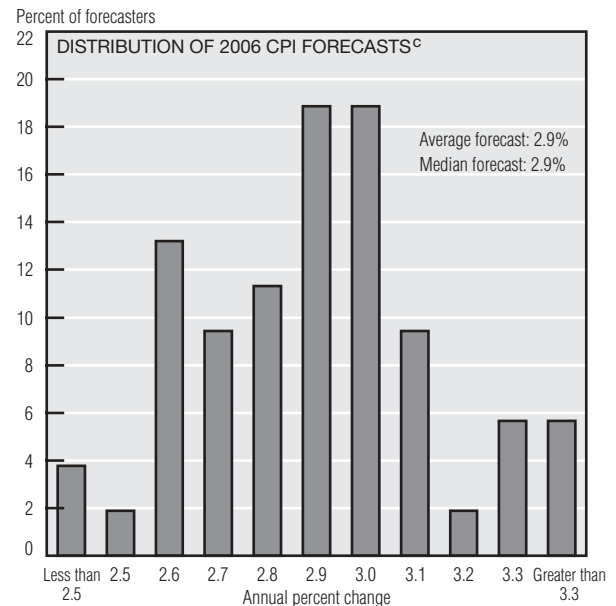
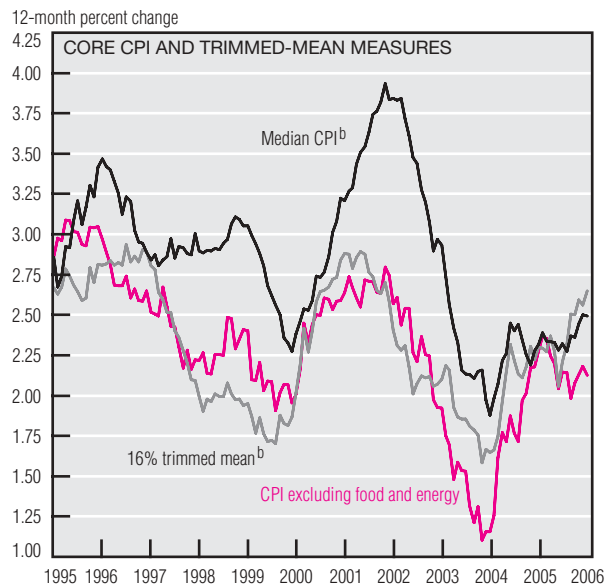
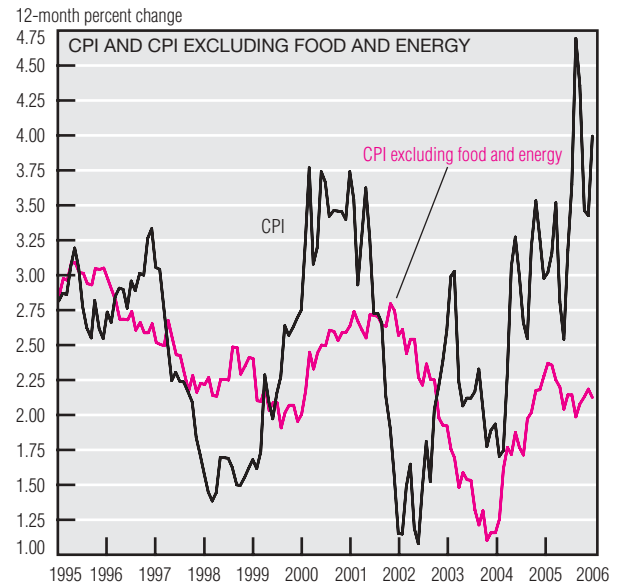


Inflation and Prices

	Percent change, last:				2005 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
January Price Statistics					
Consumer prices					
All items	8.2	-0.2	4.0	2.5	3.6
Less food and energy	2.4	2.4	2.1	2.0	2.2
Median ^b	2.6	2.7	2.5	2.7	2.5
Producer prices					
Finished goods	3.0	2.0	5.7	2.5	5.8
Less food and energy	4.7	2.6	1.5	1.1	1.7



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

c. Blue Chip panel of economists.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; *Blue Chip Economic Indicators*, February 10, 2006; and Federal Reserve Bank of Cleveland.

The Consumer Price Index (CPI) rose at the brisk annualized rate of 8.2% in January, nearly reversing the declines of the preceding two months. About 70% of the January advance was attributed to a 79.4% (annualized rate) gain in energy costs, which had remained stable or declined since September 2005. Growth in the core retail price measures was more moderate, but slightly above the 12-month trends, with the CPI excluding food and energy up 2.4% (annualized

rate) and the median CPI up 2.6% (annualized rate) during the month.

