

DAILY GLOBAL
COMMENTARY

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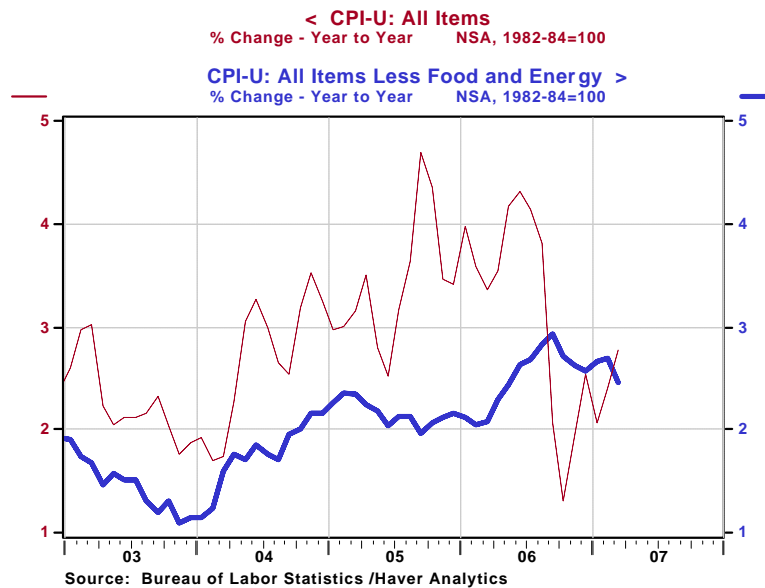
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Moderation of Core CPI Raises Probability of Fed Ease

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The Consumer Price Index (CPI) rose 0.6% in March after a 0.4% increase in February. The CPI has moved up at an annual rate of 4.7% in the first three months of 2007 after a 2.5% increase in all of 2006. The energy price index rose 5.9% and the food price index advanced 0.3% in March. The energy price index has risen at an annual rate of 22.9% in the first three months of the year, which accounts for about 41% of the first quarter advance in overall CPI. Food prices advanced 7.3% in the first three months of the year, which is responsible for 21% of the increase in the CPI.

Chart 1



Excluding food and energy, the core CPI increased only 0.1% in March, after posting gains of 0.3% and 0.2% in January and February, respectively. Year-to-date the core CPI has risen at an annual rate of 2.3% compared with a 2.6% gain in 2006. On a year-to-year basis, the core CPI was up 2.5% in March, following increases of 2.67% and 2.71% in January and February, respectively. The decelerating trend of core inflation is at the top of the FOMC's wish list to justify lowering the federal funds rate from the current level of 5.25%. Given that the economy has grown below potential GDP for three consecutive quarters and forecasts for the first-half of 2007 point to a similar trend, additional moderation of core inflation is a plausible projection. If forecast is accurate, the case for a lower federal funds rate is gaining momentum.

From the details, the 0.2% increase in housing costs reflects gains of rent and owners' equivalent rent of 0.3% each and a 2.3% drop in hotel prices. Apparel prices fell 1.0% in March after a 0.5% increase in February. Medical care prices rose only 0.1% in March, after gains of 0.8% and 0.5% in January and February, respectively. Airfares rose 0.3%, prices of new cars advanced 0.3%, and recreation costs held nearly steady.

