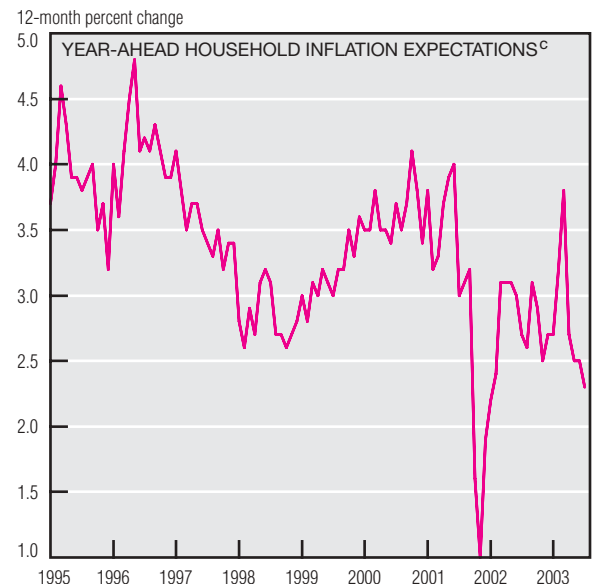
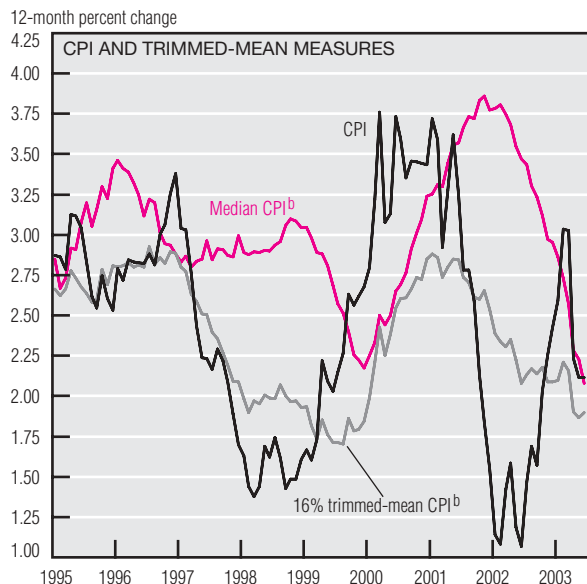
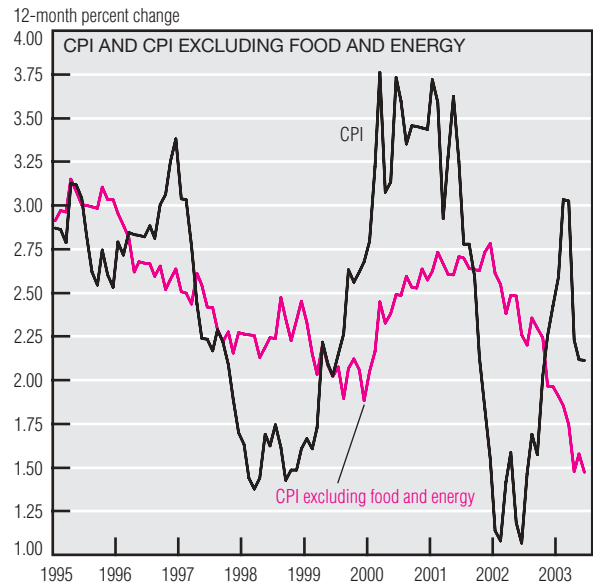


# Inflation and Prices

	Percent change, last:				2002 avg.
	1 mo. <sup>a</sup>	3 mo. <sup>a</sup>	12 mo.	5 yr. <sup>a</sup>	
<b>June Price Statistics</b>					
<b>Consumer prices</b>					
All items	2.0	-0.7	2.1	2.4	2.4
Less food and energy	0.0	1.0	1.5	2.2	2.0
Median <sup>b</sup>	1.1	1.1	2.1	2.9	3.0
<b>Producer prices</b>					
Finished goods	6.1	-6.7	2.9	1.8	1.2
Less food and energy	-1.6	-3.6	-0.3	0.9	-0.5



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

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; Federal Reserve Bank of Cleveland; and University of Michigan.

The inflation statistics remained subdued in June, seemingly still on the disinflation path begun sometime in 2001. The Consumer Price Index (CPI) rose an annualized 2% in June, mostly on the strength of rising food and energy prices. Even so, the CPI's 2.1% rise over the past 12 months is lower than its 2002 growth rate. Excluding food and energy, the CPI was unchanged in June and has grown only 1½% over the past 12 months, one-half percentage point under its modest 2002 increase. Indeed, this "core" inflation measure

