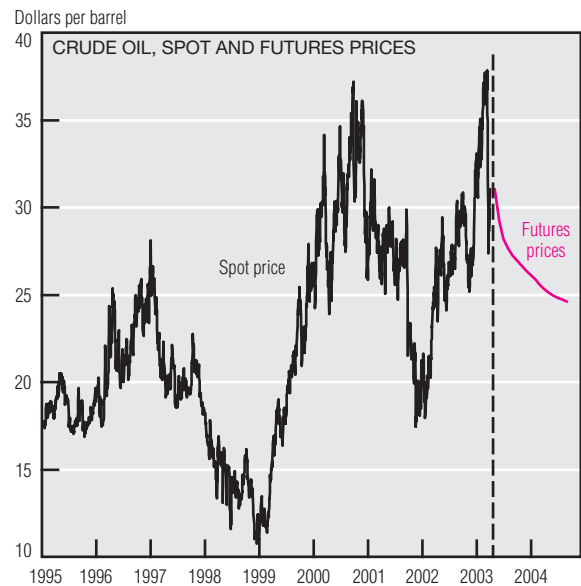
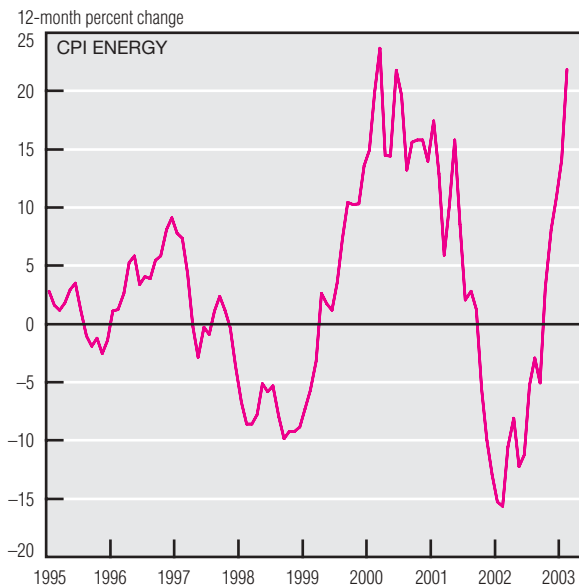
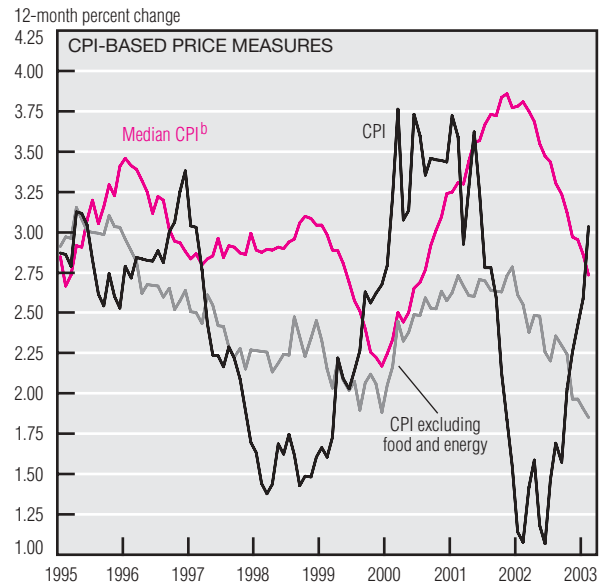


Inflation and Prices

	Percent change, last:				2002 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
February Price Statistics					
Consumer prices					
All items	7.5	4.3	3.0	2.5	2.4
Less food and energy	1.3	1.5	1.9	2.3	2.0
Median ^b	2.4	2.5	2.7	3.0	3.0
Producer prices					
Finished goods	12.5	10.1	3.5	1.8	1.2
Less food and energy	-5.4	-0.3	0.1	1.1	-0.5



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

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

Large, abrupt swings in energy prices strongly influenced the CPI in 2002 and continue to do so in 2003. After a 4.0% increase in January, energy prices rose 5.9% in February. Compare this with 2002's average monthly increase of 0.8%—itself not an insignificant rate of increase. The sharp increase in the CPI's energy index in February resulted in the largest monthly increase in overall consumer prices for nearly three years, 0.6% (7.5% on an annualized basis).