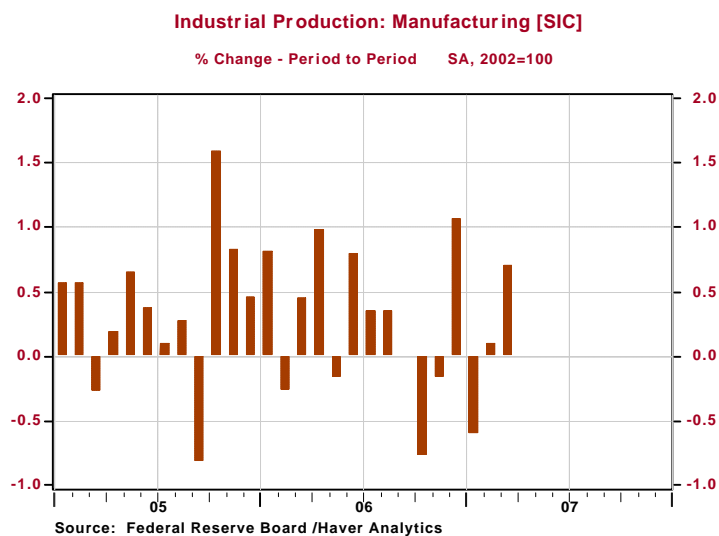
CONSUMER PRICE INDEX – MARCH 2007

	% change prior month	annualized change		% change		
		3 mo. ago	6 mo. ago	Mar-07 yoy	Mar-06 yoy	Dec-06 yoy
CPI - ALL ITEMS	0.6	4.7	2.4	2.8	3.4	2.5
CORE - ALL ITEMS LESS FOOD & ENERGY (77.4)*	0.1	2.3	1.9	2.5	2.1	2.6
CPI ALL ITEMS LESS ENERGY (91.3)	0.1	2.9	2.2	2.6	2.2	2.5
FOOD (13.9)	0.3	7.3	3.9	3.3	2.6	2.1
ENERGY (8.7)	5.9	22.9	4.3	4.4	17.3	2.9
SHELTER (32.8)	0.1	2.7	3.4	3.9	2.5	4.2
COMMODITIES (40.4)	1.2	6.3	1.1	1.8	2.9	1.3
COMMODITIES LESS FOOD & ENERGY (21.7)	-0.1	0.4	-1.1	-0.3	0.3	-0.1
SERVICES (59.7)	0.2	3.7	3.4	3.4	3.8	3.4
SERVICES LESS ENERGY SERVICES (55.7)	0.1	2.9	3.1	3.6	2.8	3.7
FRB CLEVELAND MEDIAN CPI	0.3	3.1	3.2	3.5	2.6	3.6

Factory Production Advances in March, But Future Looks Less Promising

Industrial production declined 0.2% in March vs. a 0.8% increase in February. A 7.0% drop in production at the nation's utilities led to an overall drop in industrial production. However, production in the factory sector rose 0.7% in March after a revised 0.1% increase in February, previously reported as a 0.4% gain.

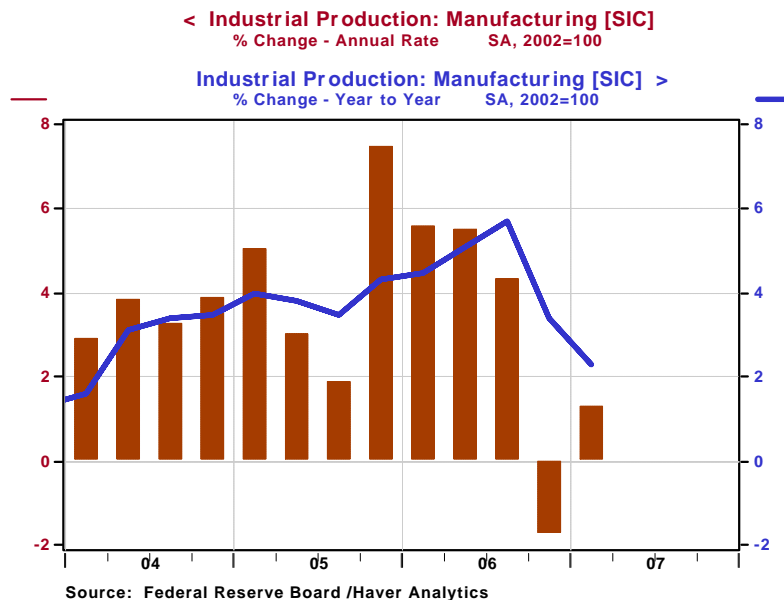
Chart 2



Strong positive contributions from high-tech, machinery, and non-mineral products helped to lift factory production in March. On a quarterly basis, there is a rebound in factory production in the first quarter after a decline in the fourth quarter. But, on a year-to-year basis, factory production in the first quarter grew at the slowest pace since first quarter of 2004 (see chart 3).

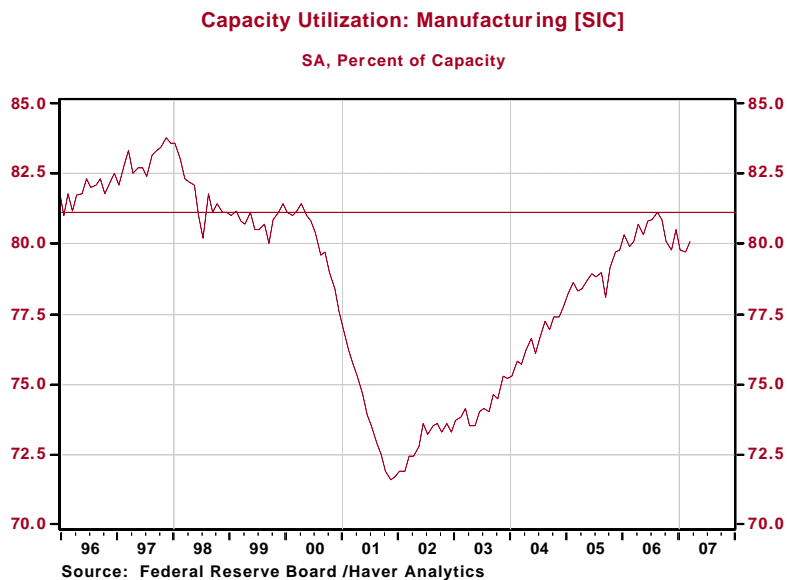
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Chart 3



Although the operating rate (80.1 percent) of the factory sector moved up slightly as production increased in March, it remains below the recent high of 81.1 percent set in August 2006. The March factory sector production data are bullish in isolation but the underlying trend remains bearish.

