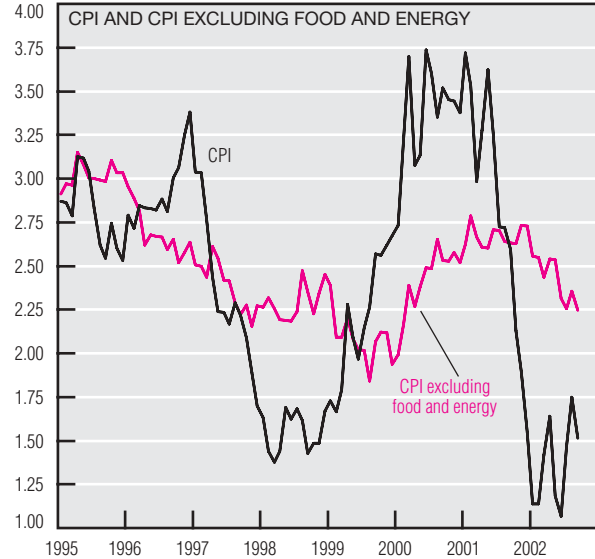


Inflation and Prices

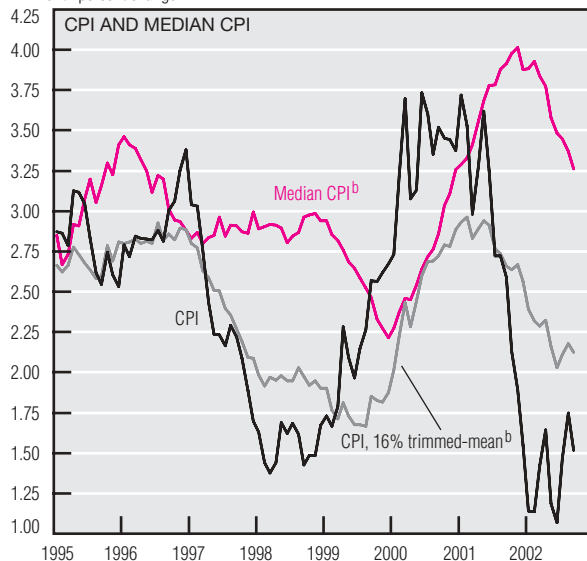
September Price Statistics

	Percent change, last:				2001 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	2.0	2.5	1.5	2.3	1.5
Less food and energy	1.3	2.3	2.2	2.4	2.7
Median ^b	2.8	3.1	3.3	3.1	3.9
Producer prices					
Finished goods	0.9	-0.6	-1.8	1.0	-1.7
Less food and energy	0.8	-1.6	-0.4	1.0	0.9

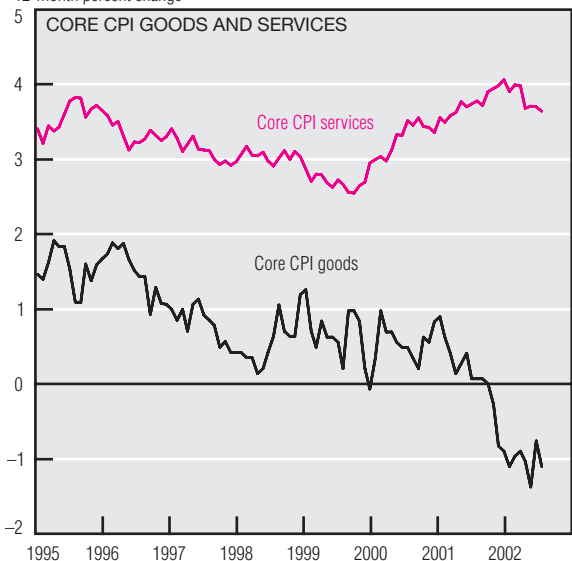
12-month percent change



12-month percent change



12-month percent change



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Federal Reserve Bank of Cleveland.

The Consumer Price Index rose 0.2% (2.0% annual rate) in September. According to the Labor Department, energy prices have risen for three consecutive months: 0.4% in July, 0.6% in August, and 0.7% in September. Despite these recent increases, however, year-over-year comparisons reveal deflation in energy prices. Higher food prices also contributed to the rise in the CPI. The index for food, after declining 0.1% in August, rose 0.2% in September.

