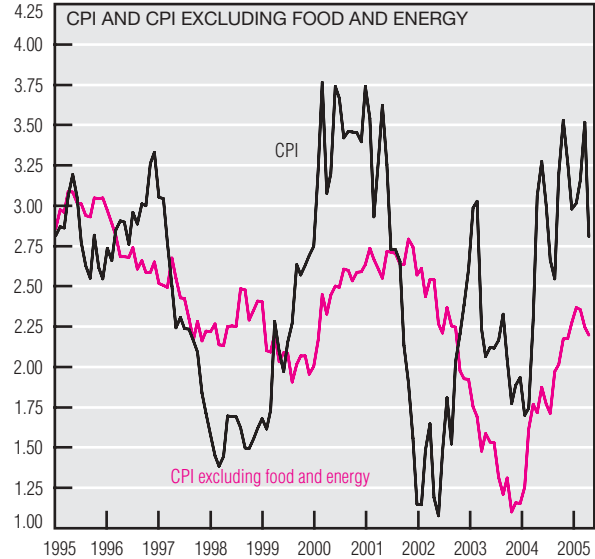


Inflation and Prices

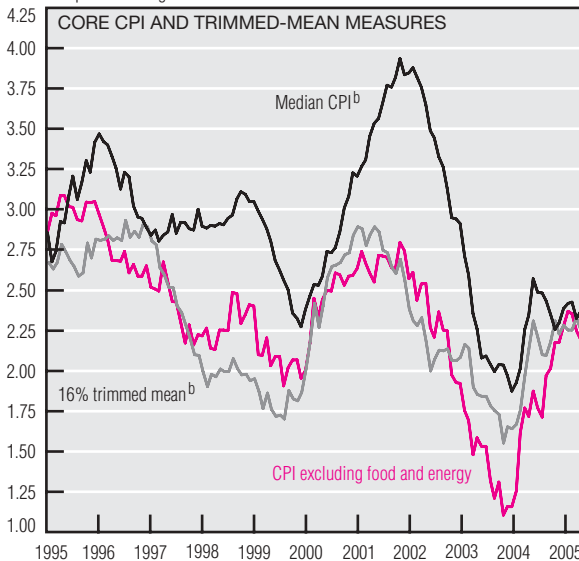
May Price Statistics

	Percent change, last:				2004 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	-0.6	4.4	2.8	2.5	3.4
Less food and energy	1.8	2.2	2.2	2.1	2.2
Median ^b	3.2	2.8	2.4	2.8	2.3
Producer prices					
Finished goods	-7.5	2.6	3.5	2.3	4.4
Less food and energy	0.8	1.6	2.6	1.1	2.2

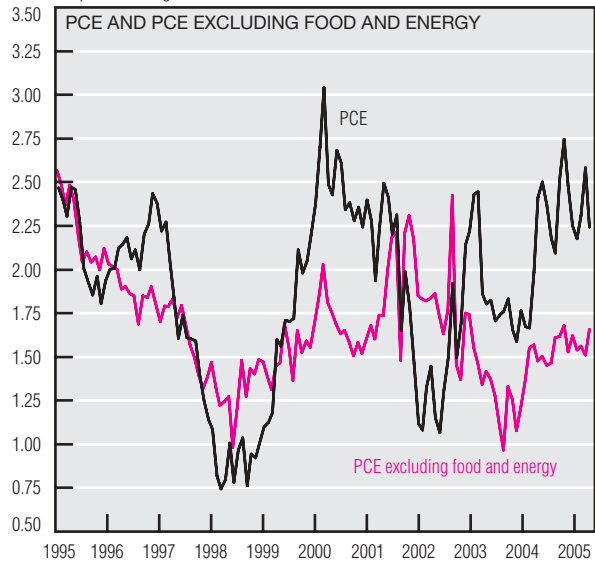
12-month percent change



12-month percent change



12-month percent change



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

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

The Consumer Price Index (CPI) declined 0.6% (annualized rate) in May following substantial gains of 6.4% (annualized rate) in April and 7.8% (annualized rate) in March. Energy prices declined at an annualized rate of 21.9% after advancing more than 60.0% the previous two months. Monthly growth in the core CPI, which excludes the volatile food and energy components, rose at a moderate 1.8% annualized rate, and the median CPI rose at 3.2%.

