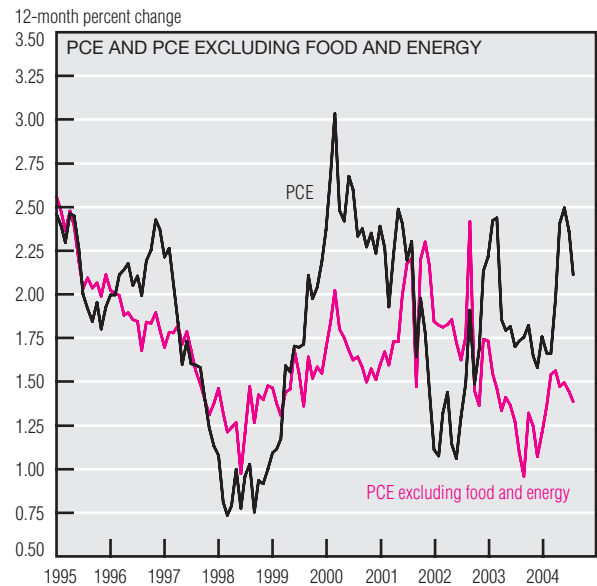
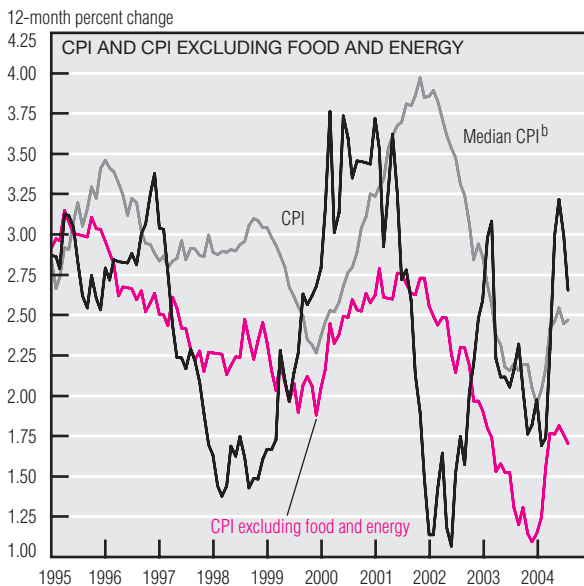
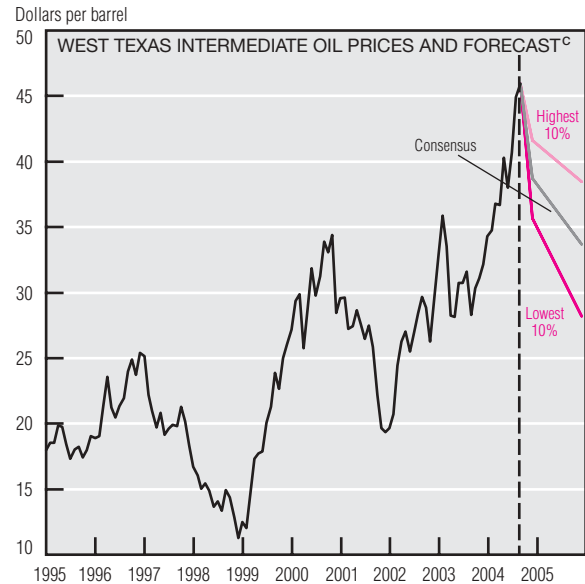


Inflation and Prices

August Price Statistics

	Percent change, last:				2003 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	0.6	1.3	2.7	2.5	1.9
Less food and energy	0.6	1.0	1.7	2.1	1.1
Median ^b	3.0	2.3	2.5	2.9	2.1
Producer prices					
Finished goods	-0.8	-1.1	3.4	2.2	4.4
Less food and energy	-1.6	0.5	1.5	1.0	1.1



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

c. Blue Chip panel of economists.

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

The August inflation data show continued moderation in retail prices. The Consumer Price Index (CPI) rose a mere 0.6% (annualized rate) during the month, reversing August's 0.6% decline. Energy costs dropped at a 3.1% annual rate (the second consecutive monthly decline), even as oil prices approached their forecasted peak. The core CPI, which excludes the volatile food and energy components, also rose—at a 0.6% annualized rate, its slowest monthly growth

rate this year—while the median CPI increased at a 3.0% annualized rate.

