec-04	\$ 869	0.3%	2.1%
Mar-05	\$ 873	0.5%	2.6%
Jun-05	\$ 878	0.6%	2.5%
Sep-05	\$ 888	1.1%	2.5%
Dec-05	\$ 895	0.8%	3.0%
Mar-06	\$ 903	0.9%	3.4%
Jun-06	\$ 913	1.1%	4.0%
Sep-06	\$ 926	1.4%	4.3%
Dec-06	\$ 940	0.5%	5.0%

Source: REIS, Inc.

December 2006 effective rent, defined as the average rent normalized by square footage, was \$940, a 5% increase from year-ago levels.

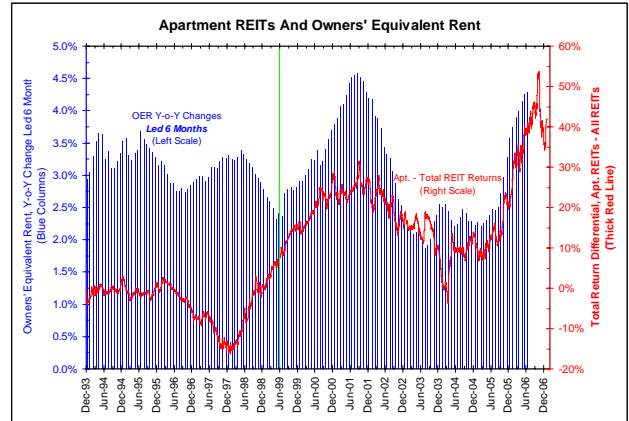
As we have noted on numerous occasions, this development was a natural consequence of the boom and subsequent decline in home prices between 2002 and 2006. The shift of the marginal resident from homeownership back to tenancy has increased the growth rate of OER (thick blue) line relative to the core CPI (thin red line). A peak in rental rates will be required for OER to peak.



Bernanke, forever thinking like an economist, has said, “Don’t worry. Supply will come online to help moderate rentals.” If the data-dependent Federal Reserve wishes to avoid further increases in the federal funds rate, a decline or moderation in OER growth would be useful. Various members of the FOMC have made it clear they regard the present course of core inflation as uncomfortably high.

A Clue From REITs

Inflation data are backward-looking snapshots. As detailed in a May 2006 [Commentary](#), forward-looking assessment of rental market conditions can be garnered from the relative performance of apartment REITs to REITs in general.



The total return differential between apartment REITs and all REITs (thick red line) leads changes in OER (blue columns) by six months on average. The relationship became especially tight once the Greenspan Federal Reserve adopted a risk management approach to monetary policy (green vertical line).

While the performance of REITs has been distorted recently by takeover activity in office REITs, the data indicate we should expect a further 3-4 months of OER growth before moderation begins.

Consumer Price Index

	Annualized through December 2006								Index Weights as of 12/31/2005
	Dec 2006	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Consumer Price Index									
All Urban Consumers									
All Items (NSA)	0.15%	-2.15%	-1.08%	2.54%	3.07%	2.69%	2.44%	3.06%	100.000
All Items (SA)	0.55%	0.20%	0.49%	2.58%	3.13%	2.72%	2.46%	3.07%	100.000
Food and beverages (SA)	0.00%	0.82%	2.06%	2.18%	2.35%	2.39%	2.34%	2.90%	15.051
Housing (SA)	0.39%	3.16%	3.48%	3.30%	3.49%	3.01%	2.92%	3.11%	42.380
Owners' Equivalent Rent (SA)	0.29%	4.05%	3.99%	4.34%	3.03%	2.88%	3.10%	3.52%	23.442
Apparel-SA	0.59%	-1.65%	-0.17%	1.01%	-0.08%	-0.81%	-0.95%	0.56%	3.786
Transportation (SA)	1.84%	-8.56%	-8.87%	1.55%	4.42%	3.51%	1.95%	2.83%	17.415
Medical care (SA)	0.09%	2.26%	3.00%	3.52%	4.05%	4.14%	3.96%	5.10%	6.220
Recreation (SA)	-0.27%	-0.72%	0.00%	1.00%	0.95%	1.02%	1.19%	N/A	5.637
Education and communication (SA)	0.17%	0.68%	1.90%	2.35%	2.10%	1.98%	1.96%	N/A	6.047
Other goods and services (SA)	0.77%	4.65%	3.64%	3.02%	2.85%	2.71%	4.13%	4.96%	3.463
Special indexes									
All items less food (SA)	0.59%	0.00%	0.30%	2.62%	3.24%	2.78%	2.47%	3.11%	86.058
All items less energy (SA)	0.10%	1.18%	1.97%	2.49%	2.34%	2.07%	2.22%	2.96%	91.315
All items less food and energy (SA)	0.19%	1.36%	2.05%	2.61%	2.35%	2.02%	2.20%	2.98%	77.373
Energy (SA)	4.63%	-11.15%	-13.42%	3.09%	12.32%	10.91%	5.25%	4.26%	8.685
Energy commodities (SA)	7.72%	-19.41%	-24.33%	6.08%	16.64%	16.01%	6.56%	5.67%	4.53
Median CPI	0.30%	3.25%	3.66%	3.87%	2.87%	2.70%	2.88%	3.25%	100.000

