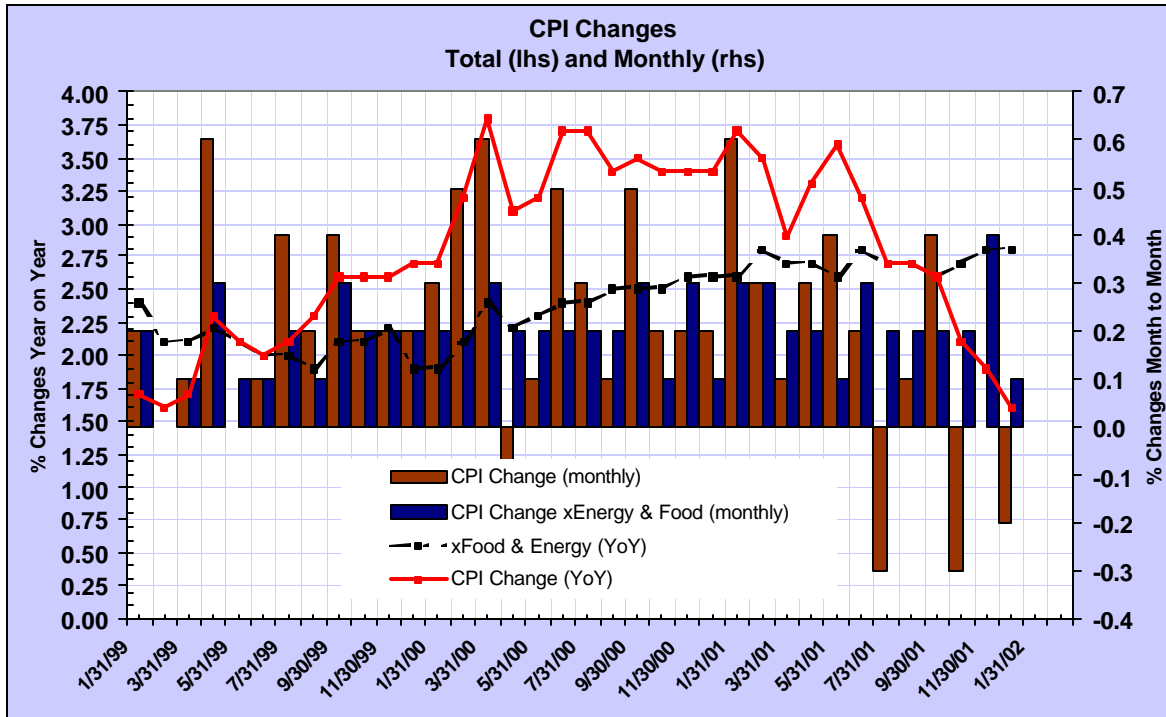




### CPI Declines: and when oil prices rise?



The Fed should be grateful for increasing Russian oil production. Russian production increases are holding OPEC in check and that makes inflation vanish....now! A falling CPI is a reflection of mammoth drops in the retail prices of petroleum products. Excluding food and energy, the CPI has been rising steadily since early in 2000, although this month's rise was only 0.1% as compared to 0.4% last month. Much of that increase reflects the service sector whose prices continue to rise. With the economy becoming much more heavily a service economy, that cannot be comforting to the Fed....Relief now, but as the economy begins to grow, it represents a problem for monetary policy in the future. Put another way, the Headlines are good, but the Bottom Line could be more ominous for a long period of quiescent monetary policy when easing stops.

With depressed corporate profits and rising unemployment, easier monetary policy has been the life raft, but as the economy regains traction, the underlying price picture will get more hostile. The Fed will be forced on to a path of tightening. The issue is only one of timing. When that occurs, critics of activist monetary policy will come out of the closet accompanied by the inflamed posse of Bond Vigilantes. Meanwhile, pray for a continued mild winter, plenty of non-OPEC oil supplies and plenty of rain to fill the reservoirs for hydro-power generation. California Governor Davis better practice a variation of the old Beantown chant when Boston was in the National League. "Spahn and Sain and pray for rain!"