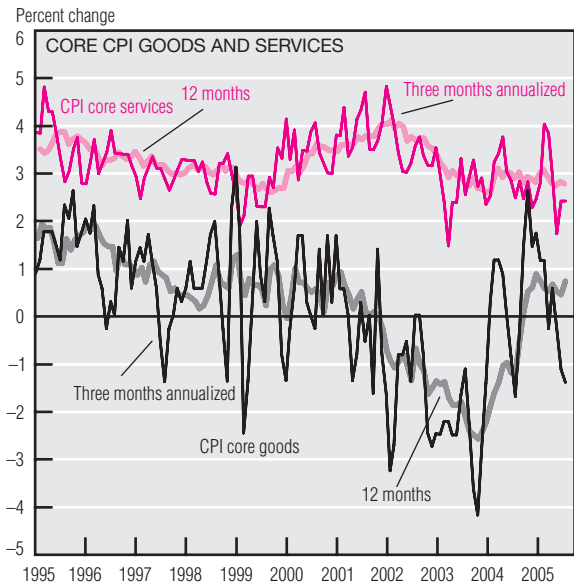
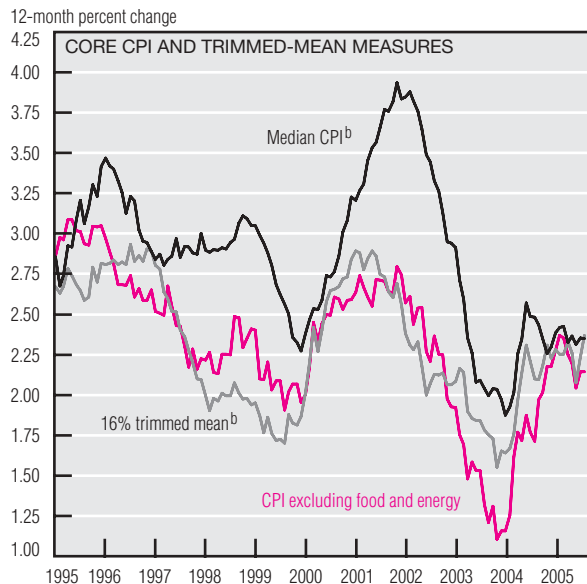
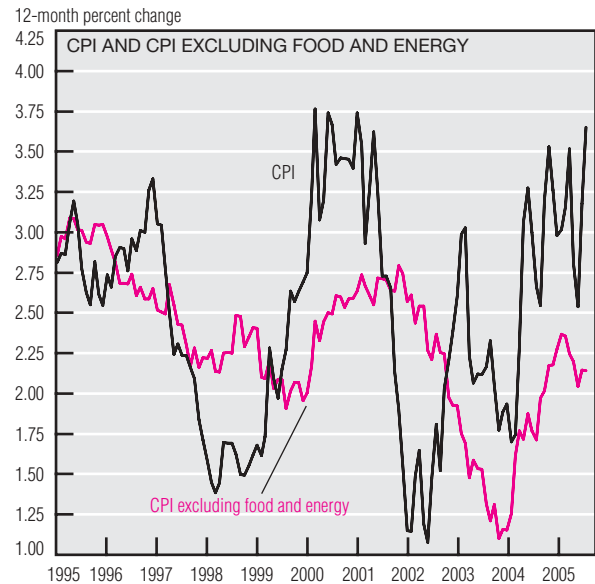


Inflation and Prices

	Percent change, last:				2004 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
August Price Statistics					
Consumer prices					
All items	6.3	4.2	3.6	2.6	3.4
Less food and energy	1.2	1.4	2.1	2.0	2.2
Median ^b	2.1	2.3	2.3	2.8	2.3
Producer prices					
Finished goods	7.2	6.7	5.1	2.5	4.4
Less food and energy	0.0	1.3	2.4	1.1	2.2



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 Consumer Price Index rose 6.3% in August, following a 6.4% rise in July. Energy prices surged ahead for the second consecutive month, jumping nearly 80% (annualized rate), but growth in the core retail price measures was much more subdued. The core CPI rose a modest 1.2%, substantially below its 12-month trend of 2.1%, while the median CPI rose 2.1%, also below its 12-month trend of 2.3%.

Meanwhile, the 12-month growth rate of CPI-measured inflation continued to rise, increasing from 3.2%

