



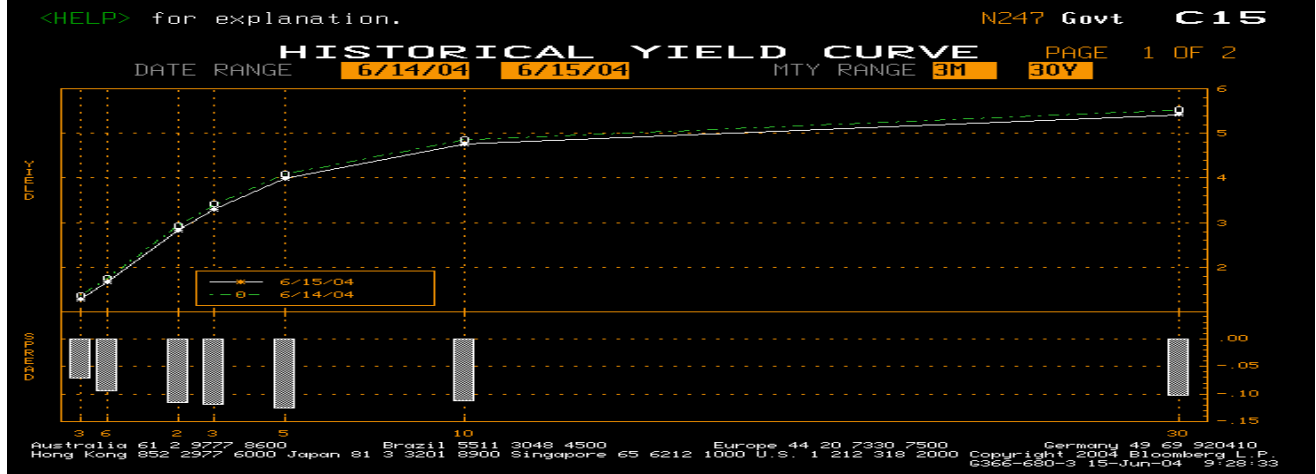
**Fear and Greed: Bond Market Rallies on CPI Relief**



<HELP> for explanation. N247 Govt C15  
 HISTORICAL YIELD CURVE PAGE 2 OF 2  
 DATE RANGE 6/14/04 6/15/04 MTY RANGE 3M 30Y

	6/14/04	6/15/04	Change
3 MONTH	1.363	1.292	-0.0715
6 MONTH	1.759	1.666	-0.0928
2 YEAR	2.929	2.814	-0.1157
3 YEAR	3.402	3.283	-0.1193
5 YEAR	4.094	3.969	-0.1255
10 YEAR	4.870	4.757	-0.1123
30 YEAR	5.530	5.428	-0.1020

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410  
 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2004 Bloomberg L.P.  
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It seems that the sell-off in the bond market in recent days was overdone and the less alarming CPI report caused a very rapid "shock" retracement. Equity markets should respond similarly, leaving the underlying issue of the pace of normalization of the Fed Funds rate to be addressed by the Fed. In the past several days, a genuine fear that the CPI numbers would "blow up" led bond traders to get "short," and when the numbers were actually released, Excedrin #56 went bi-bi...at least for now. The problem with this view is that the Fed has really not explained to the market its response criteria---aka---communication policy. Perhaps, the Chairman will make this more clear in his testimony today on his appointment, but readers are warned to observe the old Greenspan saw... 'if you have understood what I'm saying, Senator, I have been speaking too clearly!'

Meanwhile, a benign interpretation has been placed by market participants on the CPI results. The shift from a deflationary mentality to rising inflationary expectations has been so swift that the market has not really faced the reality that deflation is the aberration and inflation is the norm in modern economies with active, contra-cyclical oriented central banking. Of course, that leaves out the ECB, but there are many things Americans may never understand about Old Europe!

Hit <1,2 or 3> GO for more indices						Govt	WEI
World Equity Indices							
Base Currency: USD Ticker: N		Last Trade Information				Percent Change	
		Value	Net Chg	% Chg	Time	% Ytd	% YtdCur
<b>1) Americas</b> <b>22) News</b>							
4)	DOW JONES INDUS. AVG	10391.36	+56.63	+ .55	9:44	-.60	-.60
5)	S&P 500 INDEX	1133.49	+8.20	+ .73	9:44	+1.94	+1.94
6)	NASDAQ COMPOSITE INDEX	1990.85	+20.86	+1.06	9:44	-.62	-.62
7)	S&P/TSX COMPOSITE INDEX	8331.94	+39.63	+ .48	9:44	+1.35	-4.33
8)	MEXICO BOLSA INDEX	10135.78	+42.76	+ .42	9:44	+15.24	+13.23
9)	BRAZIL BOVESPA STOCK IDX	19908.12	+420.43	+2.16	9:44	-10.47	-17.73
<b>2) Europe/Africa/Middle East</b> <b>23) News</b>							
10)	DJ STOXX 50 PRC INDEX	2707.66	+18.38	+ .68	9:44	+1.78	-2.20
11)	FTSE 100 INDEX	4453.10	+19.90	+ .45	9:29	-.53	+1.42
12)	CAC 40 INDEX	3683.30	+36.20	+ .99	9:44	+3.52	-.52
13)	DAX INDEX	3976.02	+27.37	+ .69	9:44	+ .27	-3.65
14)	IBEX 35 INDEX	8011.80	+46.60	+ .59	9:29	+3.55	-.50
15)	MILAN MIB30 INDEX	28123.00	+205.00	+ .73	9:29	+5.27	+1.15
16)	AMSTERDAM EXCHANGES INDX	339.68	+2.39	+ .71	9:44	+ .60	-3.33
17)	OMX (STOCKHOLM) INDEX	679.90	+2.01	+ .30	9:44	+6.85	+1.53
18)	SWISS MARKET INDEX	5669.50	+35.90	+ .64	9:44	+3.31	+2.03
<b>3) Asia/Pacific</b> <b>24) News</b>							
19)	NIKKEI 225	11387.70	-103.96	-.90	4:31	+6.66	+3.59
20)	HANG SENG INDEX	12050.69	-25.88	-.21	4:08	-4.18	-4.59
21)	S&P/ASX 200 INDEX	3468.30	-9.90	-.28	2:07	+5.11	-3.82
<small>           Australia 61 2 2777 8600      Brazil 5511 3048 4500      Europe 44 20 7330 7500      Germany 49 69 920410            Hong Kong 852 2977 6000      Japan 81 3 3201 8900      Singapore 65 6212 1000      U.S. 1 212 318 2000      Copyright 2004 Bloomberg L.P.            6366-680-2 15-Jun-04 9:44:41         </small>							



