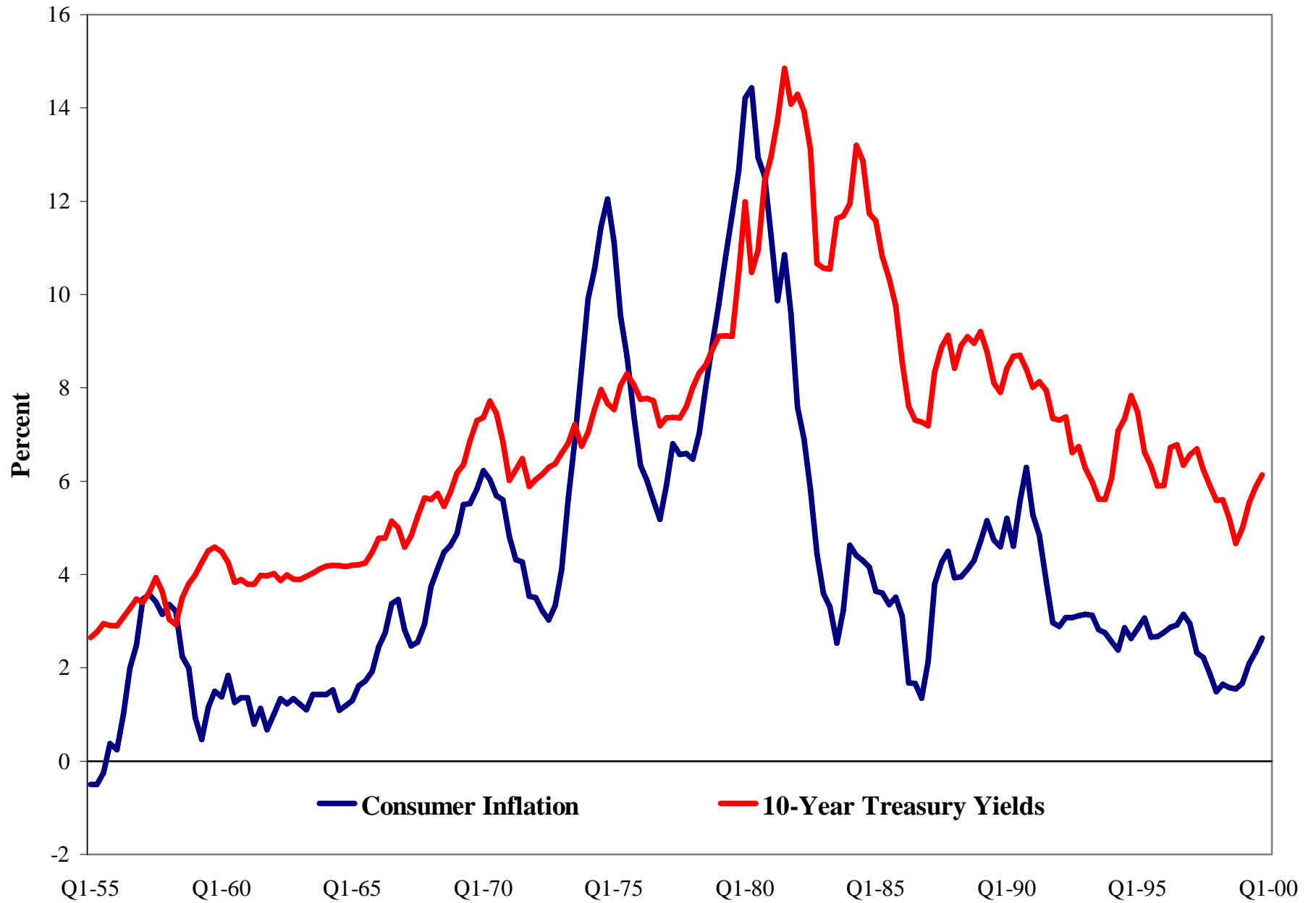
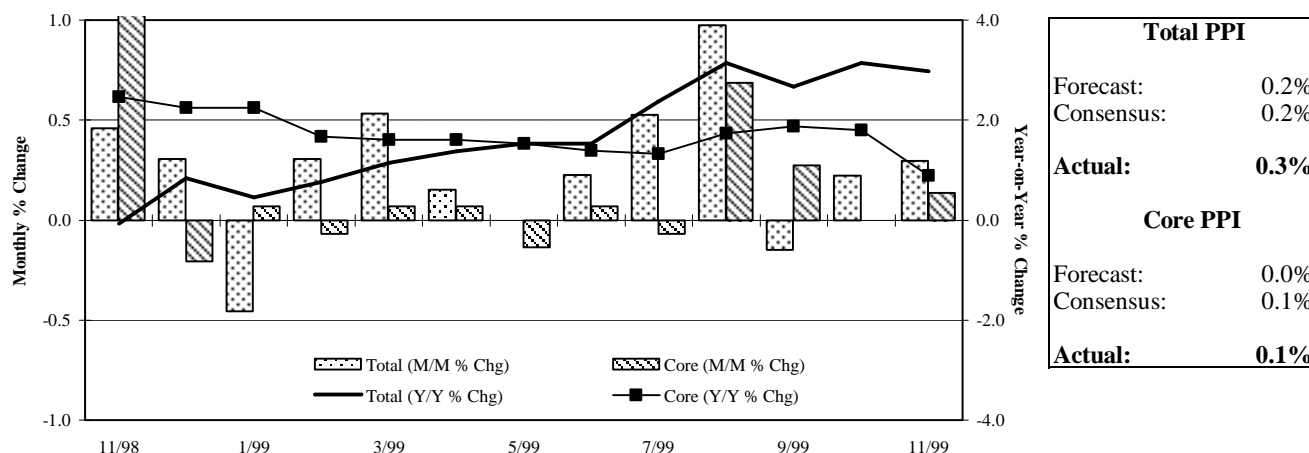