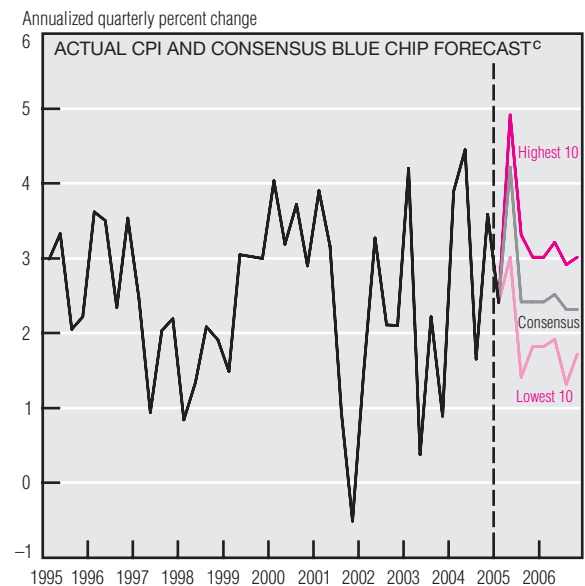
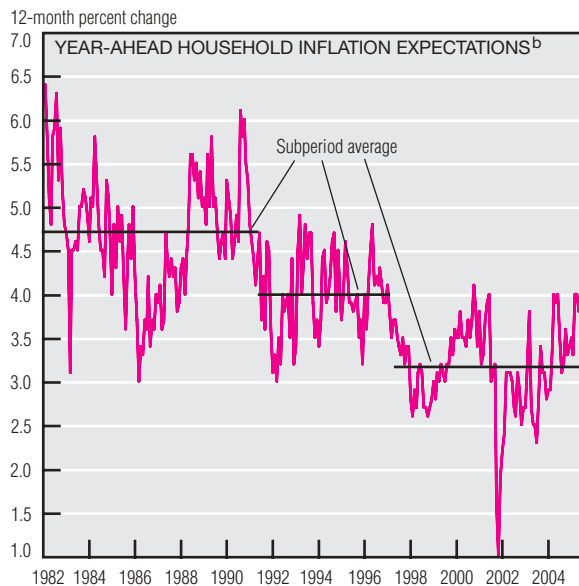
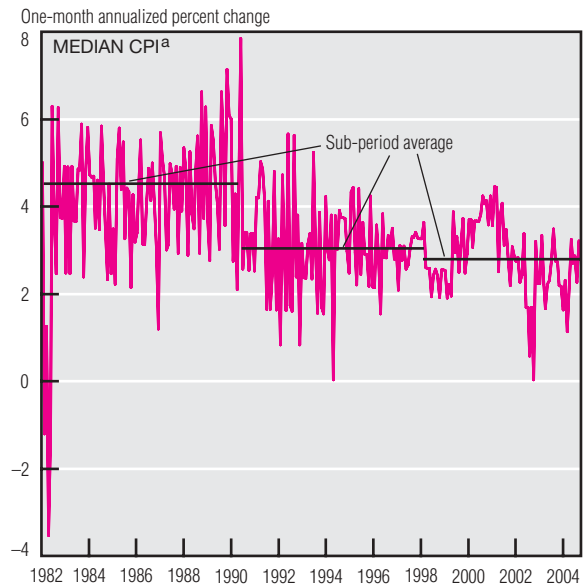
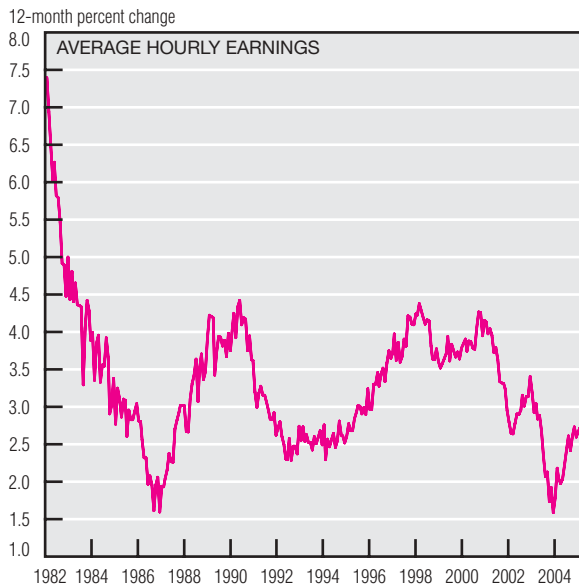
Longer-term inflation trends in the core retail price measures were generally stable during the month. Although the CPI's 12-month growth rate declined from 3.5% in April to 2.8% in May, the 12-month growth rates in the core CPI and the trimmed-mean CPI remained at 2.2% and 2.3%, respectively. The median CPI's 12-month growth rate inched up a mere 0.1 percentage point to 2.4% in May. Longer-term inflation trends in the Personal Consumption Expenditure (PCE) Price Index,

which considers an alternative market basket of consumer goods and services, mirror trends in the CPI. The PCE fell about 0.4 percentage points to 2.2%. The core PCE, which excludes the volatile food and energy components, inched upward 0.1 percentage point to 1.6% in May; this retail price measure has generally fluctuated between 1.5% and 1.6% for more than a year.

Some have noted recent price pressures resulting from rising costs, including a recent upward drift in

(continued on next page)

Inflation and Prices (cont.)



a. Calculated by the Federal Reserve Bank of Cleveland.

b. Mean expected change 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; University of Michigan; and *Blue Chip Economic Indicators*, July 10, 2005.

labor compensation, but the long-term inflation trend remains steady. Although price statistics fluctuate over short periods of time, inflation trends tend to be rather inert. As a result, economists often use longer-run averages of the data, and appeal to core inflation statistics to better gauge changes in the inflation trend. Some use statistical measures, such as "break-point" tests, to check for changes in the inflation trend. This approach reveals that inflation, as

measured by the median CPI, has followed three distinct trends in the past 23 years: Inflation averaged 4.5% from 1982 to 1990, 3.1% from 1991 to 1998, and 2.8% since 1998. In other words, the swings in the 12-month inflation trend over the past seven years or so are not clearly distinguishable from variations around one long, stable inflation episode. Applying the same techniques to measures of household inflation expectations yields essentially the same result—

while we have seen variation in the expectations data, year-ahead household inflation expectations appear to have trended just under 3.2% since the late 1990s.

Meanwhile, the Blue Chip panel of economists has increased its year-ahead CPI inflation forecast since June. In the most recent Blue Chip survey, these economists predicted that inflation would average 3.0% in the last three quarters of 2005, up from the 2.8% they estimated in June.