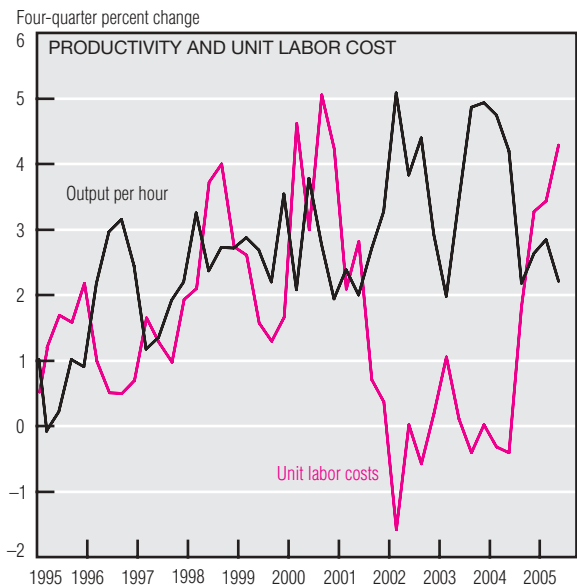
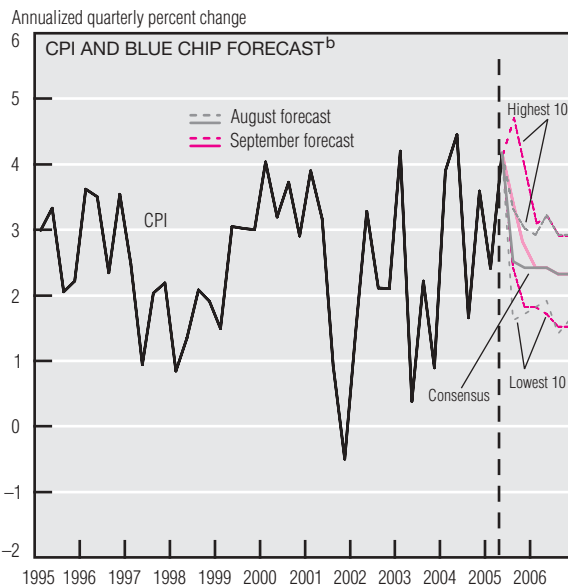
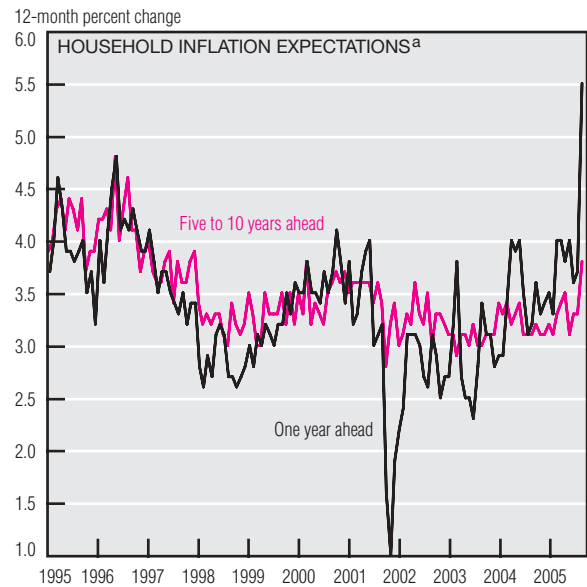
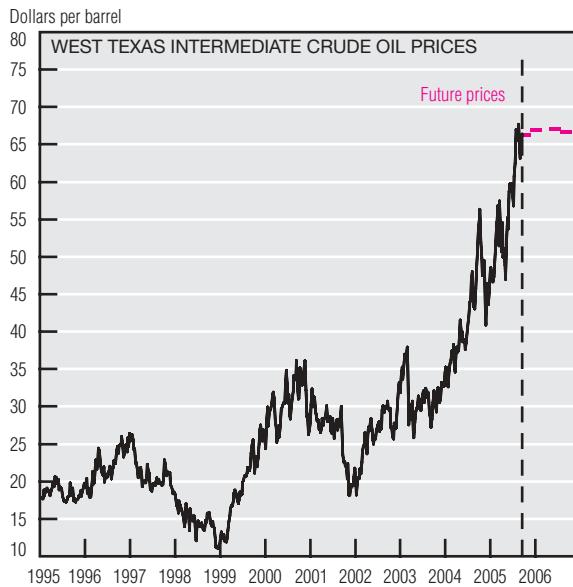
to 3.6% during the month. However, longer-term inflation trends in the core retail price measures were relatively stable. The 12-month growth rates in the core CPI and median CPI held steady at 2.1% and 2.3%, respectively. The 12-month growth rate in the 16% trimmed-mean CPI increased 0.2 percentage point to 2.4%. After trending upward throughout 2004, growth in the core retail price measures has generally remained steady over the past year or so, fluctuating between 2.0% and 2.5%. Inflation

stability is also apparent in the major core components: Growth in core services prices has trended between 2.7% and 3.0% for over a year, and growth in core goods prices, after accelerating throughout 2004, has fluctuated in a narrow range, between 0.4% and 0.7%, since the beginning of 2005.

This relatively modest growth in the core retail price measures has continued, despite the dramatic rise in energy prices. Crude oil prices, which have nearly doubled in 2005 so

(continued on next page)

Inflation and Prices (cont.)



a. Mean expected change as measured by the University of Michigan's *Survey of Consumers*.

b. Blue Chip panel of economists.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; University of Michigan; *Blue Chip Economic Indicators*, August 10 and September 10, 2005; the *Wall Street Journal*; and Bloomberg Financial Information Services.

far, are expected to remain high for at least the next year. Household inflation expectations have been shaped by this dramatic and persistent rise in energy prices and by the interruptions in energy supply and distribution caused by the devastating Gulf Coast hurricanes. In September, households expected that inflation over the next year would reach 5.5% (up from 3.7% in August). Long-term inflation expectations jumped as well: Households expected prices

to grow 3.8% over the next five to 10 years (up from 3.3% in August).

Economists are more sanguine about the inflation outlook, at least over the longer term. In the August survey, the consensus inflation outlook of the Blue Chip panel of economists was an average of 2.5% in the second half of 2005. In the September survey, this number jumped to 3.1%. However, the panel's 2006 forecast remained stable between the August and September surveys:

The consensus forecast is for inflation to average about 2.4% in 2006. One of the most important factors that will shape economists' inflation forecasts is the trend in unit labor costs: Year-over-year growth in unit labor costs has accelerated substantially, going from -0.4% to 4.3%. If the recent surge in unit labor costs persists, it may eventually push economists' inflation projections significantly upward.