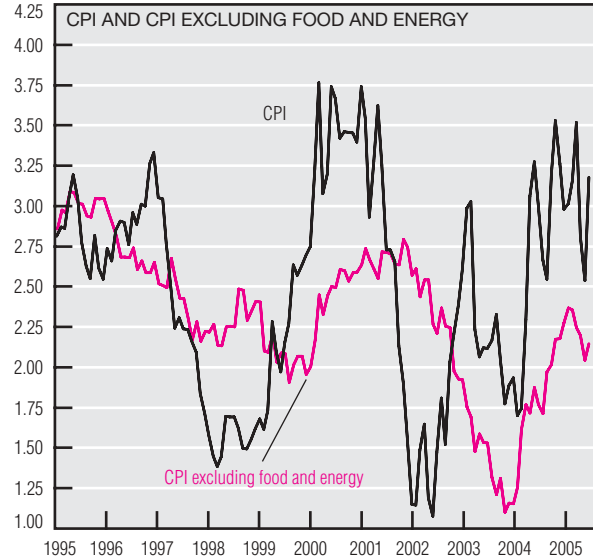


# Inflation and Prices

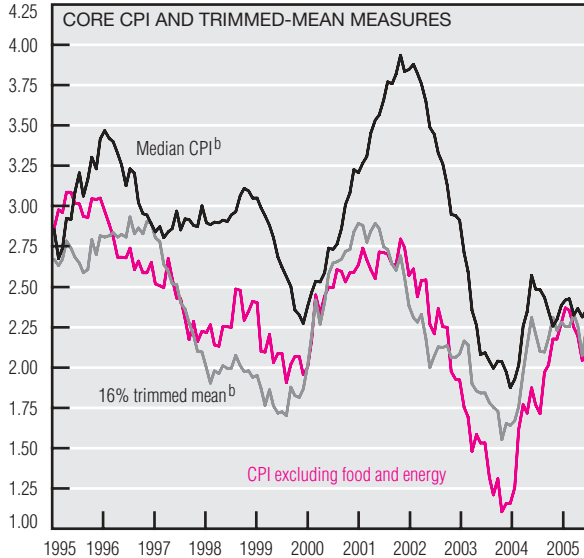
## July Price Statistics

	Percent change, last:				2004 avg.
	1 mo. <sup>a</sup>	3 mo. <sup>a</sup>	12 mo.	5 yr. <sup>a</sup>	
<b>Consumer prices</b>					
All items	6.4	1.9	3.2	2.5	3.4
Less food and energy	1.8	1.6	2.1	2.1	2.2
Median <sup>b</sup>	2.6	2.6	2.3	2.8	2.3
<b>Producer prices</b>					
Finished goods	13.3	1.6	4.6	2.3	4.4
Less food and energy	4.7	1.5	2.8	1.1	2.2

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 Energy, Energy Information Administration; and Federal Reserve Bank of Cleveland.

## State Energy Statistics

	Thousands of barrels per day			Natural gas production, 2003 (billions of cubic feet)
	Crude oil production, 2004 daily average	Crude oil distillation capacity 1-1-05	Operating refineries 1-1-05	
Alabama	20	130	2	346
Arkansas	18	77	2	170
Louisiana	228	2,773	17	1,350
Mississippi	47	365	4	134
Texas	1,073	4,628	25	5,244
U.S. total	5,419	17,125	144	19,912

The Consumer Price Index, which was unchanged in June, rose at a 6.4% annualized rate in July. After falling for two months, energy costs rose a sharp 56.8% (annualized), accounting for over half of the rise in the overall CPI. Meanwhile, growth in the core retail price measures was relatively moderate: the core CPI rose 1.8%, and the median CPI rose 2.6% (annualized).

The 12-month growth rate of CPI-measured inflation rose from 2.5% in June to 3.2% in July, but longer-term inflation trends were stable among

