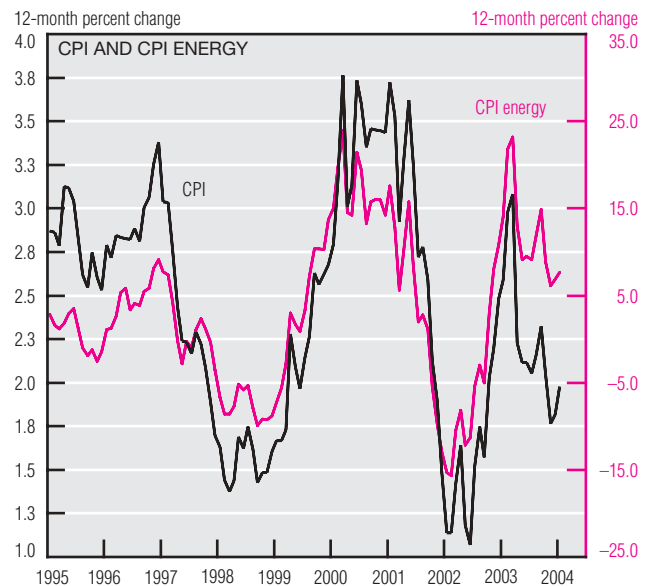
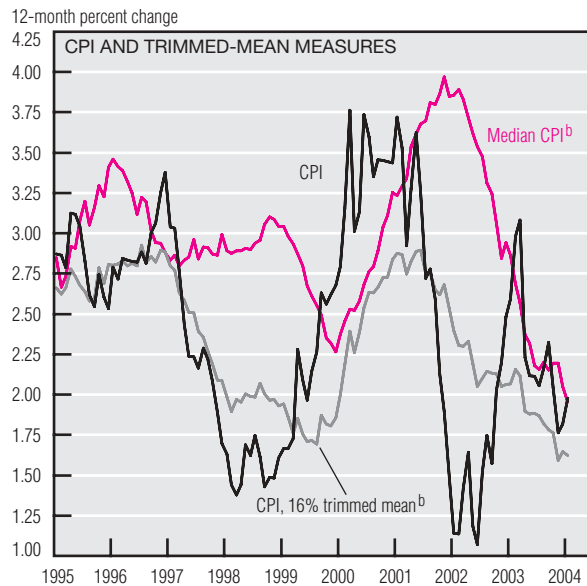
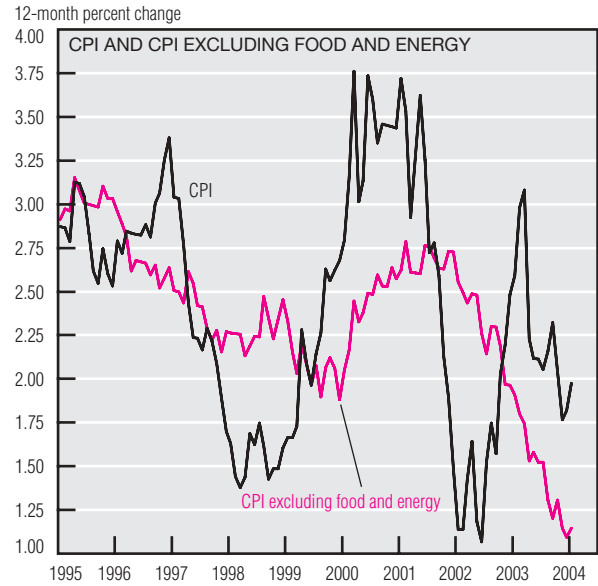


Inflation and Prices

	Percent change, last:				2003 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
January Price Statistics					
Consumer prices					
All items	6.0	2.0	2.0	2.4	1.9
Less food and energy	1.9	0.8	1.1	2.1	1.1
Median ^b	1.6	1.6	2.0	2.9	2.1
Core goods	0.0	-1.7	-2.2	-0.7	-2.5
Consumer goods imports	3.7	2.1	0.4	-0.6	0.1
Energy	73.5	7.8	7.7	7.1	16.3



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 stronger, if still modest, recent increase in retail prices continued into February. In fact, the Consumer Price Index (CPI) surged an annualized 6.0% in January, the largest monthly increase since February 2003. Although more than three-fourths of the CPI's January increase resulted from a 4.7% rise in energy costs (mostly caused by an 8.0% increase in petroleum-based energy), February's core CPI of 1.9% was also a bit higher than the recent trend. The median

CPI and the 16% trimmed-mean CPI, two inflation measures designed to exclude the most extreme price changes, increased at annualized rates of 1.6% and 2.0%, respectively.