# Inflation and Interest Rates



## US Producer Price Index



The PPI rose 0.3% in December, a bit above expectations as energy costs were higher than anticipated. Last year, the PPI rose 3.0%, its first annual gain in 3 years and the fastest increase in wholesale inflation since 1990. However, a substantial portion of the gain came from higher energy costs. The Core PPI inched up by just 0.1% in December, in line with expectations. For the year, the core PPI rose just 0.9%, less than in the prior year. These data continue to point to very subdued commodity inflation (and robust manufacturing sector productivity gains). Nevertheless, the pace of economic activity is sufficiently strong to compel the FOMC to lift interest rates by 25 basis points at their next meeting on Feb 2.

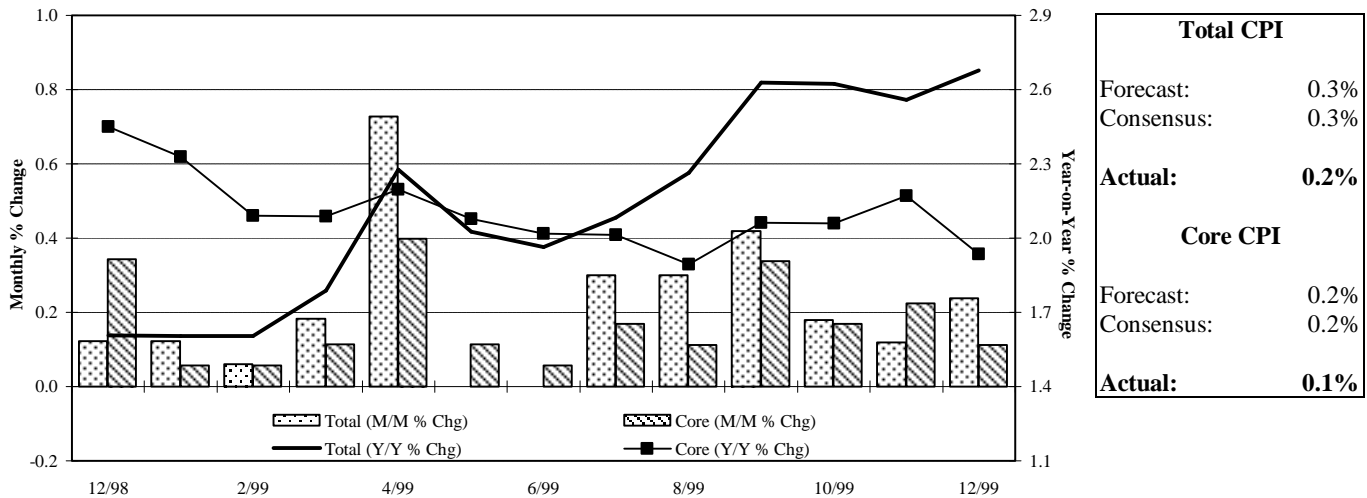
	Relative Weight	Percent Changes									
		Monthly Changes			Annual Rates of Change						
		Nov	Oct	Sep	Three Month	Six Month	Twelve Month	1998	1997	Five Year	Ten Year
<b>FINISHED GOODS</b>	100.0%	<b>0.3</b>	<b>0.2</b>	<b>-0.1</b>	<b>1.5</b>	<b>4.3</b>	<b>3.0</b>	<b>-0.1</b>	<b>-1.2</b>	<b>1.1</b>	<b>1.8</b>
First gain in 3 years.											
<b>Consumer Goods</b>	74.8%	<b>0.4</b>	0.4	-0.3	1.8	5.6	3.9	-0.1	-1.4	1.2	1.8
<b>Food</b>	23.3%	<b>0.4</b>	0.1	-0.7	-0.9	0.7	0.9	0.1	-1.0	1.1	1.5
<b>Non-food Goods</b>	76.7%	<b>0.4</b>	0.4	-0.1	2.7	7.6	5.3	-0.2	-1.6	1.2	0.6
Largest contributor to overall gain.											
<b>Energy</b>	12.0%	<b>1.2</b>	1.4	-1.0	6.8	23.4	<b>18.6</b>	-12.1	-6.6	-0.7	2.0
<b>Cars</b>	6.6%	<b>0.7</b>	0.2	1.1	7.8	7.4	1.3	0.5	-2.6	0.2	1.5
<b>Tobacco</b>	3.1%	<b>0.1</b>	0.1	0.0	<b>0.7</b>	<b>18.1</b>	8.5	3.5	0.4	0.0	5.6
Price pressure has passed through.											
<b>Capital Equipment</b>	25.2%	<b>0.1</b>	-0.1	0.3	1.5	1.0	0.3	0.0	-0.6	0.8	1.7
Still incredibly subdued.											
<b>Addendum:</b>							<b>0.9</b>	<b>2.5</b>	<b>0.0</b>	<b>1.5</b>	<b>2.0</b>
<b>less Food &amp; Energy</b>	64.7%	<b>0.1</b>	<b>0.0</b>	<b>0.3</b>	<b>1.6</b>	<b>2.2</b>					
<b>INTERMEDIATE GOODS</b>	100.0%	<b>0.2</b>	0.3	0.3	3.6	5.1	3.9	-3.4	-0.8	0.8	1.0
<b>less Food &amp; Energy</b>	83.2%	<b>0.2</b>	0.1	0.4	<b>2.7</b>	<b>2.7</b>	<b>1.9</b>	<b>-1.6</b>	0.4	1.2	1.1
Very little pass-through from crude goods prices.											
<b>CRUDE GOODS</b>	100.0%	<b>-3.9</b>	4.0	-1.6	-6.6	16.0	15.8	-16.8	-11.3	-2.3	-0.8
<b>less Food &amp; Energy</b>	21.7%	<b>1.8</b>	0.3	2.4	<b>19.6</b>	<b>23.0</b>	<b>13.5</b>	<b>-15.9</b>	-0.1	-2.4	-0.7
Pipeline price pressures still strong.											

