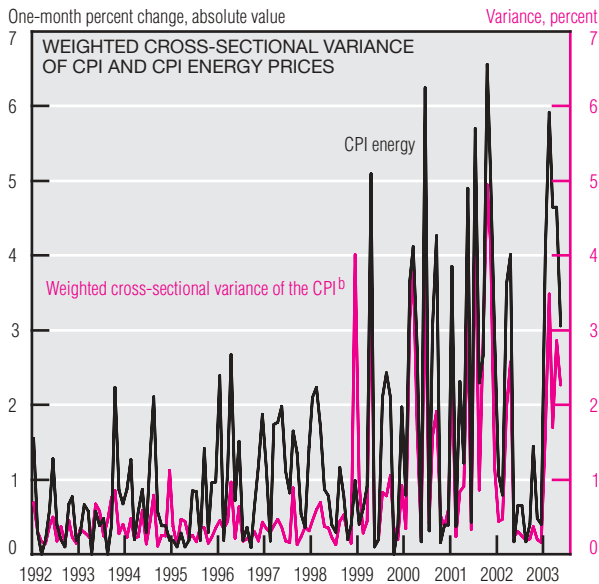
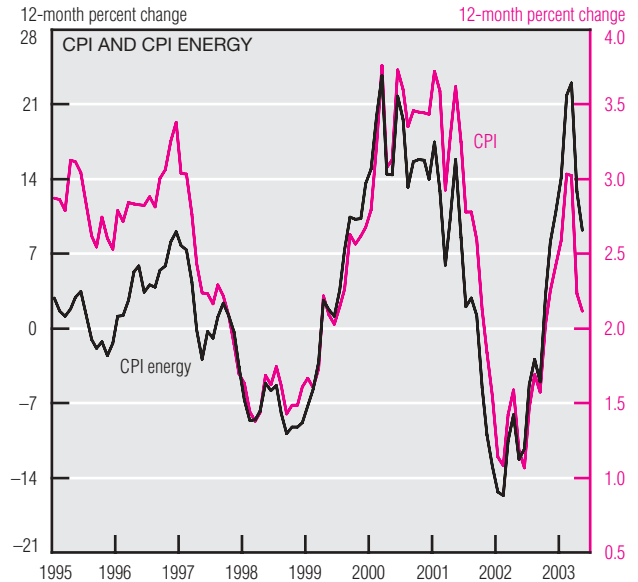


Inflation and Prices

May Price Statistics

	Percent change, last:				2002 5 yr. ^a avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	0.0	0.0	2.1	2.4	2.4
Less food and energy	3.2	1.0	1.6	2.2	2.0
Median ^b	2.2	1.1	2.2	2.9	3.0
Producer prices					
Finished goods	-3.3	-3.0	2.5	1.7	1.2
Less food and energy	1.6	-0.3	-0.1	0.9	-0.5



Extreme CPI Price Movements, May 2003

	One-month percent change	Relative importance
Largest Price Increases		
Lodging away from home	4.1	2.6
Processed fruits and vegetables	2.9	0.3
Public transportation	2.0	1.2
Fresh fruits and vegetables	2.0	0.9
Infants' and toddlers' apparel	1.1	0.2
Largest Price Decreases		
Motor fuel	-6.7	3.3
Fuel oil and other fuels	-5.6	0.2
Men's and boys' apparel	-1.8	1.1
Communication	-0.8	2.9
Used cars and trucks	-0.6	2.1

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 (CPI) was unchanged in May, the second straight month in which this retail price measure showed no inflation; in April, it fell 0.3% (-3.8% at an annual rate). Changes in the CPI continued to be highly correlated with changes in energy prices. The CPI's energy component, like the CPI, showed no inflation for the second straight month. In the most recent two-month period, this index declined nearly 8%, after increasing approximately 15% during the first three months of the year.