The outsized influence of energy prices on the CPI becomes clear

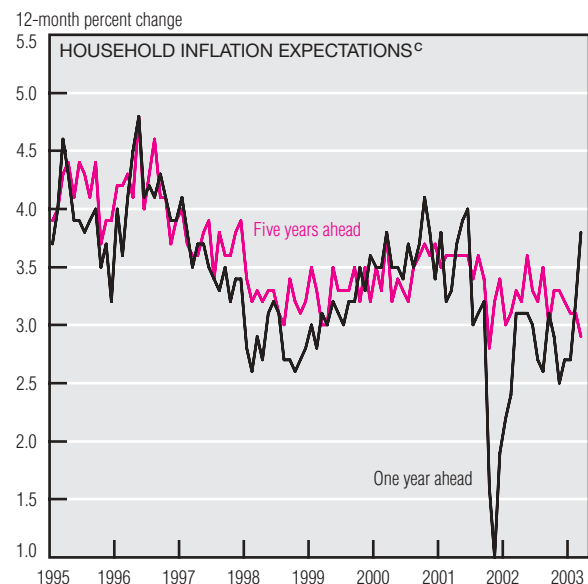
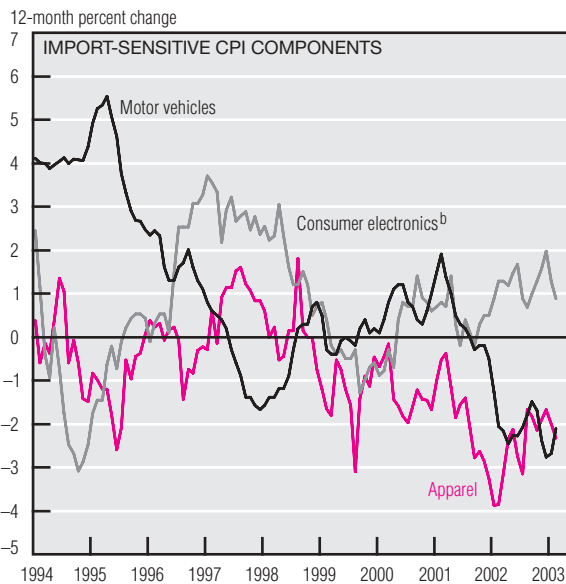
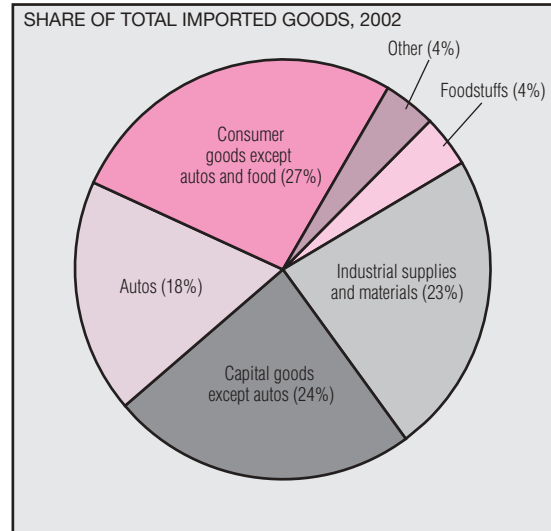
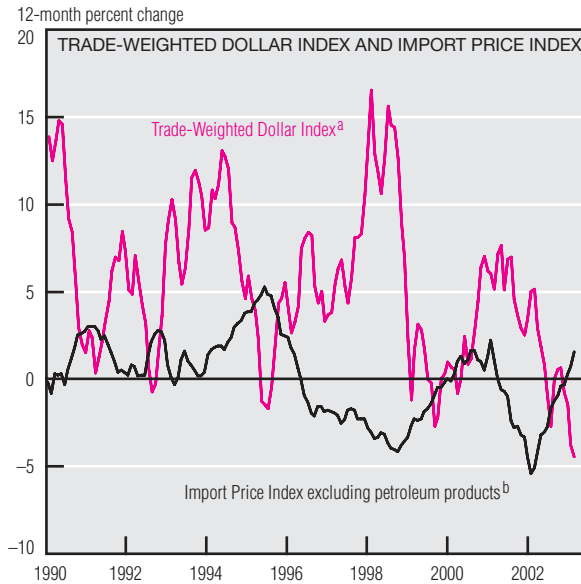
when one compares the CPI with the core inflation measures. The year-over-year rate of change in the CPI has risen sharply in the last several months; concurrently, the rates of increase in the median CPI and the CPI excluding food and energy, also on a year-over-year basis, have followed a downward trajectory. In fact, both rates have been declining steadily since the beginning of 2002. Presently, the median CPI trend has fallen below 3%, and the trend in the CPI excluding food and energy has fallen below 2%.

Depending upon the course of the current conflict with Iraq, sharp swings in energy prices are likely to continue influencing overall price statistics in the months ahead. While it is too soon to say what the impact ultimately will be, in the early days of the conflict crude oil prices fell nearly one-third from a recent high of about \$38 per barrel. Moreover, futures markets suggest a further drop in crude oil prices over the next year or so.

Non-petroleum import prices will also be worth watching in the months ahead. In the last several months,

(continued on next page)

Inflation and Prices (cont.)



a. Weighted average of the U.S. dollar's foreign exchange value against the currencies of a broad group of major U.S. trading partners.

b. Not seasonally adjusted.

c. 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; U.S. Department of Commerce, Bureau of the Census; Board of Governors of the Federal Reserve System; and the University of Michigan.

their inflation rate has turned positive after remaining negative through most of 2002.

Some of the recent increases in import prices may result from the weakening dollar. When the dollar weakens, domestic consumers have less buying power, that is, imported goods become more costly in dollar terms. In the last few months, there has been a drop in the Trade-Weighted Dollar Index, an average of U.S. exchange rates with various countries, weighted by the amount

of U.S. trade with each. In fact, the year-over-year change in the index has been trending downward since the beginning of 2002, about the same time that year-over-year price increases for non-petroleum imports started trending upward.

In some cases, such as that of apparel goods, imports constitute a large share of the items available for sale to domestic consumers, so a weakening dollar directly affects domestic retail price measures. In other cases, the impact on retail prices may be less direct and slower

to materialize, for instance, when imported products are used in the production of domestically manufactured items.

Households' longer-run expectations of future inflation (five to 10 years ahead) remain at about 3%, as they have for several months. However, shorter-run inflation expectations (one year ahead) rose sharply in the most recent report for March. In other words, households expect that any acceleration in inflation this year will be relatively short-lived.