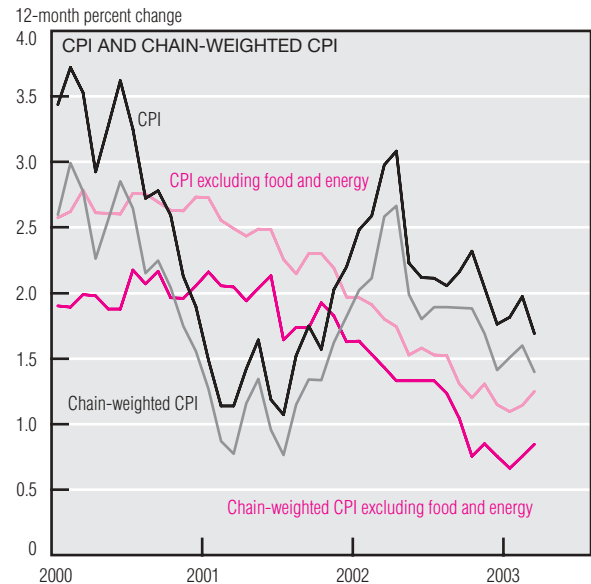
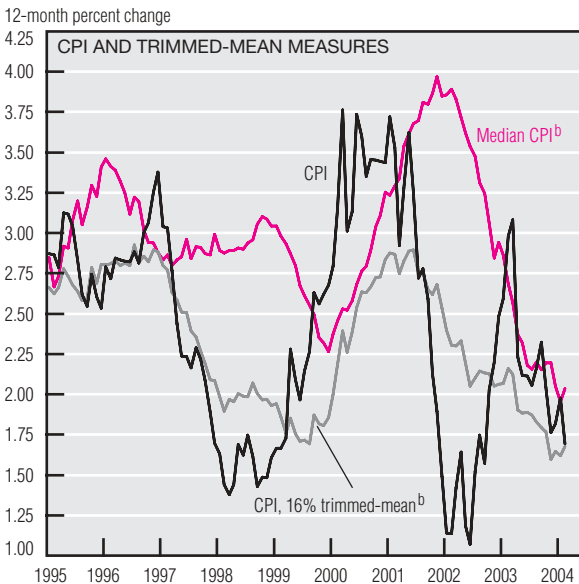
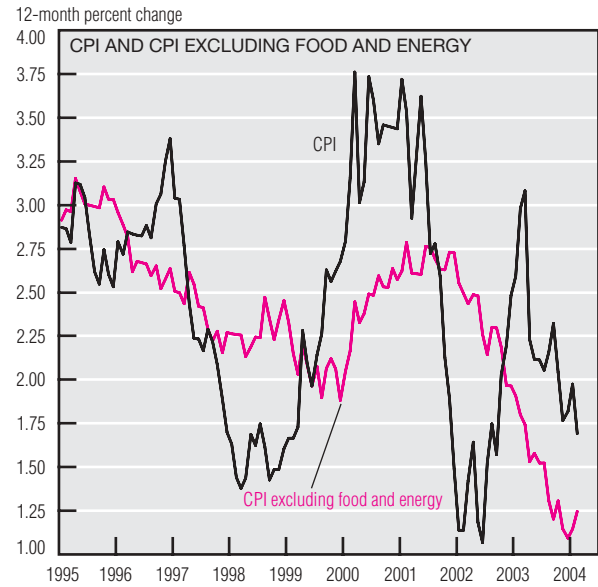


Inflation and Prices

February Price Statistics

	Percent change, last:				2003 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	3.3	3.7	1.7	2.5	1.9
Less food and energy	2.5	1.7	1.2	2.1	1.1
Median ^b	2.9	2.1	2.0	2.9	2.1
Producer prices^c					
Finished goods	7.7	2.5	3.3	2.1	4.4
Less food and energy	3.2	0.5	0.9	0.8	1.1



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

c. January 2004 Producer Price Index data.

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

Retail price data for February suggest that the disinflation pattern observed since mid-2001 may be moderating. After surging 6.0% in January, the Consumer Price Index (CPI) increased substantially, gaining an additional annualized 3.3% in February. The core CPI (the CPI excluding food and energy) also increased by an annualized 2.5% in February, its largest monthly increase since last May and higher than its 2.1% average monthly increase for the past five years. The median CPI rose 2.9%. The 12-month growth rates in the core, median, and

trimmed-mean CPI have begun to inch upward.

Some critics argue that the CPI is an inaccurate measure of inflation because it lacks flexibility in tracking consumer spending changes. Two alternative inflation measures, the chained CPI and the recently revised Producer Price Index (PPI), are designed to reflect more current expenditure and production patterns.