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

	12 Months through December 2006	10 Year High ¹	Date	10 Year Low ¹	Date
Consumer Price Index					
All Urban Consumers					
All Items (NSA)	2.54%	4.69%	Sep 2005	1.07%	Jun 2002
All Items (SA)	2.58%	4.64%	Sep 2005	1.07%	Jun 2002
Food and beverages (SA)	2.18%	3.96%	May 2004	1.02%	Jan 2003
Housing (SA)	3.30%	4.80%	Jan 2001	1.87%	Jun 2002
Owners' Equivalent Rent (SA)	4.34%	4.59%	Feb 2002	1.88%	Jan 2004
Apparel-SA	1.01%	1.66%	Aug 1998	-3.99%	Apr 2003
Transportation (SA)	1.55%	14.08%	Sep 2005	-4.99%	Oct 2006
Medical care (SA)	3.52%	4.99%	Dec 2002	2.52%	Oct 1997
Recreation (SA)	1.00%	2.81%	Jan 1997	0.09%	Jun 2005
Education and communication (SA)	2.35%	3.82%	Apr 1997	0.30%	Jun 1999
Other goods and services (SA)	3.02%	10.42%	Jan 1999	0.98%	Sep 2003
Special indexes					
All items less food (SA)	2.62%	4.99%	Sep 2005	0.85%	Feb 2002
All items less energy (SA)	2.49%	2.91%	Sep 2006	1.39%	Apr 2003
All items less food and energy (SA)	2.61%	2.93%	Sep 2006	1.04%	Dec 2003
Energy (SA)	3.09%	34.25%	Sep 2005	-15.57%	Feb 2002
Energy commodities (SA)	6.08%	52.47%	Sep 2005	-24.49%	Dec 2001
Median CPI	3.87%	4.01%	Nov 2001	1.71%	Jan 2004

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

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NSA = Not seasonally adjusted