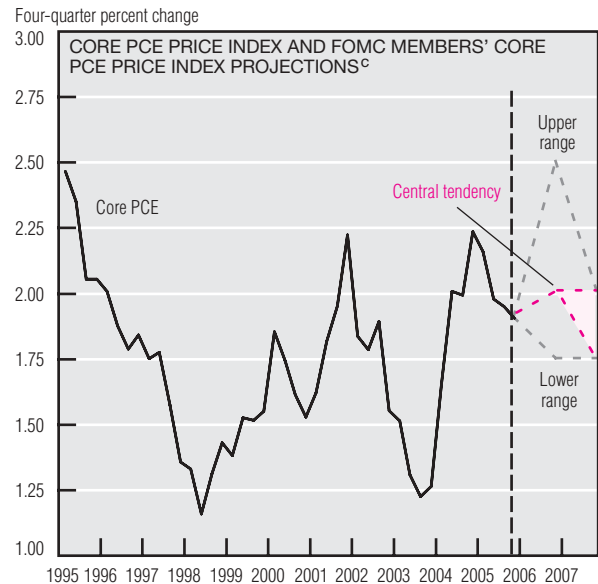
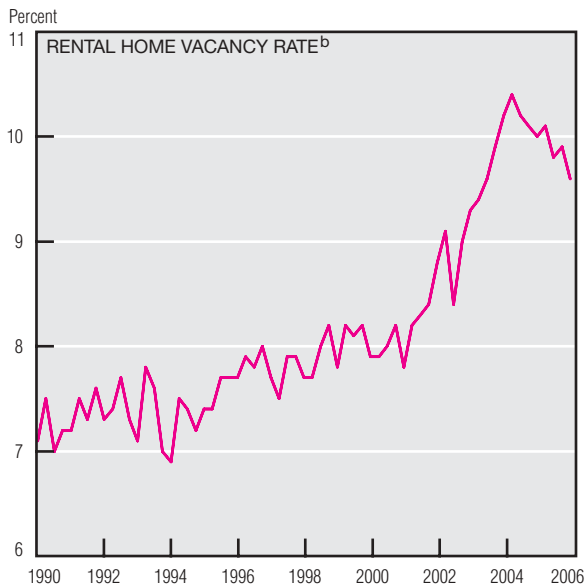
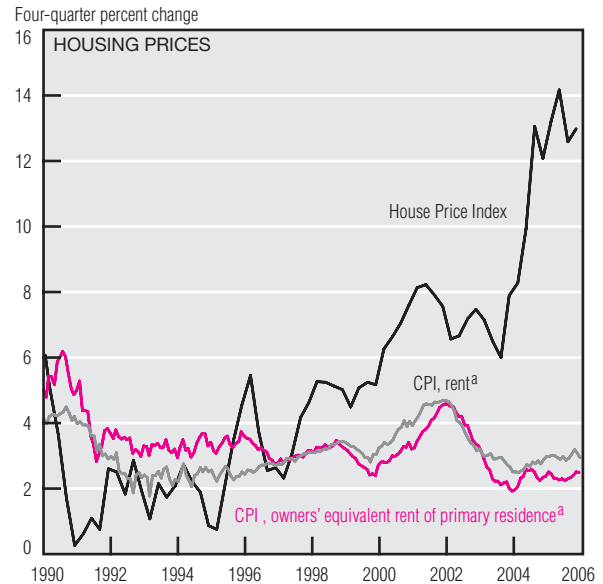
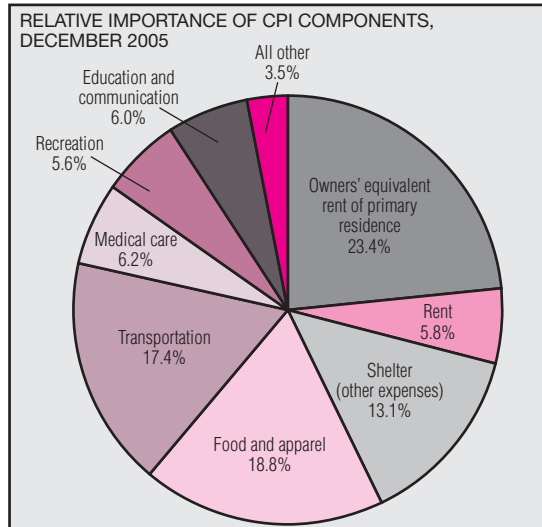
The longer-term trends of underlying inflation are just a bit north of 2%, a level that some might argue is near the upper limit of a range consistent with price stability. Specifically, the 12-month growth rates were 2.1% for the core CPI, 2.5% for the median CPI, and 2.6% for the 16% trimmed-mean CPI. And the consensus and median estimates from the Blue Chip panel of economists predict that the CPI will rise 2.9% in 2006. However, the

proportion of them (about 23%) who think the CPI could top 3% this year slightly exceeds the proportion predicting the CPI will fall back to less than a 2.7% rise.

Housing is the largest component of CPI, accounting for more than 40% of its basket of goods. The owners' equivalent rent (OER) of primary residence—the cost homeowners would assume if they rented their houses instead of owning them—is responsible for 23.4% of the overall CPI. The OER is computed using

(continued on next page)

Inflation and Prices (cont.)



a. Twelve-month percent change.

b. Vacant housing units available for rent year-round divided by the sum of renter-occupied housing units, vacant units rented year-round but awaiting occupancy, and vacant units available for year-round rent.

c. Projections by the Board of Governors of the Federal Reserve System and Reserve Bank presidents.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of the Census; Office of Federal Housing Enterprise Oversight; and Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress*, February 15, 2006.

rental prices, which have probably been lowered by the greater attractiveness of owning a home instead of renting. Indeed, as home prices have risen at a double-digit pace in the past couple of years, the OER has moderated to an annual rate of about 2¹/₄%—down from rates near 3% for most of the 1990s.

Given the large weight of the implied rental cost of homeownership in the CPI, a firming in the home rental market could have a meaningful

impact on the inflation statistic. It might be true that rents are underpriced, partly because of the housing market's strength in the past couple of years, but the potential for a significant rise in rents should be balanced against what continues to be a relatively large stock of vacant rental properties. And although the vacancy rate on rental homes has come down some since peaking in 2004, vacancies are still well above the levels seen throughout the 1990s.

No sustained rise in retail price inflation is currently being predicted inside the Federal Reserve, according to recent projections by voting and nonvoting members of the Federal Open Market Committee, which were reported in the Federal Reserve's semiannual Monetary Policy Report to the Congress. The central tendency of the group's projection for the core PCE Price Index is 2% in 2006 and 1³/₄%–2% in 2007, on a four-quarter to four-quarter basis.