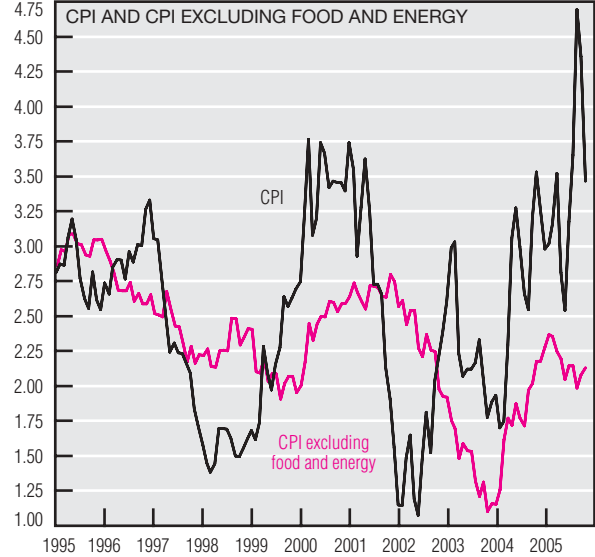


# Inflation and Prices

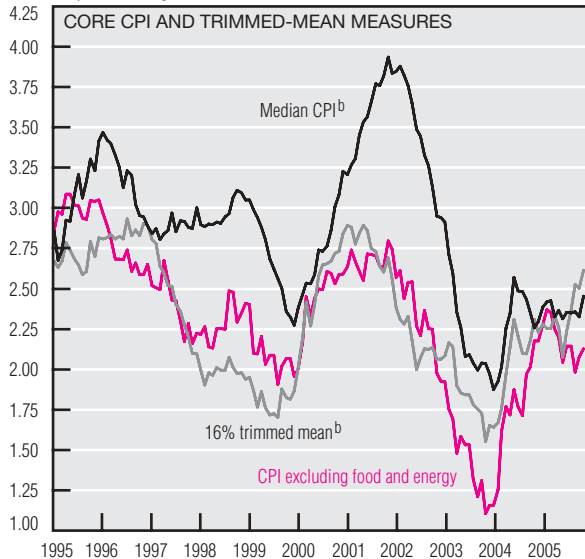
## November Price Statistics

	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	3.5	3.5	2.6	3.4
Less food and energy	3.0	2.4	2.1	2.0	2.2
Median <sup>b</sup>	2.6	2.1	2.4	2.7	2.3
<b>Producer prices</b>					
Finished goods	-7.9	7.6	4.4	2.5	4.4
Less food and energy	1.5	0.5	1.8	1.1	2.2

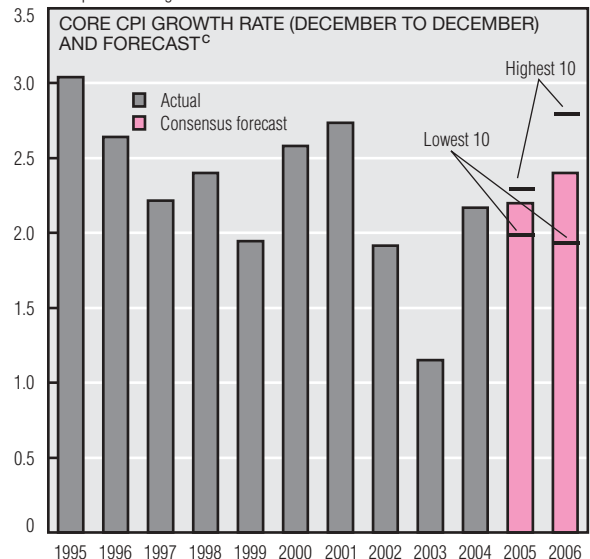
12-month percent change



12-month percent change



12-month percent change



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

c. The 2005 core CPI forecast is from *Blue Chip Economic Indicators*, November 10, 2005. The 2006 core CPI forecast is from *Blue Chip Economic Indicators*, December 10, 2005.SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; and *Blue Chip Economic Indicators*, November 10, 2005 and December 10, 2005.

The Consumer Price Index (CPI) declined at an annualized rate of 6.4% in November, its largest monthly drop in more than 55 years. However, growth in the core CPI measures was troublesome: The CPI excluding food and energy rose 3.0% (annualized rate) for the second consecutive month, and the median CPI increased 2.6% (annualized rate).