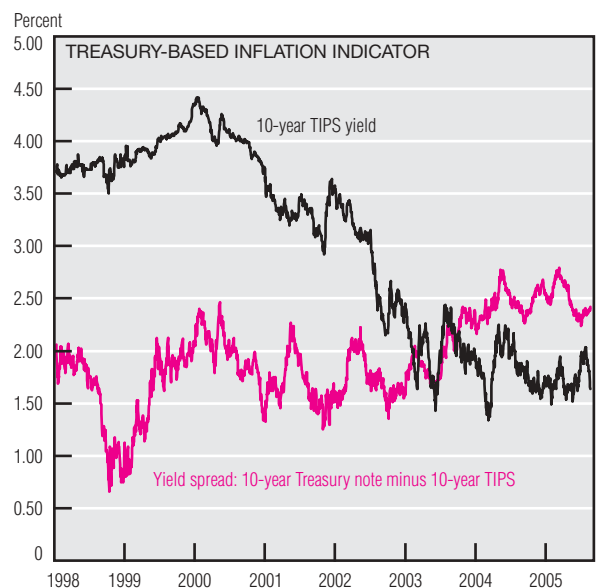
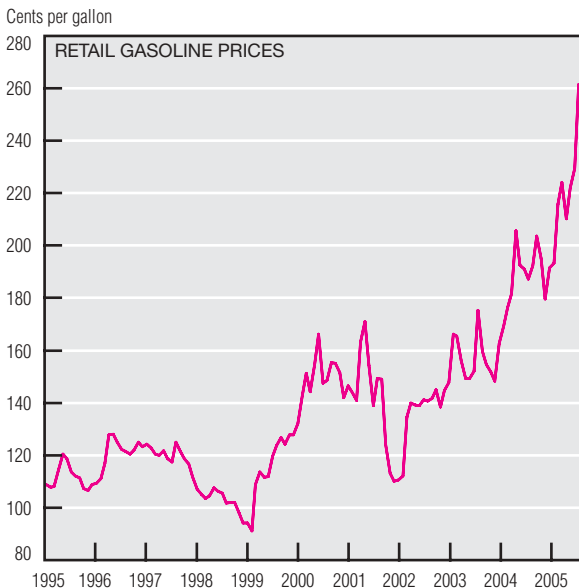
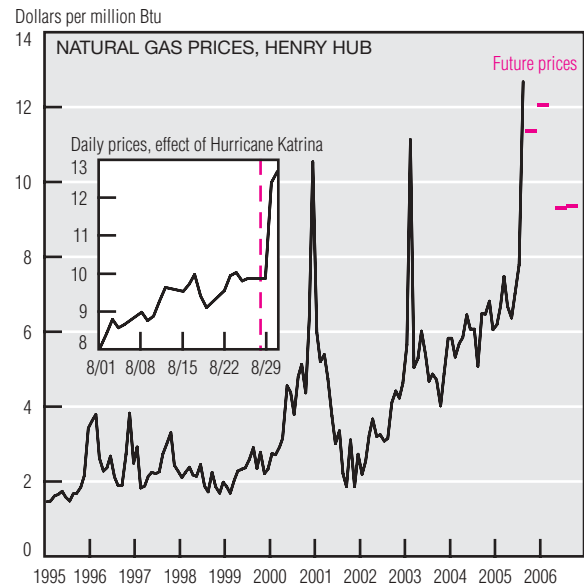
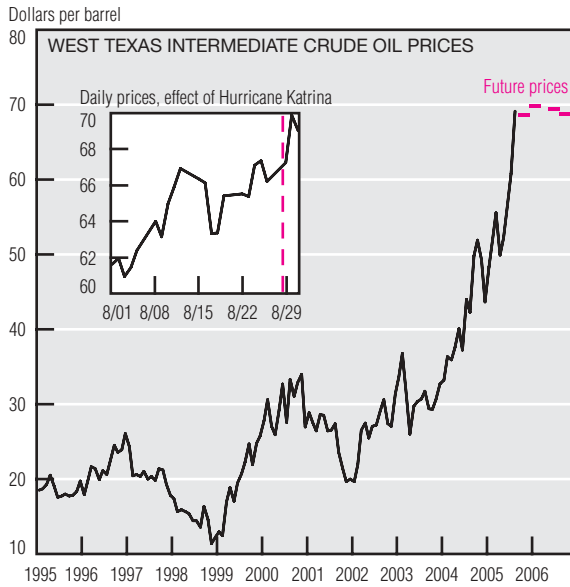
the core retail price measures. The 12-month growth rate in the core CPI remained at 2.1%, and the median CPI held at 2.3%, while the 12-month growth rate in the 16% trimmed-mean CPI inched upward to 2.2%. These measures have fluctuated between 2.0% and 2.5% for about a year, despite the dramatic rise in energy prices.

Price pressures from rising energy costs are likely to worsen in the aftermath of Hurricane Katrina. As this text is being written, the full extent of

the damage to the Louisiana and Mississippi oil refineries, the U.S. oil fields in the Gulf of Mexico, and the natural gas pipelines across the Gulf Coast region is unknown. Indeed, the condition of these facilities may not be clear for some time. The federal government has reported that in Louisiana alone, eight oil refineries have suspended production. As of September 1, the Department of Energy estimated that 91% of the Gulf region's daily petroleum production was still shut in, as was 83% of its

(continued on next page)

## Inflation and Prices (cont.)



SOURCES: U.S. Department of Energy, Energy Information Administration; the *Wall Street Journal*; and Bloomberg Financial Information Services.

natural gas production. The futures markets indicate that crude oil prices, which rose from \$67.2 to \$69.8 per barrel directly after the most dramatic hurricane damage, are expected to remain at around \$70 over the next 12 months. These markets also suggest that natural gas prices, which surged from \$9.80 to \$12.40 per million Btu after the disaster, may remain high throughout the home heating season before falling late next year.

Meanwhile, retail gasoline prices, which have leaped nearly 40% in 2005 alone and generally mirror crude oil prices, are expected to remain high; by some reports, they may climb even higher. While the market for gasoline is about to enter a season when demand traditionally declines, gasoline inventories are at relatively low levels. Damage to the Gulf region's refineries will almost certainly aggravate the volatile market for gasoline even further.

For now, long-term inflation expectations in financial markets remain well contained. Average annual inflation expectations (over the next 10 years) are reflected by the yield spread between 10-year Treasury notes and 10-year, inflation-protected securities. This spread, which has fluctuated between 2<sup>1</sup>/<sub>4</sub>% and 2<sup>3</sup>/<sub>4</sub>% since late 2003, suggests that securities market participants currently anticipate an average annual inflation rate of 2.4% over the next 10 years.