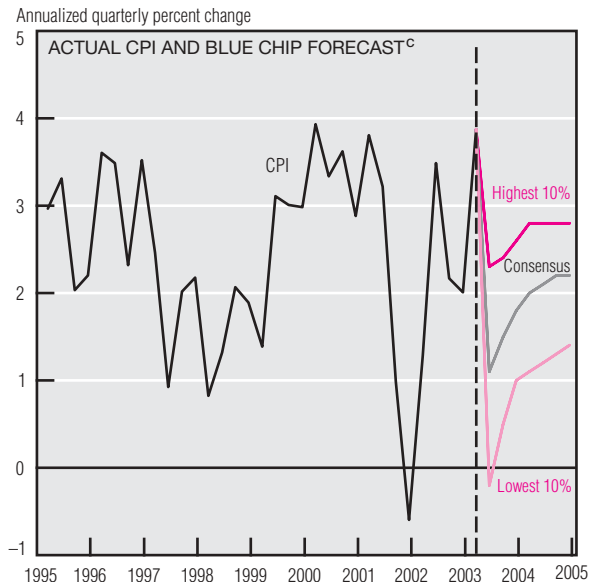
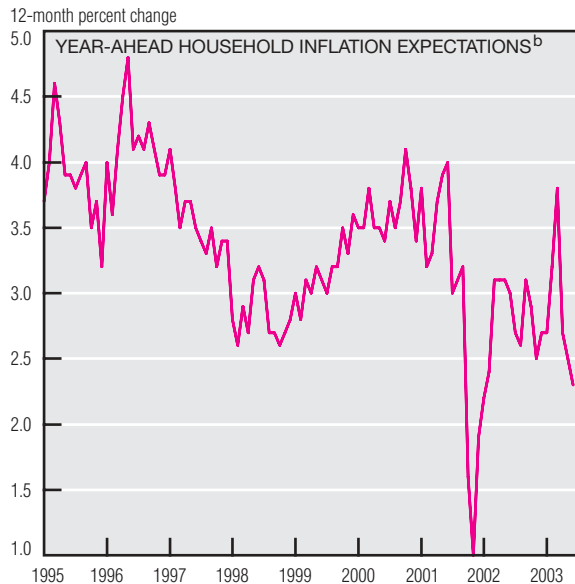
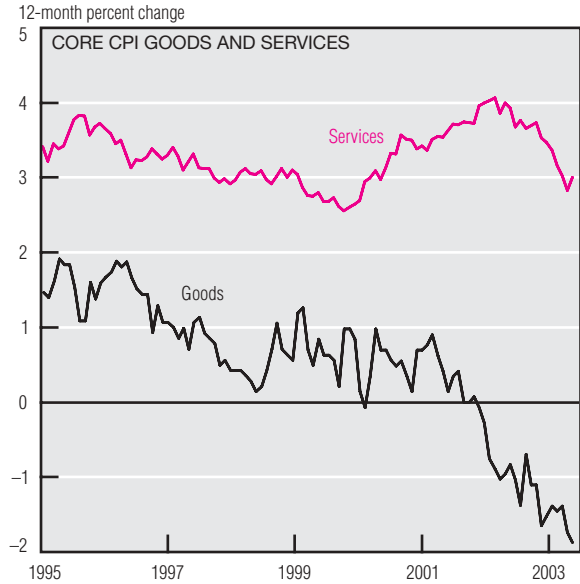
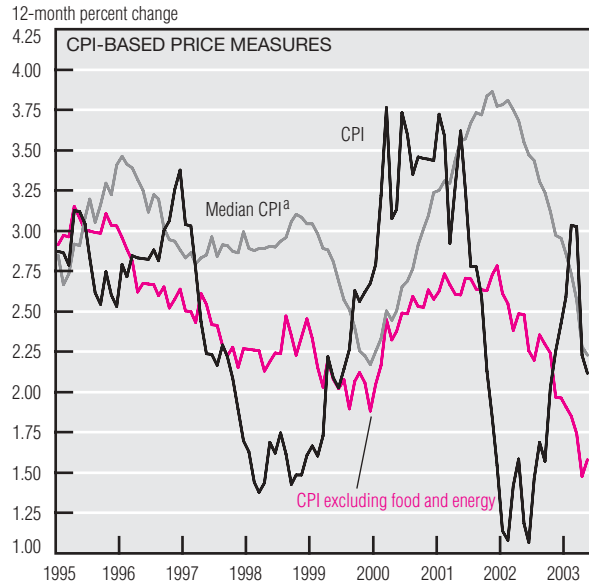
This volatility in energy prices is not unexpected. Indeed, it is the reason why energy prices are often excluded from the calculation of consumer prices, on the grounds that their variability can obscure the underlying trend in other prices. But in recent years, energy prices have been even more volatile than usual, exhibiting far more pronounced fluctuations than was the case during the energy crises of the 1970s. Energy components constitute only about 7% of the CPI, but the increasing magnitude of their price movements since 1999—measured as the absolute

value of the monthly percent change in their prices—has caused a substantial increase in the weighted, cross-component variability in the CPI.

While energy prices showed some of the sharpest decreases in the most recent CPI report, at the opposite end of the spectrum, the CPI's index for lodging away from home showed some of the most significant increases. In fact, the Labor Department reported that most of the increase in the CPI excluding food and energy (the core CPI) resulted from increases in the lodging component and in other

(continued on next page)

Inflation and Prices (cont.)



a. Calculated by the Federal Reserve Bank of Cleveland.

b. Mean expected change in consumer prices as measured by the University of Michigan's *Survey of Consumers*.

c. Blue Chip panel of economists.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; University of Michigan; and *Blue Chip Economic Indicators*, June 10, 2003.

items that make up the CPI's shelter component. This component rose 0.6% in May after rising only 0.1% in the previous month.

The core CPI itself rose 0.3% (3.2% at an annual rate) in May, and, for the first time in nine months, the 12-month rate of change in this measure rose as well: After falling to 1.5% in April, it ticked up a tenth of a percent to 1.6% in May. Another measure that attempts to isolate the underlying inflation trend is the median CPI. It rose 0.2% (or 2.2% at an annual rate) in May, and rose 2.2% in the

12 months ending in May. For the same 12-month period, the CPI rose 2.1%.

The 12-month rates of change in both the core and the median CPI have been drifting downward since late 2001. Does this suggest that, apart from some volatile sectors, most prices in the economy are moving inexorably toward deflation? Breaking down the core CPI into goods and services reveals that some of the items in consumers' market baskets are indeed undergoing persistent price declines, or deflation. However, more than half of the items

in the index—services, to be specific—are seeing price increases on the order of 3% per year.

Households do not foresee deflation in the months ahead. Although their inflation expectations have drifted downward in recent months, they nevertheless expect prices to increase about 2.5% over the next 12 months. Private forecasters anticipate a similar scenario: Their consensus expectation for the coming months has inflation settling between 2% and 2.5% by the end of 2005.