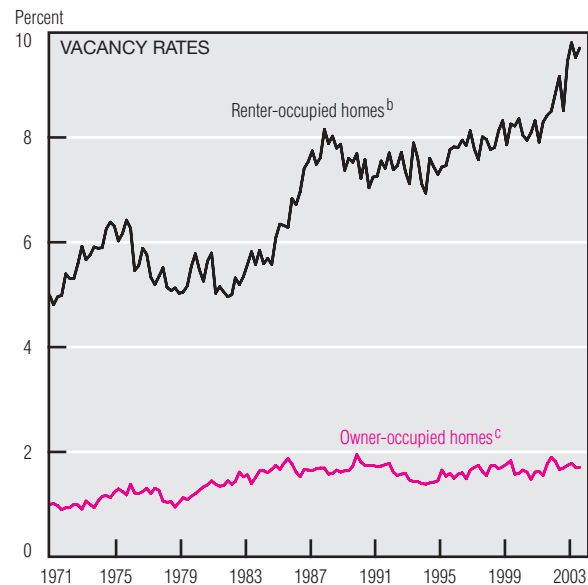
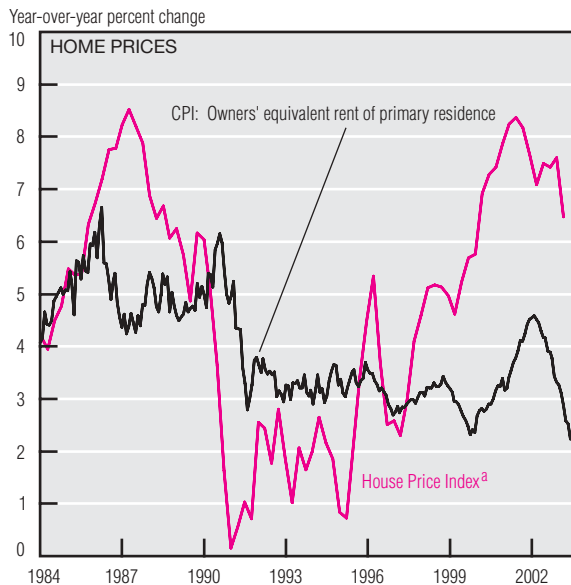
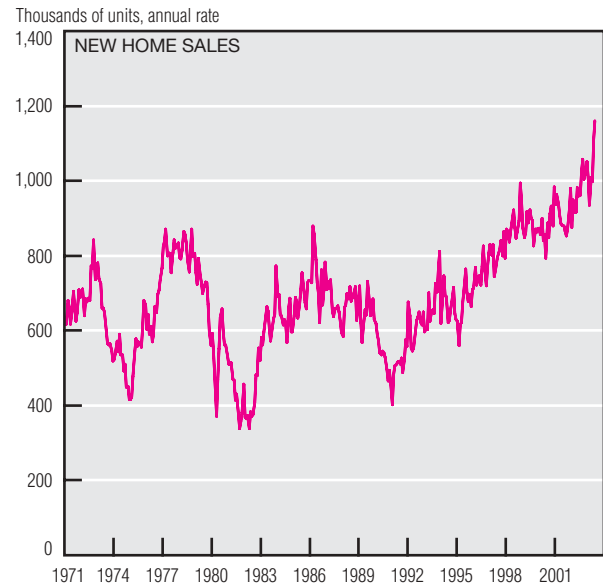
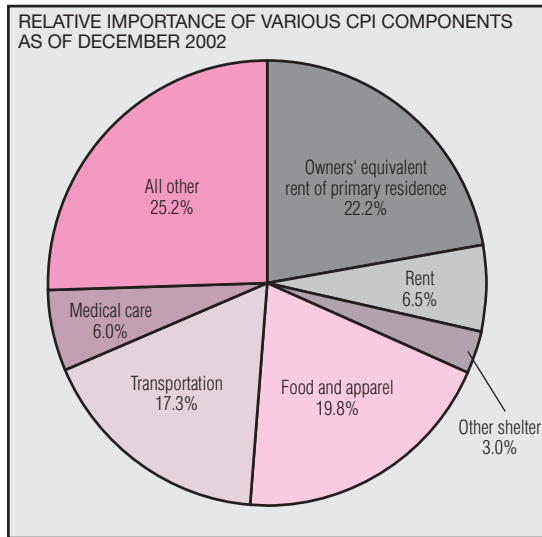
has fallen 1¼ percentage points since early 2002 and is now posting its lowest 12-month increase since 1966.

Equally dramatic has been the recent downward migration of the Federal Reserve Bank of Cleveland's median and 16% trimmed-mean CPI, two inflation measures that attempt to gauge the persistent component of the inflation trend by eliminating the most extreme observations. Both measures have shown a determined disinflation pattern over the past few years and both now put the inflation trend at about 2%.

The continued downturn in inflation appears to have been accompanied by lowered inflation expectations, at least according to the University of Michigan's *Survey of Consumers*. The survey shows that consumers expect prices to increase slightly more than 2% over the next 12 months, a decline in inflation expectations of about 1½ percentage points since 2000. Indeed, with inflation moderating by virtually every measure, there seems to be little immediate danger that inflation will reignite.

(continued on next page)

## Inflation and Prices (cont.)



a. Calculated by the Office of Federal Housing Enterprise Oversight.

b. Vacant housing units available for rent year-round divided by the sum of vacant housing units available for rent year-round and renter-occupied housing units.

c. Vacant housing units available for sale year-round divided by the sum of vacant housing units available for sale year-round and owner-occupied housing units.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of the Census; Office of Federal Housing Enterprise Oversight; and Federal Reserve Bank of Cleveland.

One caution, however, comes from the CPI housing measure. Costs associated with shelter represent more than 30% of the CPI—its single largest component. Prior to the 1980s, the CPI was computed using home purchase prices and mortgage interest rates. This methodology tended to cause wide fluctuations in the inflation measure that were not thought to reflect accurately the true cost of housing to U.S. homeowners. That methodology was changed to an “owners’ equivalent rent of

primary residence” (OER)—the cost homeowners would have to pay to live in their homes if they attempted to rent the house rather than own it. Roughly 22% of the CPI represents the implied rents of U.S. homeowners.

While conceptually appealing, the OER measure is sometimes difficult to implement because the stock of owner-occupied housing is not always easy to replicate in the rental market. For one, it is not a simple matter to assure that the qualities seen in the owner-occupied market are the same as those measured in

the rental market. In light of the rather dramatic rise in home sales in recent years, coincident with a rising vacancy rate for rental homes, it is reasonable to be circumspect about the recent moderation coming from the large OER component in the CPI. Consider that home prices have been rising at a rate well in excess of the OER since the late 1990s. If people are abandoning home rentals for home ownership, the disinflation in shelter costs led by OER may be understating actual inflation.