SA = Seasonally adjusted

¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

Personal Consumption Expenditures

	Annualized through December 2006							
	Dec 2006	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years
Personal Consumption Expenditures								
PCE								
All Items (SA)	0.36%	0.68%	0.84%	2.29%	2.71%	2.42%	2.01%	2.57%
Core PCE - Less Food and Energy	0.12%	1.65%	1.91%	2.22%	2.18%	1.92%	1.77%	2.47%
Durable Goods								
All (SA)	-0.40%	-2.98%	-2.36%	-1.61%	-1.04%	-1.98%	-2.06%	-0.58%
Motor Vehicles and Parts (SA)	-0.24%	-3.88%	-1.83%	-0.33%	0.78%	-0.42%	-0.18%	1.23%
Furniture and Household Equipment	-0.58%	-4.30%	-4.62%	-4.54%	-3.96%	-4.74%	-5.16%	-3.45%
Other (SA)	-0.39%	1.38%	0.79%	1.30%	0.48%	-0.28%	-0.45%	0.86%
Nondurable Goods								
All (SA)	0.92%	-2.81%	-2.51%	2.07%	3.06%	2.74%	2.04%	2.39%
Food (SA)	-0.03%	0.69%	1.76%	2.13%	2.26%	2.24%	2.20%	2.55%
Clothing and Shoes (SA)	0.63%	-2.18%	0.04%	0.71%	-0.38%	-0.92%	-1.31%	-0.33%
Gasoline, Fuel Oil, and Other Energy	7.59%	-18.21%	-23.49%	6.13%	15.91%	15.71%	6.45%	5.58%
Other (SA)	0.06%	-1.55%	0.01%	0.95%	1.46%	1.16%	1.93%	2.53%
Services								
All (SA)	0.24%	3.18%	3.17%	3.17%	3.31%	3.19%	2.88%	3.37%
Housing (SA)	0.30%	4.16%	4.10%	4.31%	3.20%	2.99%	3.16%	3.33%
Household Operation (SA)	0.59%	1.68%	3.09%	1.69%	4.29%	3.51%	2.21%	2.13%
Transportation (SA)	-0.01%	0.35%	0.14%	1.86%	3.02%	2.86%	2.42%	3.08%
Medical care (SA)	0.20%	3.97%	3.32%	2.90%	3.25%	3.37%	3.06%	4.21%
Recreation (SA)	0.03%	-0.63%	0.34%	2.11%	2.66%	2.65%	2.86%	3.23%
Other (SA)	0.23%	3.66%	3.68%	3.52%	3.37%	3.30%	2.78%	3.20%

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#pci>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

	12 Months through December 2006	10 Year High ¹	Date	10 Year Low ¹	Date
Personal Consumption Expenditures					
PCE					
All Items (SA)	2.29%	3.80%	Sep 2005	0.74%	Jan 2002
Core PCE - Less Food and Energy (SA)	2.22%	2.44%	Aug 2006	0.97%	Jan 2002
Durable Goods					
All (SA)	-1.61%	-0.18%	Dec 2004	-4.29%	Oct 2003
Motor Vehicles and Parts (SA)	-0.33%	2.72%	Jan 2005	-3.60%	Oct 2003
Furniture and Household Equipment (SA)	-4.54%	-2.79%	Oct 2004	-7.09%	Sep 2003
Other (SA)	1.30%	1.30%	Dec 2006	-2.25%	May 2003
Non-Durable Goods					
All (SA)	2.07%	6.68%	Sep 2005	-0.78%	Dec 2001
Food (SA)	2.13%	3.56%	May 2004	1.10%	Jan 2003
Clothing and Shoes (SA)	0.71%	1.24%	Aug 1997	-3.93%	Jan 2002
Gasoline, Fuel Oil, and Other Energy (SA)	6.13%	52.54%	Sep 2005	-23.69%	Dec 2001
Other (SA)	0.95%	5.53%	Jan 1999	-0.41%	Jun 2003
Services					
All (SA)	3.17%	3.68%	Oct 2005	1.88%	Jun 1998
Housing (SA)	4.31%	4.32%	Feb 2002	2.07%	Jan 2004
Household Operation (SA)	1.69%	9.74%	Jan 2006	-2.36%	Jun 2002
Transportation (SA)	1.86%	5.31%	Sep 2005	0.41%	Jan 2002
Medical care (SA)	1.86%	4.62%	Feb 2004	2.12%	Nov 1997
Recreation (SA)	2.90%	4.16%	Sep 2000	2.04%	Jul 1998
Other (SA)	2.11%	6.53%	Sep 2002	-0.31%	Feb 2001

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#pci>)

