

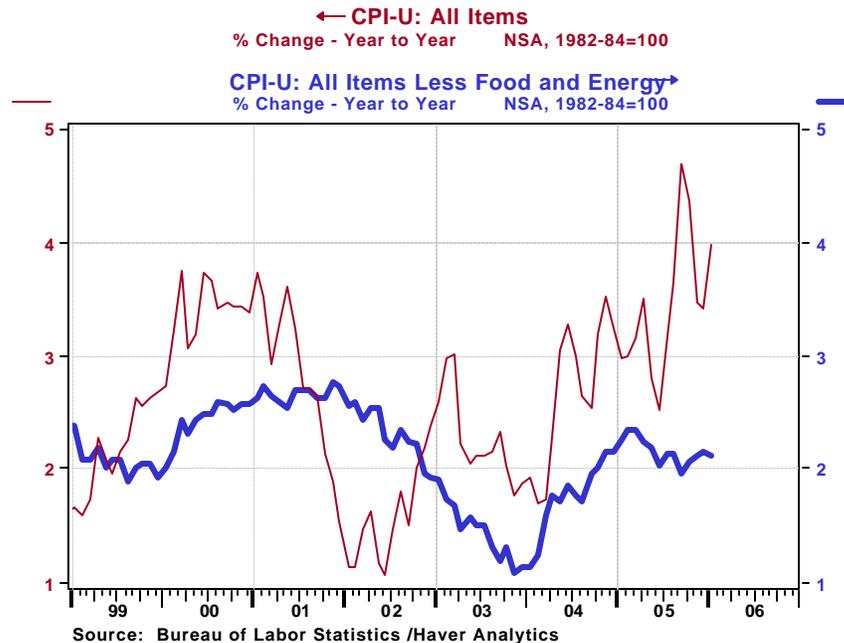
Higher Energy and Non-energy Prices Lift Overall CPI

February 22, 2006

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The 0.7% increase in the Consumer Price Index (CPI) was led by higher prices for energy, food and other core items. The 5.0% increase in the energy price index accounted for over 70.0% of the increase in the CPI during January.



In addition to higher energy prices, the food price index advanced 0.5% in January, with higher prices for fresh fruits and vegetables accounting for more than half this increase. Each of the six major categories of the food price index posted gains in January.

The core CPI, excluding food and energy, edged up 0.2% in January, following a 0.1% increase in December. On a year-to-year basis, the core CPI advanced 2.1% in January compared with a 2.2% increase in all of 2005. New car prices rose 0.6% in January, after two monthly declines. The 0.1% increase in shelter costs reflects a 0.1% increase in rent, a 0.2% gain in owner's equivalent rent, and a 0.5% increase in hotel prices. Airfares rose 1.2% after posting declines in November and December. Apparel prices increased 0.3% in January after a 0.3% drop in the prior month. The 1.5% annualized gain in the medical price index represents a small deceleration in costs after posting a 5.3% annualized increase during the three months ended December.

Conclusion – The minutes of the January meeting and Bernanke’s testimony lead us to conclude that a 4.75% federal funds rate is nearly certain on March 28. The FOMC remains highly concerned about the pass through of higher energy prices to prices of core consumer goods and services. The pass through has not surfaced as yet, but the FOMC remains vigilant to prevent inflation from taking hold.

CONSUMER PRICE INDEX – JANUARY 2006

	% change	annualized change		% change	
	prior month	3 mo. ago	6 mo. ago	year ago	y-o-y '05**
CPI - ALL ITEMS	0.7	-0.2	4.0	4.0	3.4
CORE - ALL ITEMS LESS FOOD & ENERGY (77.4)*	0.2	2.4	2.2	2.1	2.2
CPI ALL ITEMS LESS ENERGY (91.3)	0.2	2.4	2.3	2.2	2.2
FOOD (13.9)	0.5	3.4	2.8	2.6	2.3
ENERGY (8.69)	5.0	-20.6	23.1	24.8	17.1
SHELTER (32.26)	0.1	2.9	2.4	2.6	2.6
COMMODITIES (40.79)	0.9	-6.4	2.6	3.8	2.7
COMMODITIES LESS FOOD & ENERGY (22.31)	0.2	0.6	0.6	0.1	0.2
SERVICES (59.2)	0.5	4.2	4.9	4.1	3.8
SERVICES LESS ENERGY SERVICES (55.05)	0.2	3.1	2.9	2.9	2.9
FRB CLEVELAND MEDIAN CPI	0.2	2.7	2.5	2.5	2.5