Longer-term inflation trends were mixed. Although the 12-month growth rate in the CPI moderated, falling from

4.3% in October to 3.5% in November, it was still elevated, whereas the core CPI's 12-month growth rate remained steady at 2.1%. Both the median CPI and the 16% trimmed-mean CPI inched upward 0.1 percentage point to 2.4% and 2.6%, respectively. Taken as a whole, the core retail price measures suggest that inflation is still between 2.0% and 2.5%, the range it has held to since the end of 2004 at least. Economists expect this relative price stability to continue: The Blue Chip panel of economists predicts

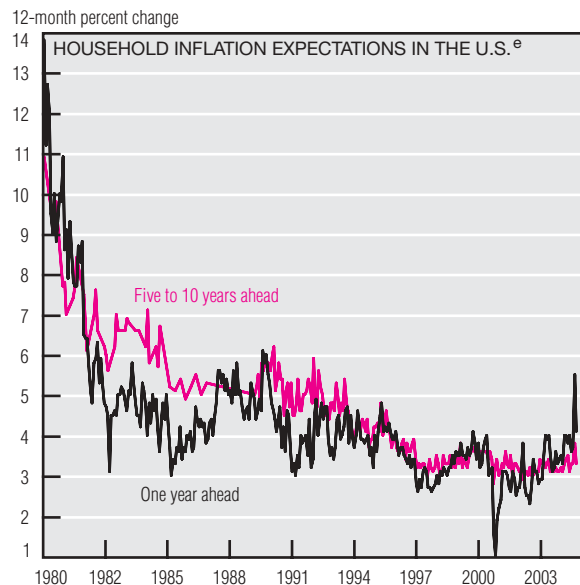
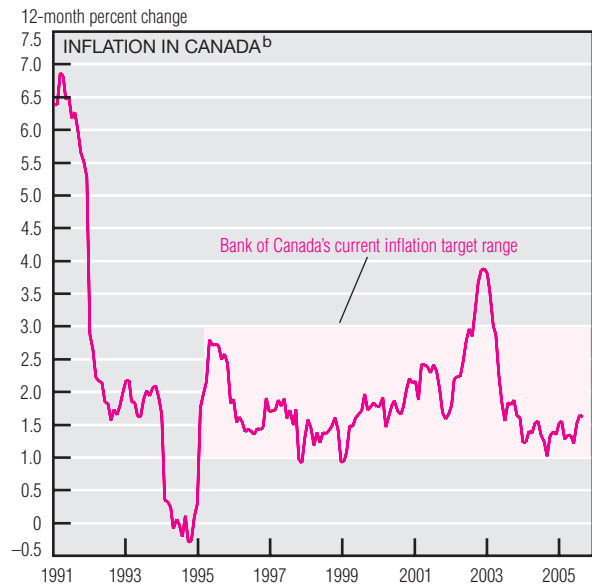
that core retail prices will rise 2.2% in 2005 and 2.4% in 2006.

In addition to delivering relatively low inflation rates, many central banks around the world set inflation targets, which they believe help to anchor inflation expectations and enhance a central bank's ability to respond to short-term changes in output and employment. It is certainly true that the central banks using such targets have enjoyed some success in maintaining a comparatively low level of

(continued on next page)

## Inflation and Prices (cont.)

Formal Inflation Objectives <sup>a</sup>		
Country	Target (percent)	Further details
Australia	2–3	Average over the business cycle
Canada	1–3	To the end of 2006; six- to eight-quarter horizon
Mexico	3	Tolerance band of $\pm 1$ percentage point
New Zealand	1–3	Average over the medium term
Sweden	2	One- to two-year horizon; tolerance band of $\pm 1$ percentage point
U.K.	2	Tolerance band of $\pm 1$ percentage point
Euro area	<2	Below but close to 2% for the euro area as a whole over the medium term



- a. Reproduced from a table compiled by the Reserve Bank of Australia <[http://www.rba.gov.au/Education/monetary\\_policy.html#what\\_are\\_the\\_objectives\\_of\\_mp](http://www.rba.gov.au/Education/monetary_policy.html#what_are_the_objectives_of_mp)>.
- b. The Bank of Canada's operational target for monetary policy actions is the core CPI, which excludes the eight most volatile components as well as the effect of changes in indirect taxes on the remaining components.
- c. Harmonised Index of Consumer Prices (HICP).
- d. CPI excluding food and energy.
- e. Mean expected change as measured by the University of Michigan's *Survey of Consumers*.
- SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Organisation for Economic Co-operation and Development; Statistical Office of the European Communities (Eurostat); Reserve Bank of Australia; and University of Michigan.

inflation. For example, Canada's 12-month inflation rate has dropped from more than 6.0% in the early 1990s and has remained between 1.0% and 3.0% over the past decade. Inflation has also been brought down substantially in the euro area, although it has been a challenge to contain it below the 2.0% target that the European Central Bank's Governing Council has defined as price stability. Like the U.S., the euro area seems to have been experiencing an inflation trend just above 2.0%.

Establishing an inflation target for the Federal Reserve has been advocated by the person nominated to be its next chairman, Ben Bernanke. As a Fed governor, he described his view of inflation targeting as "constrained discretion," in which "the central bank is free to do its best to stabilize output and employment in the face of short-run disturbances ... [but] must also maintain a strong commitment to keeping inflation—and, hence, public expectations of inflation—firmly under control ..."

However, some have argued that a central bank needn't define an inflation target explicitly if it can gain a solid reputation for maintaining low and stable inflation. Indeed, in the U.S., where core inflation has fluctuated between 1.0% and 3.0% over the past decade, households have significantly reduced their long-term inflation expectations, which have remained remarkably even despite the shocks that have buffeted the U.S. economy over the past decade.