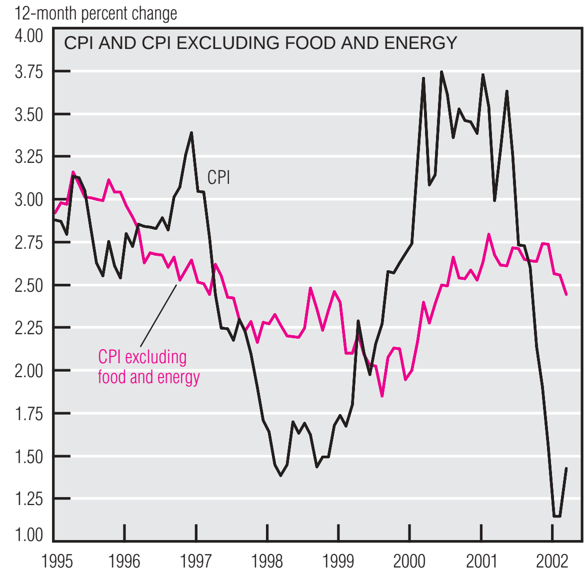
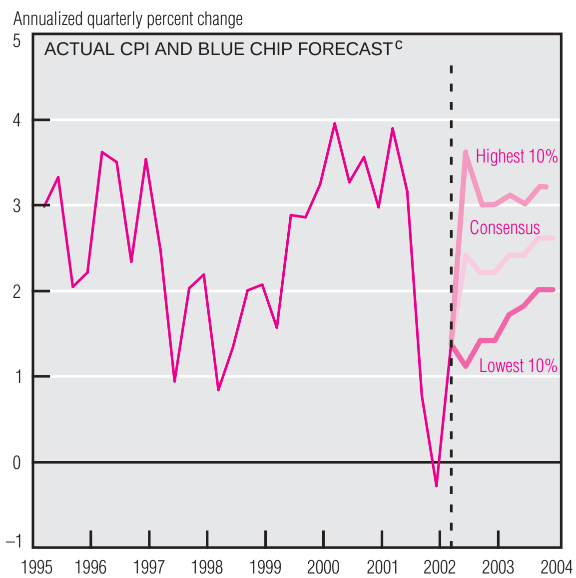
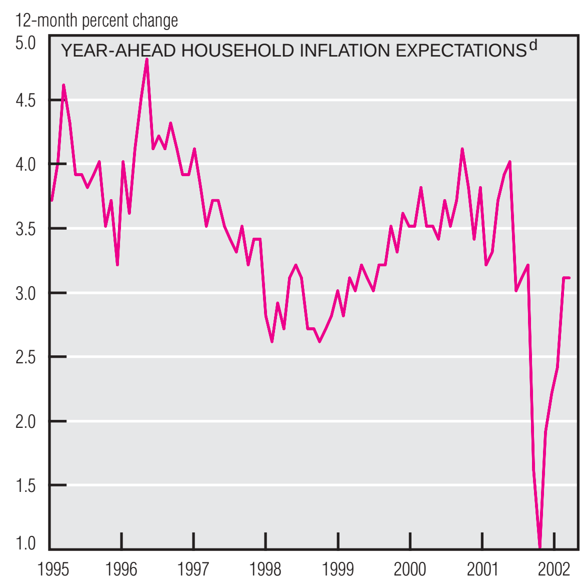
Inflation and Prices

March Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	2001 avg.
Consumer prices					
All items	4.1	3.0	1.4	2.2	1.5
Less food and energy	1.3	2.1	2.4	2.4	2.7
Median[b]	3.4	3.8	3.8	3.1	3.9
Producer prices					
Finished goods	12.9	5.6	–1.6	1.0	–1.9
Less food and energy	1.6	0.3	0.5	1.0	0.7







a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. Blue Chip panel of economists.
d. Mean expected change in consumer prices as measured by the University of Michigan's *Survey of Consumers*.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; University of Michigan; and *Blue Chip Economic Indicators*, April 10, 2002.

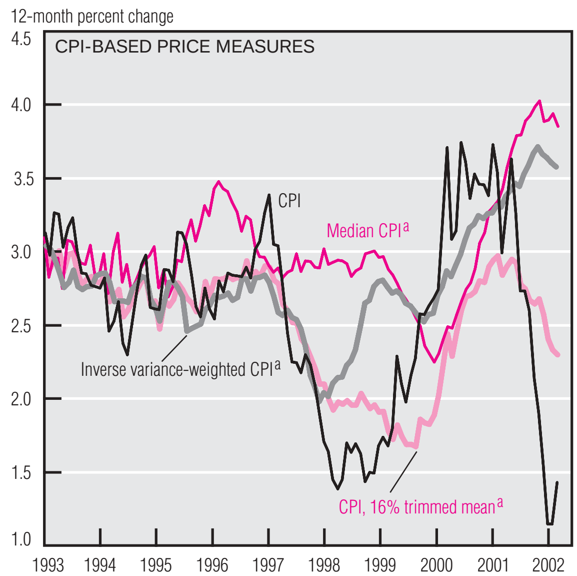
The roller coaster of retail prices continued in March, when the Consumer Price Index (CPI) jumped an annualized 4.1% following February's 2.7% rise. Over the past three months, retail prices have advanced at a 3% annualized pace, twice the CPI's growth rate in 2001. Do recently accelerated retail price increases signal that inflationary pressures are building? Perhaps. But for most economists, inflation has two defining characteristics that distinguish it from just any price rise: It must be broadly diffused across prices, and its advance must be persistent.