** - Dec.-to-Dec.

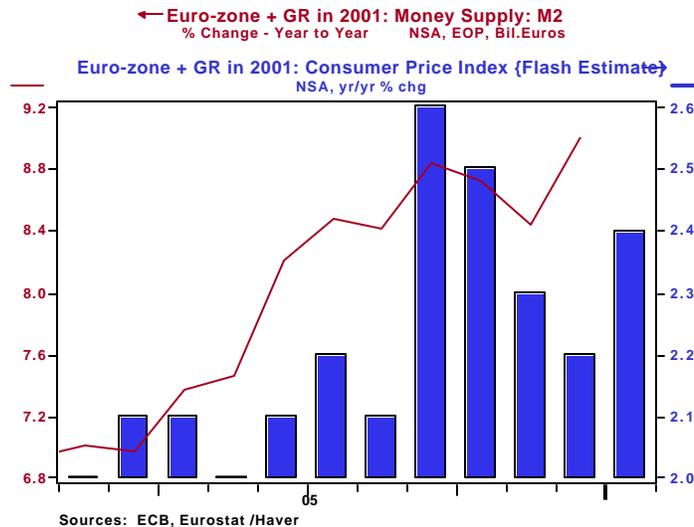
* - Figures in parentheses denote the relative importance of each category in the CPI.

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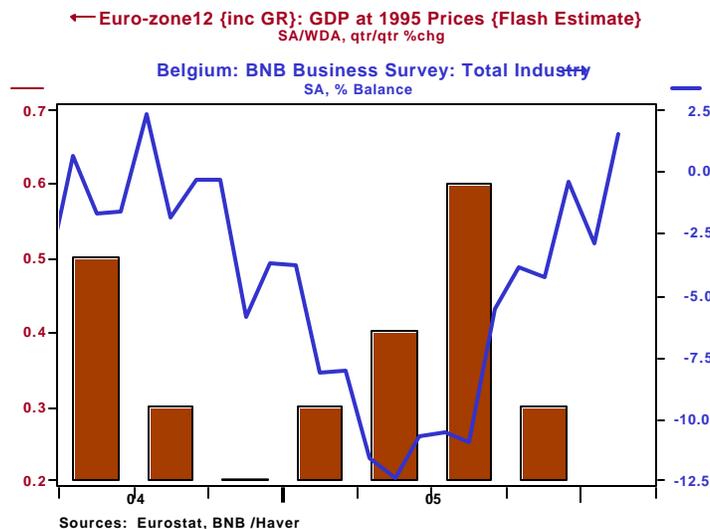
Data Confirm a March 2 ECB Rate Hike

Recent data releases and comments from European Central Bank policymakers confirm the view that the ECB will hike the refi rate 25 basis points next week, to 2.50%. Although the Euro-zone’s Q4 GDP data was a little rocky, the growth outlook for 2006 remains relatively upbeat. More to the point, the ECB continues to focus on the need to counter inflationary pressure from high and volatile energy prices and from fast credit growth. After easing somewhat in the final months of 2005, the annual increases in both headline CPI and in M2 are back on an upward trajectory.

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As expected, the Euro-zone economy hit a bit of a rough patch in the final months of 2005, with Q4 GDP rising just 0.3% on the quarter, down from 0.6% in Q3. In Germany, healthy exports could not counter still-weak consumer demand, leaving GDP in that country flat, after 0.6% growth in Q3. In France, the second-largest Euro-zone economy, overall GDP managed 0.2% quarterly growth, but this was down from 0.7% in Q3. However, data for the first weeks of this year are looking more healthy. As we noted last month, business sentiment is picking up strongly in Germany, and both business and consumer morale has picked up in France and in Italy so far this year.



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More telling for the Euro-zone outlook is what has been happening with the Belgian business confidence index – a leading indicator for the Euro-zone as a whole thanks to Belgium’s strong trade ties with its neighbors. The index has climbed fairly steadily since Q2 2005, and jumped to +1.5 in February, its highest point in 19 months and up from -2.9 in January.

Meanwhile, ECB Governing Council members have been reiterating that their focus is on medium-term prospects for price stability, that economic growth should pick up, and that inflation risks remain high. Trichet told the European Parliament on Monday that markets are “perfectly sensible” to price in a quarter point rise in the refi rate on March 2. For all of the reasons mentioned above, it seems safe to assume that two more hikes will be forthcoming this year.