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## US CPI



Consumer Prices rose 0.2% in December, a bit below expectations. For the year, consumer inflation rose 2.7%, up a full percentage point from the prior 2 years. However, nearly all of the acceleration last year was due to surging energy prices, up 13.4%, and tobacco costs, up 11.4%. Core Consumer Prices rose just 0.1% in December, also a bit below expectations. For the year, core consumer inflation rose just 1.9%, its lowest level in 34 years! The FOMC will be pleased with these data, especially given expectations of flattish energy and tobacco prices this year. Nevertheless, the Committee will lift its funds rate target by 25 basis points at the Feb 2 meeting.

	Relative Weight	Percent Change											
		Monthly % Changes			Annual Rates of % Change								
		Dec	Nov	Oct	Three Month	Six Month	Twelve Month	1998	1997	Five Year	Ten Year		
<b>All Items</b>	100.0%	<b>0.2</b>	<b>0.1</b>	<b>0.2</b>	<b>2.2</b>	<b>3.2</b>	Energy and tobacco induced jump.		<b>2.7</b>	<b>1.6</b>	<b>1.7</b>	<b>2.3</b>	<b>3.1</b>
<b>Food &amp; Beverages</b>	16.4%	<b>0.1</b>	0.1	0.2	2.0	2.2	2.0	2.2	1.7	2.6	3.0		
<b>Housing</b>	39.8%	<b>0.1</b>	0.3	0.1	2.2	2.5	2.2	2.3	2.4	2.5	3.0		
<b>Apparel &amp; Upkeep</b>	4.8%	<b>0.0</b>	-0.5	0.6	0.6	0.3	-0.5	-0.7	1.0	-0.3	1.1		
<b>Transportation</b>	17.0%	<b>0.7</b>	0.0	0.2	3.6	7.4	5.4	-1.7	-1.4	1.2	2.4		
<b>Medical Care</b>	5.7%	<b>0.4</b>	0.4	0.2	3.7	3.8	Modest acceleration.		<b>3.7</b>	<b>3.4</b>	<b>2.8</b>	3.6	5.6
<b>Recreation</b>	6.1%	<b>0.2</b>	0.2	0.1	2.0	0.0	0.8	1.2	1.6	2.0	#N/A		
<b>Education and Communication</b>	5.5%	<b>0.2</b>	0.3	0.2	2.8	2.2	1.5	0.7	3.0	2.9	#N/A		
<b>Other Goods &amp; Services</b>	4.6%	<b>0.2</b>	0.0	0.1	1.1	5.6	5.1	8.8	5.2	5.2	5.9		
<b>Addendum:</b>							Sharp turnaround						
<b>Energy</b>	6.3%	<b>1.4</b>	0.0	-0.1	5.2	16.6	<b>13.2</b>	<b>-8.8</b>	-3.6	-0.8	1.0		
<b>less Food &amp; Energy</b>	78.3%	<b>0.1</b>	<b>0.2</b>	<b>0.2</b>	<b>2.0</b>	<b>2.3</b>	<b>1.9</b>	<b>2.5</b>	<b>2.2</b>	<b>2.6</b>	<b>3.4</b>		
							Softer gain.						

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# The Output Ratio and Inflation