Chart 4



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Industrial Production – March 2007

	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07
Industrial Production*	-0.4	0.6	-0.4	0.8	-0.2
Total Capacity Utilization	81.3	81.6	81.1	81.6	81.4
Manufacturing output*	-0.2	1.1	-0.6	0.1	0.7
Man. Capacity Utilization	79.8	80.5	79.8	79.7	80.1
Capacity Utilization ex. High-tech industries	80.0	80.7	80.1	80.1	80.4
High-tech industries - output*	0.8	1.1	0.3	0.8	3.2
Manufact. Ex high-tech output*	-0.2	1.1	-0.7	0.0	0.5

Construction Activity in the Midwest Raises Housing Starts

Construction of new homes increased 0.8% in March to an annual rate of 1.518 million units after a downwardly revised gain of 7.6% in February. The level of housing starts in March is lower than the original estimate for February (1.525 million units). The increase in March came entirely from a 44.5% jump in activity in the Midwest, which appears to be a weather-related event. Housing starts fell in the other regions of the nation. On a year-to-year basis, housing starts are down 23.8% from a year ago. Single-family starts increased 2.0% and that of multi-family units fell 3.8% in March.

Chart 5



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The March increase in housing starts does not point to a rapid recovery in home building activity. Construction of single-family homes is down about 33.0% from a peak pace of 1.814 million units in January 2006. The Housing Market Index of the National Association of Home Builders for April is at 33.0, down from a recent high of 72.0 in May 2005, reflecting pessimistic sentiments. Although permit extensions for single-family homes rose 1.4% in March, the level of units issued in March is 30.0% below the pace reported a year ago. The weakness in the home building is unlikely to correct in the near term.

Housing Starts – March 2007

	<u>Total</u> <u>(mil. units)</u>	<u>% change from</u> <u>previous month</u>	<u>Single-family</u> <u>(mil. units)</u>	<u>% change from</u> <u>previous month</u>	<u>Multi-family</u> <u>(mil. units)</u>	<u>% change from</u> <u>previous month</u>
Sep-06	1.724	3.9	1.393	2.1	0.331	12.6
Oct-06	1.478	-14.3	1.187	-14.8	0.291	-12.1
Nov-06	1.565	5.9	1.271	7.1	0.294	1.0
Dec-06	1.633	4.3	1.245	-2.0	0.388	32.0
Jan-07	1.399	-14.3	1.119	-10.1	0.280	-27.8
Feb-07	1.506	7.6	1.194	6.7	0.312	11.4
Mar-07	1.518	0.8	1.218	2.0	0.300	-3.8

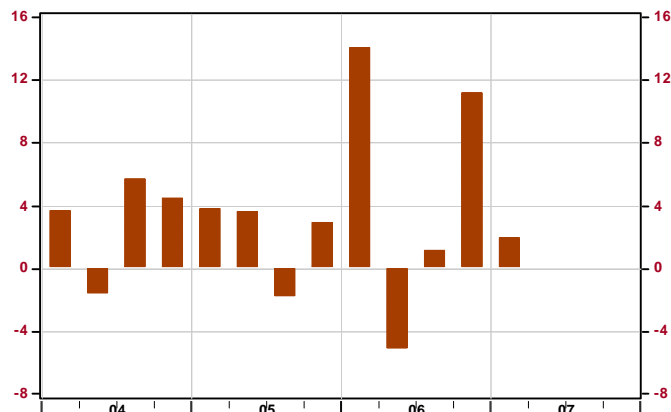
Inflation Adjusted Retail Sales Is Notably Soft in March and Bodes Poorly for Q2

The headline number for retail sales in March (+0.7%) appears bullish but upon closer examination, after adjusting for inflation, the March retail sales number is on the soft side in Q1 and arithmetic points to a soft Q2 also. Inflation-adjusted retail sales in March (using the commodities price index from the Consumer Price Index report) fell 0.5% after a 0.1% increase in February and a steady reading in January. Inflation-adjusted retail sales in the first quarter grew at an annual rate of only 1.93% compared with an 11.2% increase in the fourth quarter. Therefore, consumer spending has certainly shifted to a lower gear. What about retail sales in the second quarter? The inflation-adjusted retail sales number for March (\$2.247 billion) is lower than the first quarter average (\$2.255 billion), implying that the arithmetic of averaging does not favor a strong performance of retail sales in the second quarter.

Chart 6

Inflation Adjusted Retail Sales

% Change - Annual Rate millions



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