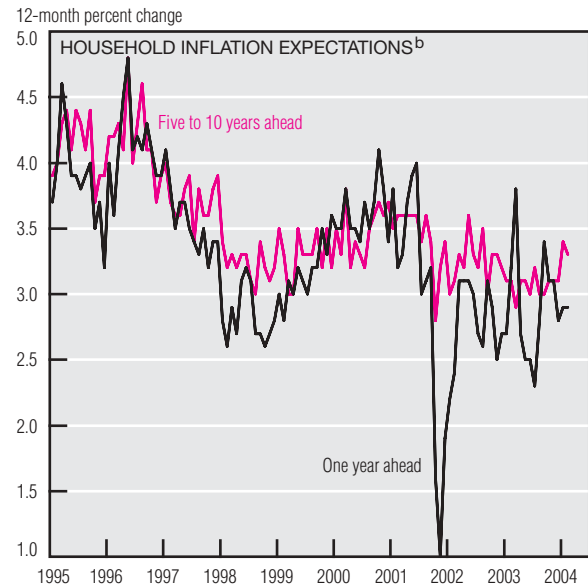
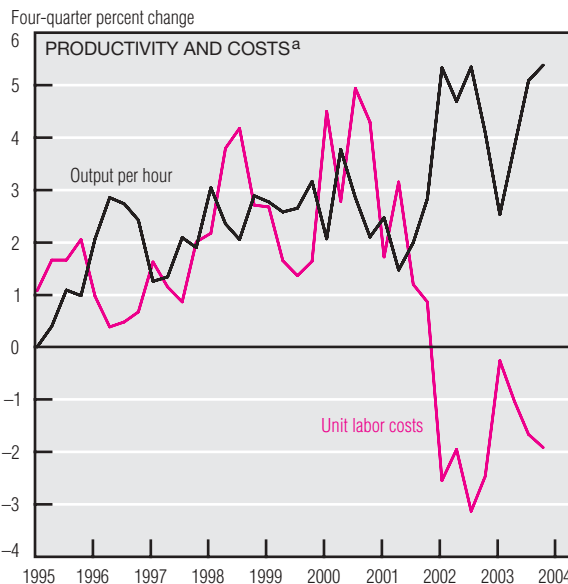
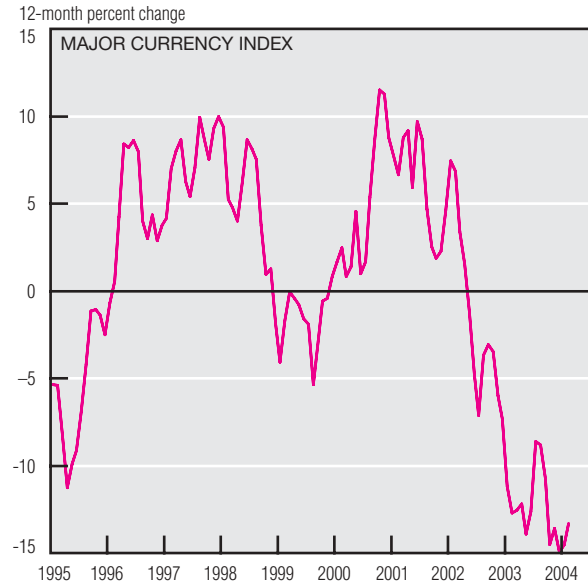
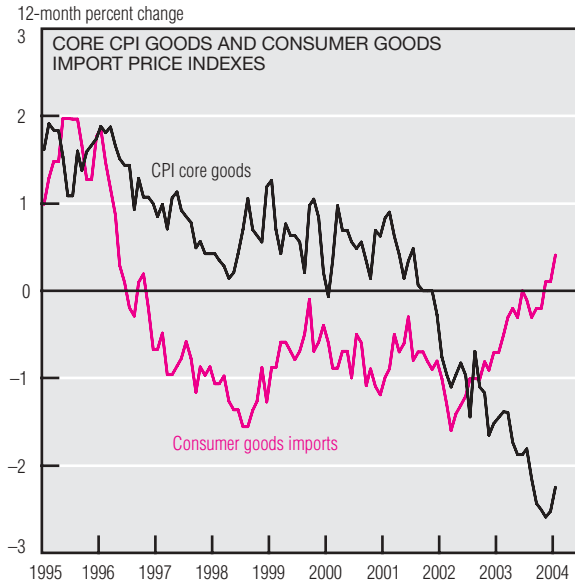
In his semiannual report to Congress, Federal Reserve Chairman Greenspan testified that because of measurement problems, recent inflation performance "puts measured inflation in a range consistent with price stability." Year-over-year inflation measures now indicate that prices are rising 1%–2% annually,

with core CPI showing a modest 1% increase since last year.

In evaluating the inflation situation, Chairman Greenspan noted that "[t]he recent performance of inflation has been especially notable in view of the substantial depreciation of the dollar in 2003." A falling dollar ordinarily would be expected to put upward pressure on import prices and, in turn, consumer goods prices. Indeed, the falling dollar has been associated with a turnaround in imported consumer goods price increases. Still,

(continued on next page)

Inflation and Prices (cont.)



a. Nonfarm business sector.

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; Board of Governors of the Federal Reserve System, "Foreign Exchange Rates," *Federal Reserve Statistical Releases* H.10; and University of Michigan.

the weaker dollar's pass-through to higher consumer goods prices has been slight. According to the Chairman, "foreign exporters have [apparently] been willing to absorb some of the price decline measured in their own currencies and the consequent squeeze on profit margins it entails."

Perhaps an even more important factor in the unusually low inflation numbers over the past several years has been the spectacular rise in U.S. productivity coupled with modest wage growth, which has caused a

drop in what economists call unit-labor costs. Output per hour has risen from around 2¹/₂% to 4% in the last three years, while increases in hourly compensation fell from around 5¹/₂% to about 3%; thus, unit labor costs have fallen dramatically. In fact, the 12-month trend in unit labor cost growth has been *negative* since late 2001.

In light of the strong performance of U.S. productivity and generally sluggish labor markets, most hold a favorable prognosis for relative price stability. According to the Chairman,

"increases in efficiency and a significant level of underutilized resources should help keep a lid on inflation," and U.S. households seem to share his view. The University of Michigan's Survey of Consumers shows that both short- and long-term inflation expectations are holding steady at recent levels. February survey data show that U.S. households anticipate price increases of about 3% over the next 12 months and 3¹/₄% over the next five to 10 years.