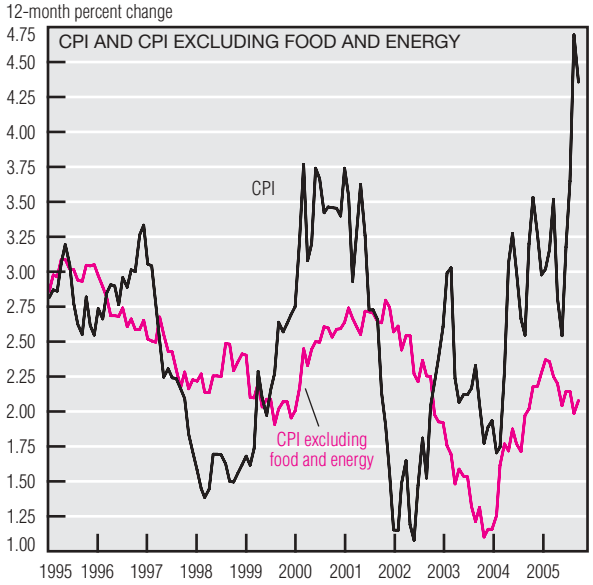
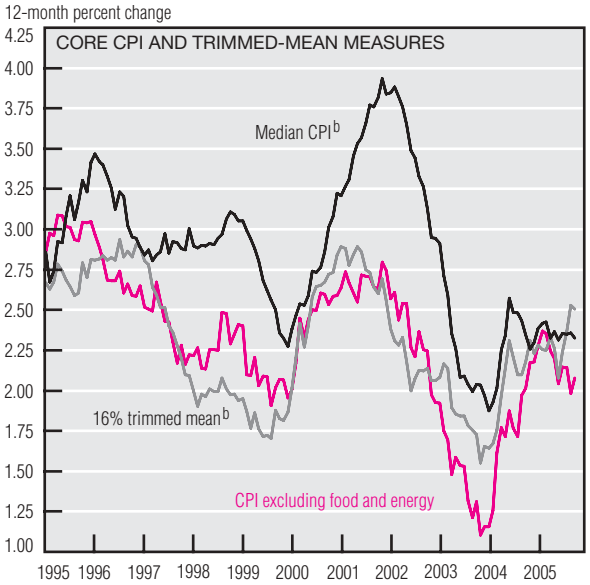
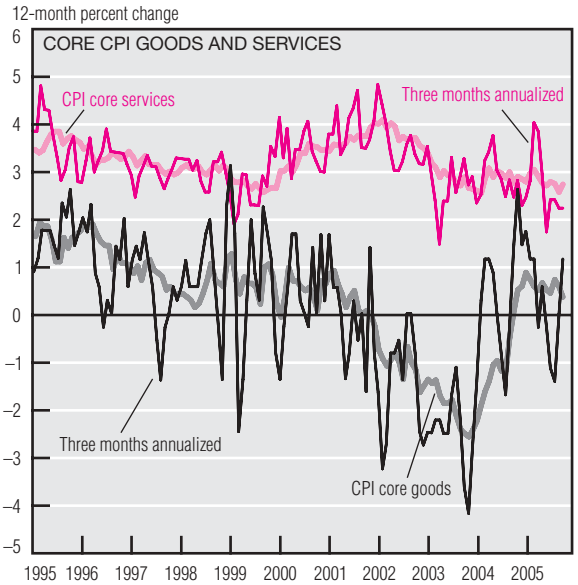
Inflation and Prices

October Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	2004 avg.
Consumer prices					
All items	2.4	8.0	4.3	2.7	3.4
Less food and energy	3.0	1.8	2.1	2.0	2.2
Median[b]	1.9	1.9	2.3	2.7	2.3
Producer prices					
Finished goods	8.6	13.2	5.9	2.8	4.4
Less food and energy	–3.0	0.0	1.9	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.

After surging 15.7% (annualized rate) in September—its largest monthly rise in more than 25 years, the Consumer Price Index (CPI) rose a relatively modest 2.4% (annualized rate) in October. Energy prices, which rose sharply throughout the third quarter, declined 2.9% (annualized) in October. Growth in the core CPI rose to 3.0% (annualized), higher than its three- and 12-month growth trends, whereas the median CPI's monthly growth rate was a subdued 1.9%.

Longer-term inflation trends were mixed. The CPI's 12-month growth rate ticked down from 4.7% in September to 4.3% in October, the second-highest 12-month growth rate since the early 1990s. The 12-month growth rates of the core CPI and the median CPI remained steady at 2.1% and 2.3%, respectively. However, the 16% trimmed-mean CPI's 12-month growth rate has accelerated just a bit since June, reaching 2.5% in October. Taken as a whole, the data suggest that there has been a retail inflation trend in the range of 2.0% to 2.5% since at least the end of 2004; prices of both core goods and core services have been showing some stability.

Meanwhile, household inflation expectations fell from a 15-year high of 5.5% in September and October to 4.1% in November. The improved household inflation sentiment probably reflects the continued decline in petroleum prices, which fell from their recent peak of nearly $70 per barrel in August to about $57 in November. However, even longer-term inflation expectations—which are less likely to be influenced by fluctuations in energy prices—declined 0.5 percentage points to 3.3% in November.