Excluding food and energy, the CPI rose only 0.1% (1.3% annual rate) in

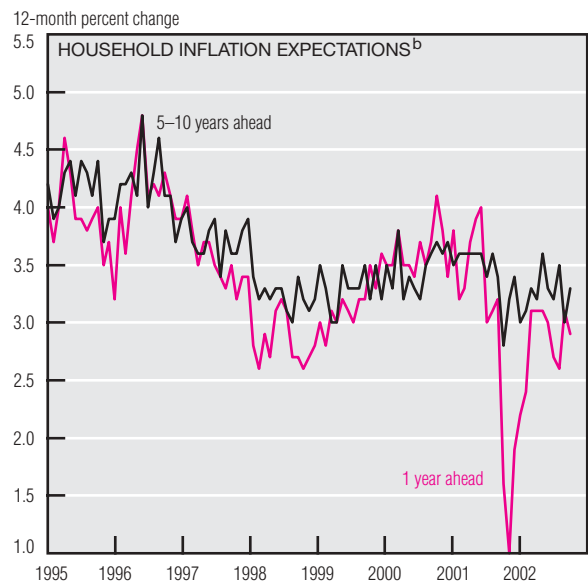
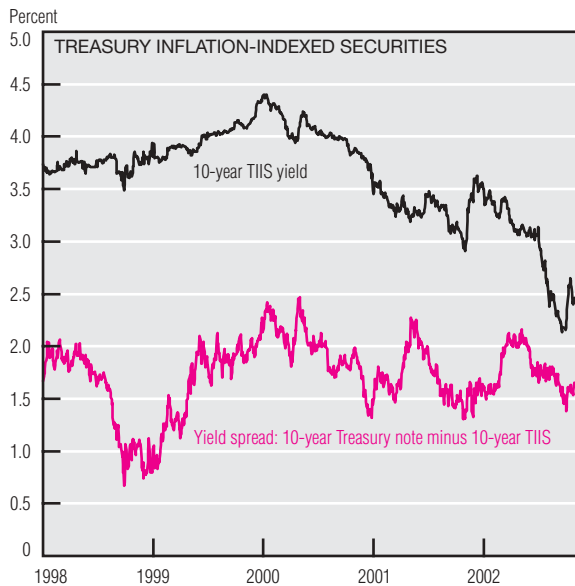
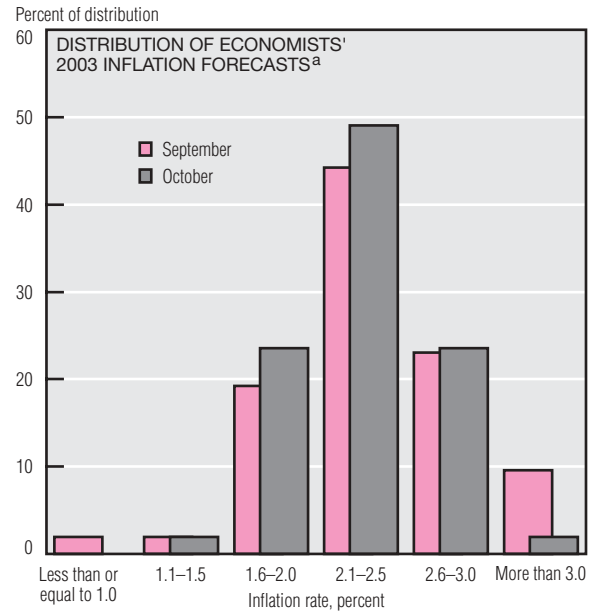
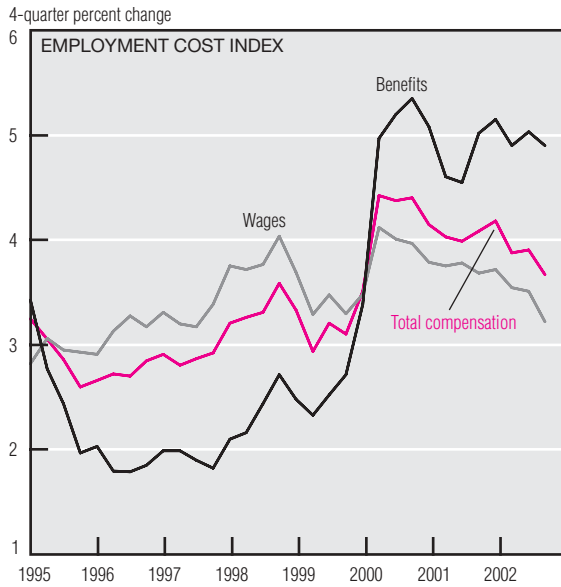
September, after August's increase of 0.3% (3.9% annual rate). Other core measures showed a similar deceleration. On an annual-rate basis, the median CPI rose 2.8% in September after increasing 3.3% in August, while the 16% trimmed-mean CPI rose 2.0% after increasing 2.9% in August. The 12-month rates of change in all core measures also indicate disinflation and have been trending down throughout the year. By contrast, the CPI's year-over-year change throughout 2002 has been more erratic.

The deceleration in core measures over the last several months results

partly from disinflation in the service sector. The 12-month percent change in the prices of core services (which exclude energy services) has been trending down after peaking at about 4% in February, and other core measures of inflation have fallen along with it. This is not surprising, because services constitute about 70% of the items in the CPI less food and energy. Moreover, because goods prices recently have seen much smaller increases than services prices (if not outright declines), measures like the median and the trimmed mean,

(continued on next page)

Inflation and Prices (cont.)



a. Blue Chip panel of economists.

b. 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; University of Michigan; Bloomberg Financial Information Services; and *Blue Chip Economic Indicators*, September 10, 2002 and October 10, 2002.

which focus on the middle of the price-change distribution, tend to include disproportionately more services than goods.

Two factors may explain a hefty share of the disinflation in service-sector prices over the last several months. First, the inflation rate for implied rents has fallen sharply since the beginning of the year, perhaps because the real estate market has slackened. Second, wage growth, as measured by the Employment Cost Index, has decelerated more markedly in 2002 than in 2001. Because wages represent a substantial share of service

employers' costs, less rapidly rising wages may mean less inflation in service-sector prices.

The most recent Blue Chip survey of economists, conducted in October, generated a consensus inflation expectation of 2.3% in 2003, little changed from the 2.4% consensus expectation in the September survey. The distribution of economists' forecasts, however, narrowed in October. Compared with September, more economists—roughly half—saw 2003 inflation settling into the low 2% range. And while nearly 10% of September respondents expected

inflation to exceed 3% in 2003, only 2% expected this in October.

Financial markets provide another way to gauge inflation expectations. The difference between the yields on a 10-year Treasury note and its equivalent-maturity inflation-indexed security—the yield spread—indicates market participants' expectation of average annual inflation over the next 10 years. Currently, this yield spread stands at 1.6%, about half of what households say they expect inflation to average over the next five to 10 years.