

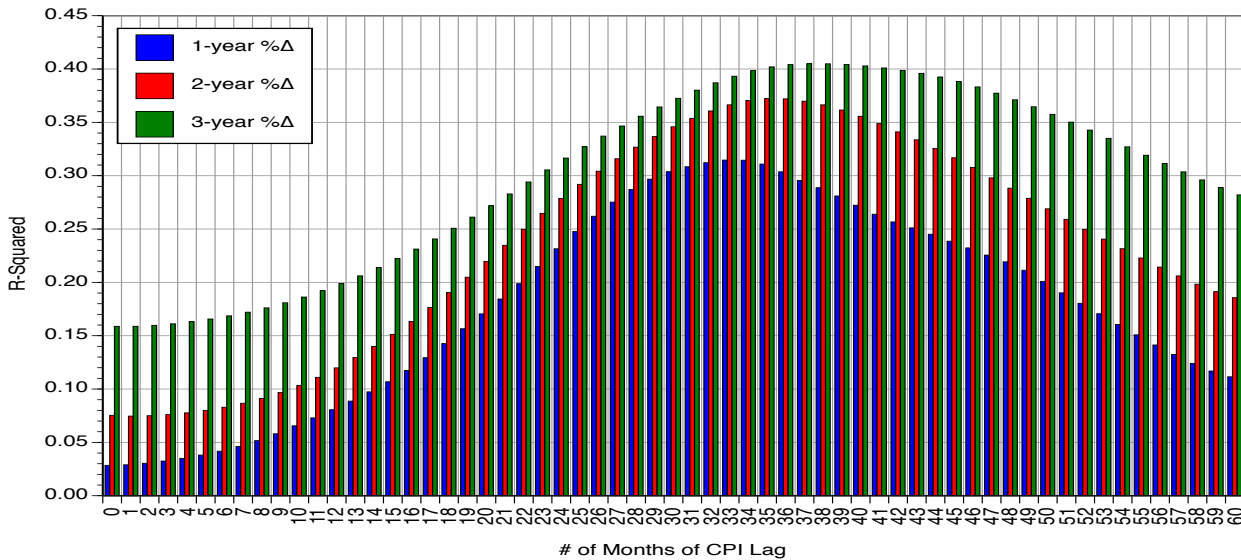
INTEREST RATE MANAGEMENT

All this whining and moaning about inflation. It just seems like yesterday everyone was worried about deflation. So where is inflation headed?

This writer, in order to get some tuition refunds, occasionally looks at the relationship between monetary growth and inflation. The graph below outlines the relationship between monetary growth and CPI since 1960.

M2 and CPI Growth

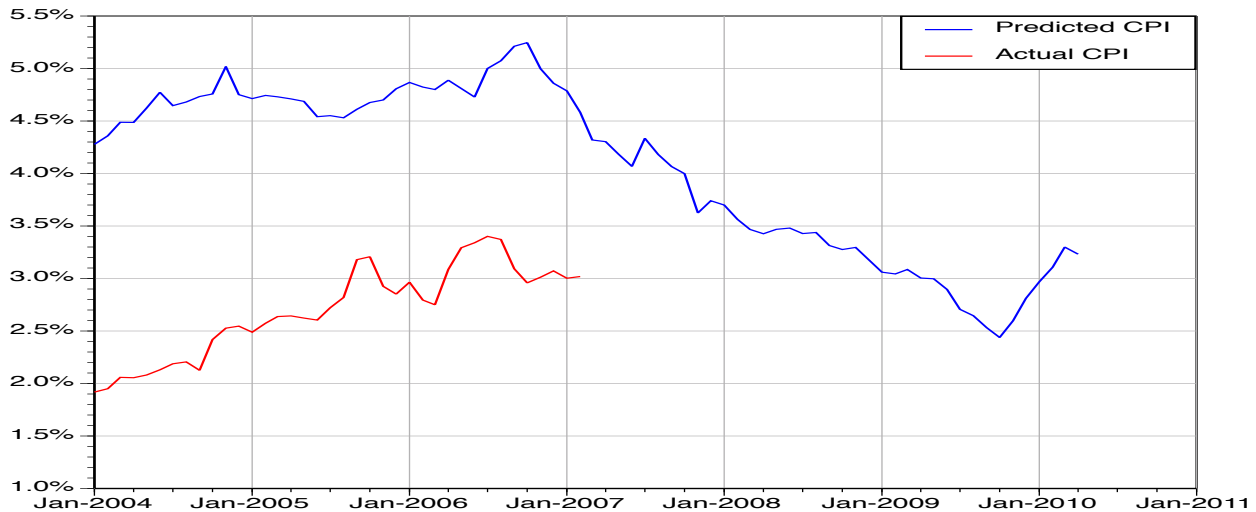
Coefficient of Determination (R-Squared) at Various CPI Lags
January, 1960 – February, 2007



Well, if we know what monetary growth has done in the past we should be able to come up with a forecast for inflation. Based upon the above, we should be able to have an educated guess of future inflation. As you can see from the graph below, inflation in the future should be less than it is now.

Regression-Predicted CPI vs. Actual CPI

Change in CPI from 3 years prior (annually compounded rate per annum)*



*Based on linear regression of the 3-year change in CPI as a function of the 3-year change in M2 from 38 months prior