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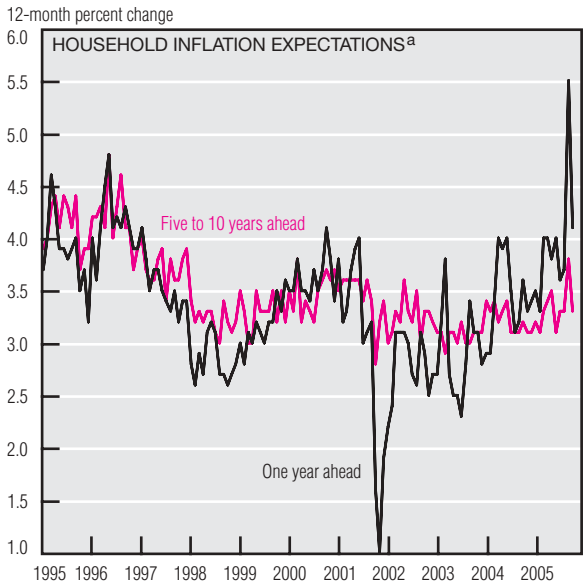
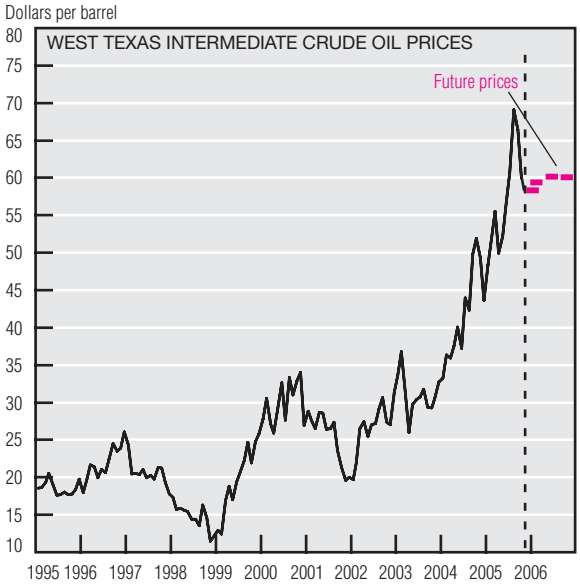
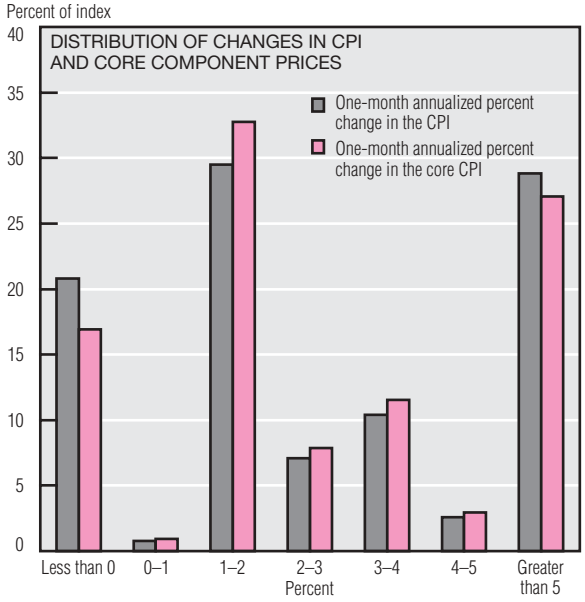
Inflation and Prices (cont.)







Accuracy in Predicting CPI Growth over the Next 12 Months: Root Mean-squared Errors

Annualized percent change, last	CPI	Core CPI	Median CPI	16% trimmed-mean CPI
One month	2.83	2.75	2.35	2.22
Three months	2.20	2.39	2.12	2.01
Six months	1.99	2.32	2.03	1.97
Nine months	1.98	2.36	2.05	2.01
12 months	2.09	2.44	2.13	2.11

a. Mean expected change as measured by the University of Michigan's Survey of Consumers.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; University of Michigan; and the *Wall Street Journal*.

Although underlying inflation patterns seem relatively subdued, some CPI components are still subject to pricing pressure. Indeed, apart from energy, 27% of the CPI's components showed annualized price increases of more than 5% in October. These price increases were largely offset, however, by deflation in roughly 17% of the core CPI's components.

This uneven distribution of component price changes across the consumer's market basket makes it difficult to gauge any potential shift in the growth trend in overall retail prices. Indeed, even the core inflation measures have been showing somewhat contradictory patterns in the monthly data: The CPI excluding food and energy accelerated, the trimmed-mean CPI decelerated, and the median CPI held comparatively steady. Which of these is likely to be the most accurate? Although no single monthly measure of inflation should be given a great deal of weight, an examination of these alternative measures' forecasting record suggests that the trimmed-mean and median CPI measures tend to predict future CPI trends more accurately than the more traditional core statistic. That is, when it comes to forecasting CPI-measured inflation over the next 12 months, the one- and three-month annualized percent changes in the median CPI and 16% trimmed-mean CPI are more accurate than either the regular CPI or the CPI excluding food and energy.