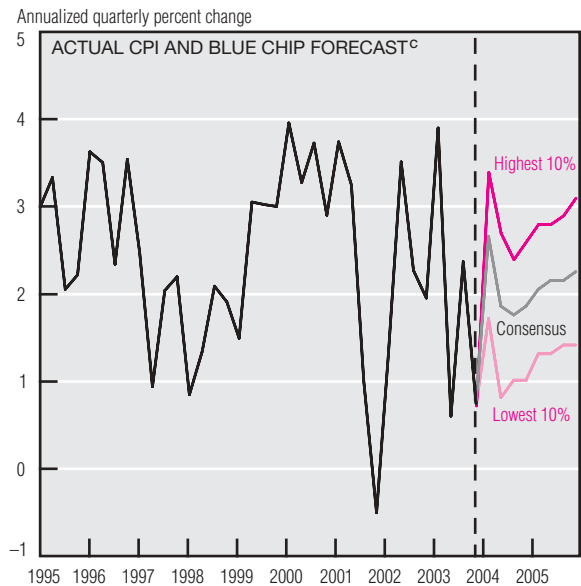
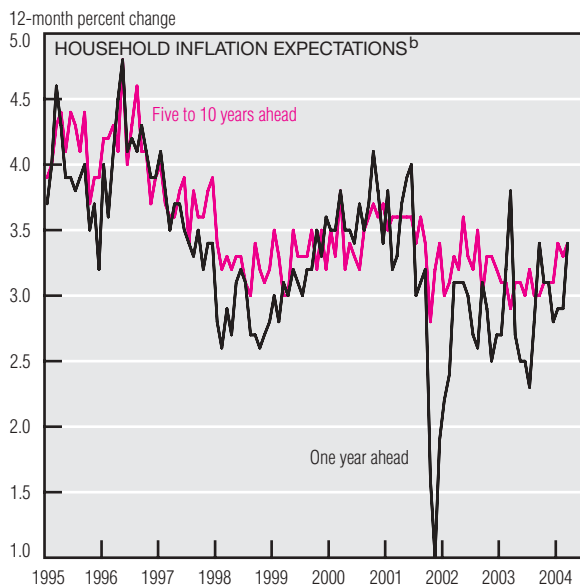
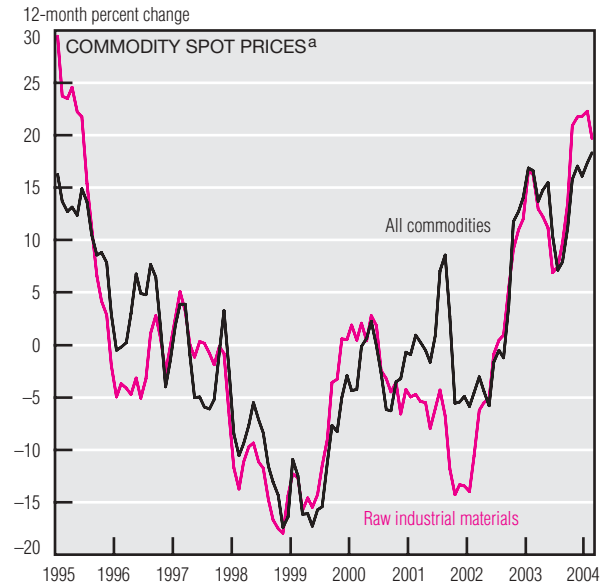
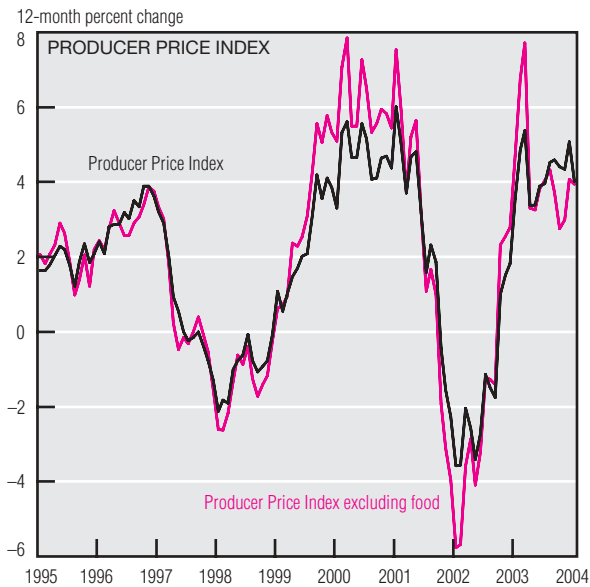
The chained CPI and chained core CPI are sometimes considered more accurate inflation measures because they account for substitutions that arise as consumers react to changes in

the relative costs of their purchases. In contrast, the conventional CPI assumes that the consumer market basket remains fixed for a period of several years. Thus, the chained CPI measures prices in a consumer market basket that is more comparable to current expenditures. Because of differences in market baskets, the conventional CPI is currently about 0.3–0.4 percentage point above the chained CPI measure.

Unlike retail price measures, increases in factory price increases on finished consumer goods, measured by the

(continued on next page)

Inflation and Prices (cont.)



a. As measured by the Knight-Ridder Commodity Research Bureau's Composite and Raw Industrials Spot Commodity Price Index.

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; Commodity Research Bureau; University of Michigan; and *Blue Chip Economic Indicators*, March 10, 2004.

PPI, have remained relatively high, rising approximately 4.0% on a 12-month basis in January. These price increases are partly the result of a sustained increase in commodity prices whose full impact apparently has not been passed along to consumers.

Similarly, the recently released and revised PPI data have reclassified economic activity according to the North American Industry Classification System, which is designed to account for the changing industrial composition of the U.S. economy. The PPI used to be

computed on the basis of producer prices categorized according to the Standard Industrial Classification system, which was developed at a time when the U.S. economy was dominated by manufacturing activity. The revision did not materially alter the aggregate price patterns in the wholesale data.

Households' inflation expectations and economists' forecasts are consistent with a shift in inflation patterns. Households' year-ahead inflation expectations increased from 2.9% in February to 3.4% in March (long-term

inflation expectations remain fairly constant). And the Blue Chip panel's consensus CPI forecast now predicts a 2.6% inflation rate in the first quarter, compared with 2.1% last month. The longer-term forecast predicts 1.8% CPI inflation by the end of 2004 (down from February's 1.9% consensus forecast); however, the range of longer-term inflation forecasts has widened, with pessimists predicting a CPI inflation rate of about 2.6% by the end of the year and optimists predicting a 1.0% CPI inflation rate.