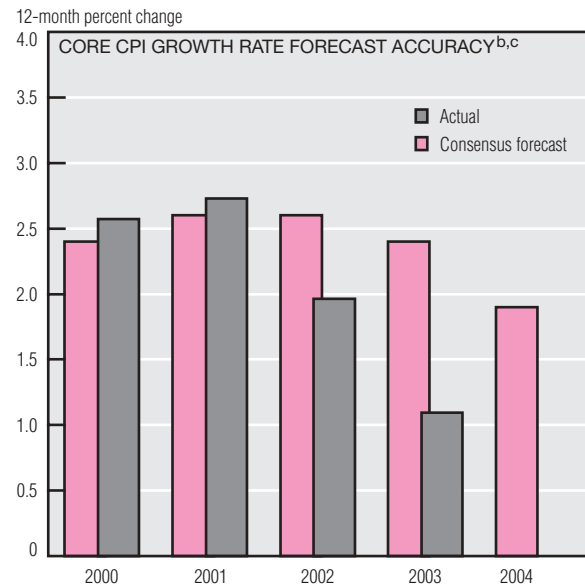
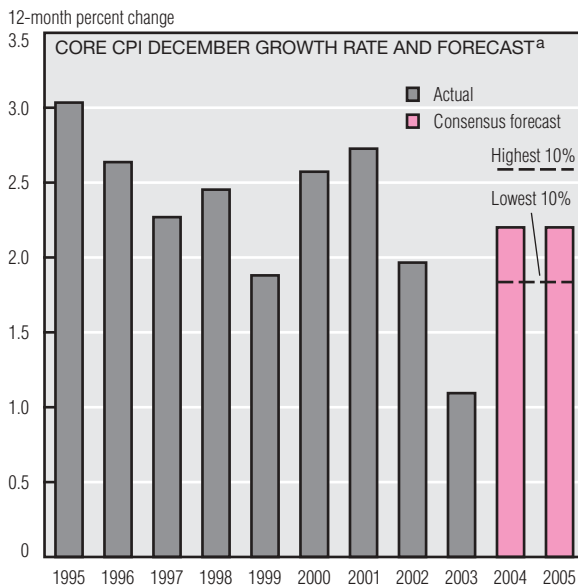
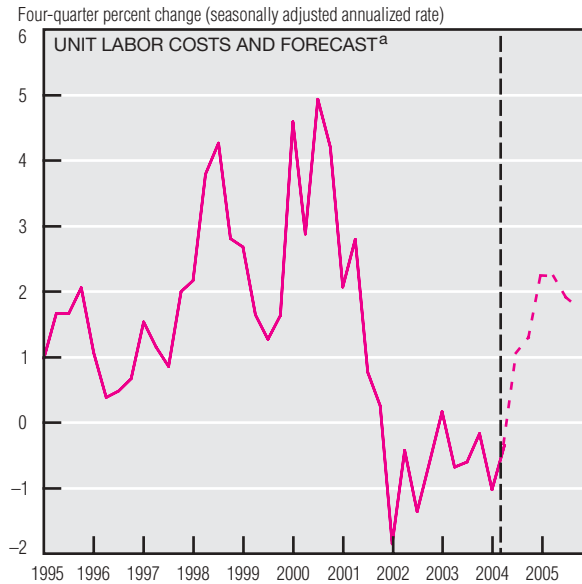
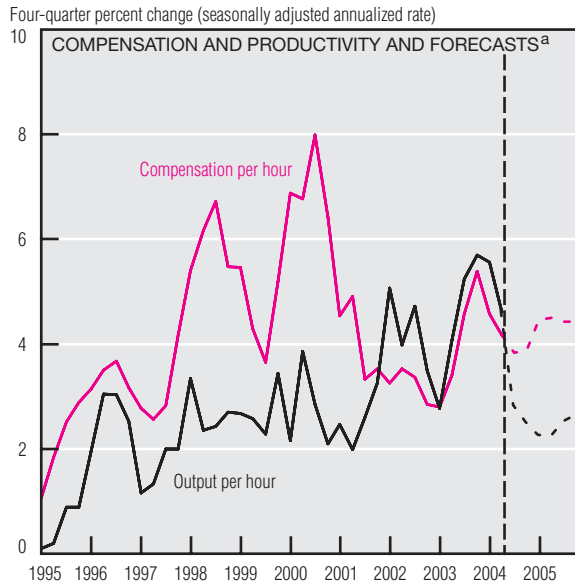
Longer-term trends in the price measures continue to indicate that retail price increases are stabilizing despite escalating energy prices. The CPI increased 2.7% from August 2003, less than July's 12-month growth rate of 3.0%. The 12-month core CPI growth rate fell 0.1 percentage point (pp) to 1.7%, while the median CPI's rose 0.1 pp to 2.5%. The Personal Consumption Expenditures Price Index

(PCE), which measures prices in an alternative consumer goods market basket, reveals similar patterns. The PCE increased 2.1% since August 2003, down from July's 12-month growth rate of 2.4%, while the 12-month growth rate of the core PCE remained stable at 1.4%.

Beyond the near-term price disturbances, caused by oil among other important factors, are the longer-term issues that could accelerate inflation—a persistent rise in the

(continued on next page)

Inflation and Prices (cont.)



a. *Blue Chip Economic Indicators*, September 10, 2004.

b. Blue Chip panel of economists.

c. Forecasts reported in June, July, or August for the 12-month growth rate in December of the following year.

SOURCES: Department of Labor, Bureau of Labor Statistics; and *Blue Chip Economic Indicators*, July 10, 1999, August 10, 2000, June 10, 2001, August 10, 2002, June 10, 2003, and September 10, 2004.

overall level of prices. Among the longer-term factors, economists often look to patterns in unit labor costs—the difference between the growth rate of worker compensation and the growth rate of their productivity.

Indeed, many economists credit much of the current expansion's relatively modest inflation performance to strong U.S. labor productivity growth, which has exceeded the growth of worker compensation over much of the past four years. In other words, the

trend in U.S. unit labor costs has been negative since 2001, which may have put substantial downward pressure on U.S. prices over this period. The consensus view among economists, however, is that this pattern of strong growth in productivity relative to compensation will not persist much longer and, indeed, may have turned around already. According to *Blue Chip Economic Indicators*, unit labor costs are now thought to be trending higher and should top 2% by year's end.

The stronger pace of unit labor costs is consistent with economists' expectation that the growth rate of the core CPI will also top 2% this year and will hold there in 2005, higher than the annual core CPI growth rates in 2002 and 2003. However, in each of the previous two years, economists have overpredicted the core CPI's growth rate by a substantial margin.