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Table A. Percent changes in CPI for Urban Consumers (CPI-U)

Expenditure Category	Seasonally adjusted							Un- Compound adjusted	
	Changes from preceding month							annual rate	12-mos.
	2003		2004					3-mos. ended	ended
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	May '04	May '04
All Items	-.2	.2	.5	.3	.5	.2	.6	5.5	3.1
Food and beverages	.4	.5	-.1	.2	.2	.2	.9	5.1	4.0
Housing	-.1	.2	.4	.2	.3	.4	.4	4.3	2.4
Apparel	-.5	-.3	-.3	-.1	.9	.0	.3	5.1	.7
Transportation	-1.3	-.2	1.7	.7	1.1	.1	1.7	12.4	5.1
Medical care	.3	.5	.2	.6	.6	.4	.3	4.9	4.6
Recreation	.2	.1	.0	.3	.3	.2	-.2	1.1	1.1
Education and communication	.2	.2	.1	.3	.1	.3	.0	1.4	1.8
Other goods and services	.0	.2	.3	.2	.2	.1	.1	1.7	1.9
Special Indexes									
Energy	-3.0	.3	4.7	1.7	1.9	.1	4.6	29.7	15.0
Food	.4	.5	.0	.2	.2	.2	.9	5.1	4.1
All Items less food and energy	.0	.1	.2	.2	.4	.3	.2	3.3	1.7

The core MOM change was **0.2 (cf 0.3 for April)** and the YOY was **1.7 (cf 1.8 for April)**. **Relief or trend break?** Maybe the best way to look at the numbers is to think of the old distinction between "averages" and "marginals," with the marginals being the annualized 3-month data. Except for the categories "Education and communication" and "Other goods and services," the **marginals are above the averages**. **Prices are definitely on the uptrend**. **The issue for the Fed is how far up, how long prices will rise and what the trend will do to**



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expectations.

Table B. Percent changes in CPI for Urban Wage Earners and Clerical Workers (CPI-W)

Expenditure Category	Seasonally adjusted							Compound annual rate 3-mos. ended May '04	Un- adjusted 12-mos. ended May '04.
	Changes from preceding month								
	2003		2004						
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May		
All Items	-.3	.2	.6	.3	.5	.2	.7	5.6	3.0
Food and beverages	.5	.4	-.1	.2	.2	.2	.9	5.1	4.1
Housing	-.1	.2	.5	.2	.2	.3	.3	3.3	2.3
Apparel	-.4	-.3	-.1	.0	.8	-.1	.2	4.1	1.1
Transportation	-1.6	-.2	1.8	.6	1.3	-.1	2.1	13.9	4.7
Medical care	.3	.4	.3	.7	.6	.4	.3	4.9	4.7
Recreation	.2	.1	-.1	.4	.3	.0	.0	1.1	1.0
Education and communication	.1	.1	.1	.2	.1	.2	-.2	.4	1.1
Other goods and services	-.1	.3	.3	.2	.2	.2	.1	1.7	1.8
Special Indexes									
Energy	-3.1	.3	4.9	1.6	2.2	-.1	5.0	32.3	16.0
Food	.5	.5	-.1	.2	.2	.1	1.0	5.3	4.2
All Items less food and energy	-.1	.1	.2	.2	.3	.2	.1	2.6	1.3



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The second table tells us something about “costs of living” in the urban areas and perhaps something about the income requirements that city workers have and will have in the months to come. Our view is that as the labor market tightens, the skill premium will be stressed more, partly aggravated by the rising cost of living in urban areas. Workers with much better than average human capital skills that emphasize adaptability will find their wages rising both because their own demands will increase and firms will find it even more important to drive further productivity gains. Our normal measures of productivity gain do not adjust for a ‘constant labor force quality’ so that much of what we ‘measure’ as a productivity gain is really a disguised return to higher skills in the work force. Firms and skilled workers both know that and the “wage bargain” will be influenced by demand and ‘supply’ factors, such as the rising cost of living. Ultimately, it becomes the Fed’s duty to provide less fuel for those pressures

Energy costs that have risen very sharply across the board influenced these data to a very large degree. Absent a much higher level of terrorism that actually shuts in production, it is likely that the rates of increase experienced over the first 5 months of the year will not be replicated through the rest of the year. But “absent” is a big assumption in a world in which Terrorism is now the major geopolitical driver.

On its own, this report can serve to keep the Fed “measured” but not oblivious to the need to begin dis-accommodation. How the report ultimately plays in the bond market may be further influenced by Greenspan’s testimony on his reappointment later today.