NSA = Not seasonally adjusted

SA = Seasonally adjusted

¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

Producer Price Index

	Annualized through December 2006								Index Weights as of 12/31/2005
	Dec 2006	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	20 Years	
Producer Price Index									
Commodities									
All (NSA)	0.55%	1.46%	-0.12%	1.84%	5.97%	5.34%	2.55%	2.58%	100.000
Industrial (NSA)	0.47%	0.24%	-1.40%	1.74%	6.69%	5.62%	2.74%	2.71%	86.213
Farm Products (NSA)	2.25%	26.69%	24.74%	4.95%	0.75%	5.64%	1.02%	1.53%	13.787
Finished Goods									
All (SA)	0.94%	5.10%	0.12%	1.19%	3.77%	3.26%	1.99%	2.25%	100.000
All Less Energy (SA)	0.50%	2.80%	2.42%	1.91%	1.97%	1.59%	1.30%	1.82%	79.860
Finished consumer goods (SA)	1.21%	5.95%	-0.48%	0.84%	4.38%	3.97%	2.44%	2.53%	75.270
Capital equipment (SA)	0.20%	3.02%	1.91%	2.41%	2.01%	1.24%	0.71%	1.47%	24.730
Intermediate Goods									
All (SA)	0.49%	0.24%	-1.20%	2.81%	6.90%	5.55%	2.69%	2.61%	100.000
Manufacturing (SA)	-0.19%	-1.51%	0.64%	5.20%	6.40%	4.80%	2.09%	2.18%	45.283
Construction (SA)	-0.05%	-2.90%	0.85%	4.34%	6.77%	4.82%	2.74%	2.86%	12.604
Processed fuels and lubricants (SA)	2.91%	3.07%	-10.74%	-3.87%	12.15%	11.67%	5.39%	4.38%	20.719
Containers (SA)	0.06%	1.36%	1.25%	4.35%	4.94%	3.10%	2.56%	2.33%	3.015
Supplies (SA)	0.19%	4.12%	3.34%	3.37%	3.73%	2.90%	1.64%	2.07%	18.379
Crude materials									
All (SA)	2.88%	28.65%	17.59%	-2.38%	11.30%	15.54%	4.84%	4.17%	100.000
Foodstuffs and feedstuffs (SA)	0.23%	27.64%	23.16%	2.80%	0.29%	5.64%	1.07%	1.55%	28.028
Nonfood except fuel (SA)	2.69%	-9.82%	-13.65%	8.47%	17.87%	19.67%	6.54%	5.26%	35.218
Fuel (SA)	5.94%	113.19%	78.28%	-16.78%	17.39%	25.09%	7.78%	N/A	36.754

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>)

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	12 Months through December 2006	10 Year High ¹	Date	10 Year Low ¹	Date
Producer Price Index					
Commodities					
All (NSA)	1.84%	10.80%	Oct 2005	-8.21%	Jan 2002
Industrial (NSA)	1.74%	12.38%	Oct 2005	-9.45%	Jan 2002
Farm Products (NSA)	4.95%	25.43%	Dec 2003	-14.09%	Jul 1997
Finished Goods					
All (SA)	1.19%	6.38%	Sep 2005	-2.74%	May 2002
All Less Energy (SA)	1.91%	3.19%	Feb 2005	-0.94%	Sep 2002
Finished consumer goods (SA)	0.84%	7.97%	Sep 2005	-3.48%	May 2002
Capital equipment (SA)	2.41%	2.85%	Apr 2005	-1.00%	Aug 2002
Intermediate Goods					
All (SA)	2.81%	10.50%	Oct 2005	-4.86%	Feb 2002
Manufacturing (SA)	5.20%	9.83%	Aug 2006	-3.26%	Feb 2002
Construction (SA)	4.34%	10.73%	Jan 2005	-0.73%	Mar 2001
Processed fuels and lubricants (SA)	-3.87%	35.91%	Oct 2005	-20.56%	Jan 2002
Containers (SA)	4.35%	8.31%	Mar 2005	-7.02%	Jan 1997
Supplies (SA)	3.37%	4.67%	Jul 2004	-1.40%	Sep 1998
Crude materials					
All (SA)	-2.38%	55.10%	Jan 2001	-39.75%	Jan 2002
Foodstuffs and feedstuffs (SA)	2.80%	28.21%	Oct 2003	-14.54%	Jul 1997
Nonfood except fuel (SA)	8.47%	62.59%	Feb 2000	-29.01%	Nov 2001
Fuel (SA)	-16.78%	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

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¹ Education and communication Index started January 1994

¹ Recreation Index started January 1994

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