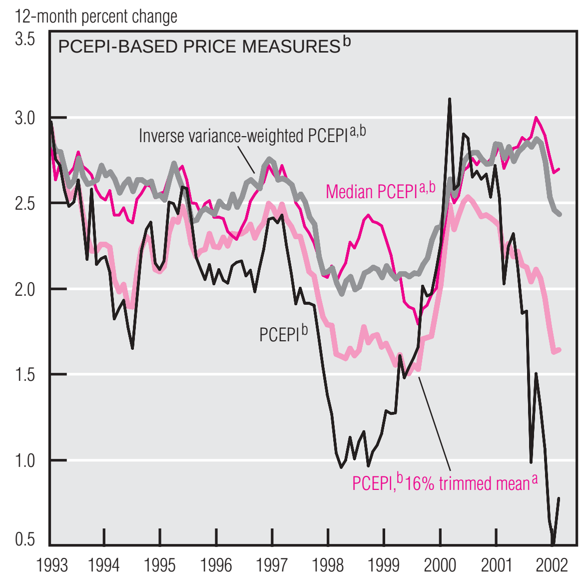
Consider, for example, that once we separate the usually volatile food and energy goods from the consumer's market basket, the recent rise in retail prices looks much more modest (1.3% annualized in March and only 2.1% annualized over the past three months, compared with the 2001 increase of 2.7%). And while both economists and households are predicting that retail prices will rise faster over the next 12 months compared to the past 12, their inflation expectations remain below the growth trends seen in 2000 and the first half of 2001.

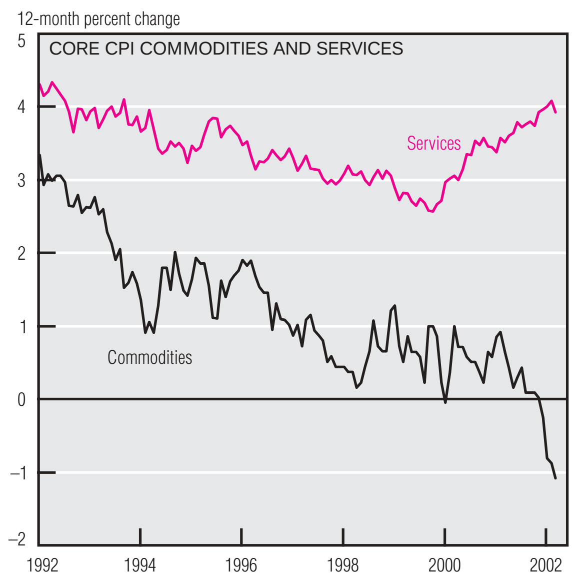
To better understand the breadth and likely persistence of recent price increases, we can discount markedly large price movements, say the largest 8% of the increases and 8% of the decreases. With this measure, called the 16% trimmed-mean estimator, we see larger retail price increases currently than with the the more commonly used inflation measures, the CPI and the Personal Consumption Expenditures Price Index (PCEPI). Even more extreme are the trends shown by the median CPI and the median PCEPI, inflation measures that

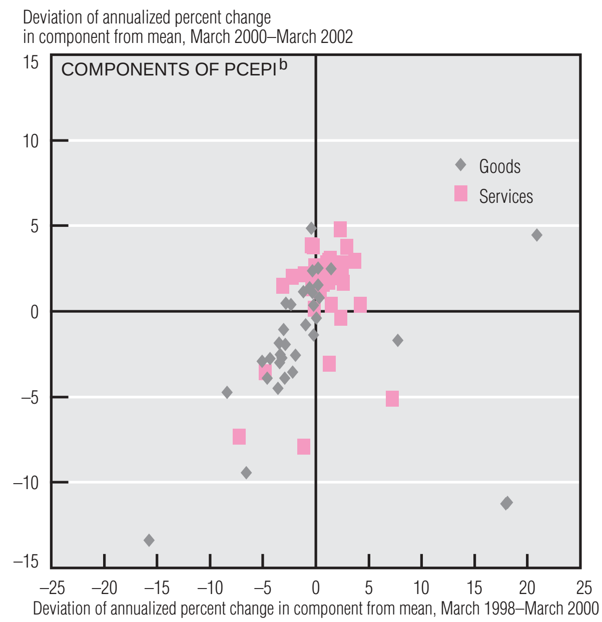
(continued on next page)

Inflation and Prices (cont.)









a. Calculated by the Federal Reserve Bank of Cleveland.
b. Personal Consumption Expenditures (chain type) Price Index.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; and Federal Reserve Bank of Cleveland.

trim away all but the price movements in the center of the price-change continuum. Another way to identify the persistent, broadly diffused pattern in retail prices is to weight price changes in inverse proportion to an item's observed price volatility over time. That is, assign lower weights to prices that fluctuate widely from month to month and give higher weights to prices that show more stable growth patterns. Such "inverse variance-weighted" measures reveal a recent growth trend in retail prices that is quite similar to the median inflation measures.

The reason for the divergence between some of these price measures lies in the radically different behavior of commodities price increases compared to services price increases. While the former have been declining for nearly a year and a half—and have accelerated that decline in recent months—the latter have tended to move steadily higher. Because commodity prices tend to be more volatile from month to month than services prices, these alternative inflation measures tend to give them less significance.

Is inflation heading higher? The answer depends on whether commodity prices follow the pattern we have been seeing in services prices, or vice versa. But this dichotomy in the price behavior of commodities compared to services has been widening for many years now and may not be resolved any time soon. An examination of price increases for 70 components of the PCEPI shows that services prices that exhibited above-average increases over the past two years tended to show above-average increase over the two years previous to those; commodities that tended to show below-average price increases earlier are probably still doing so today.