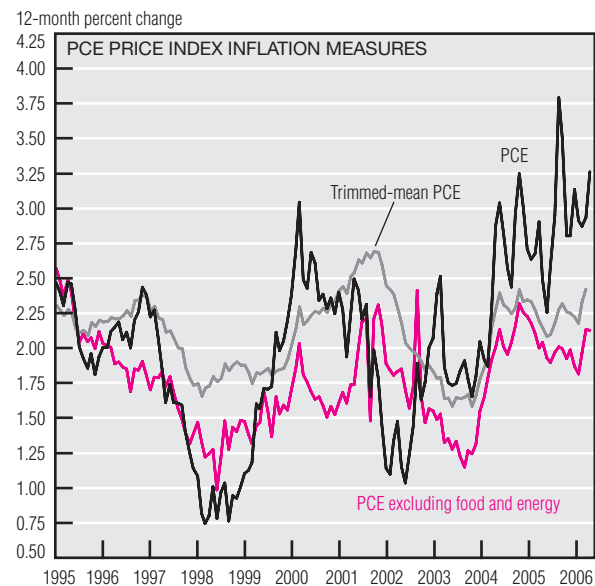
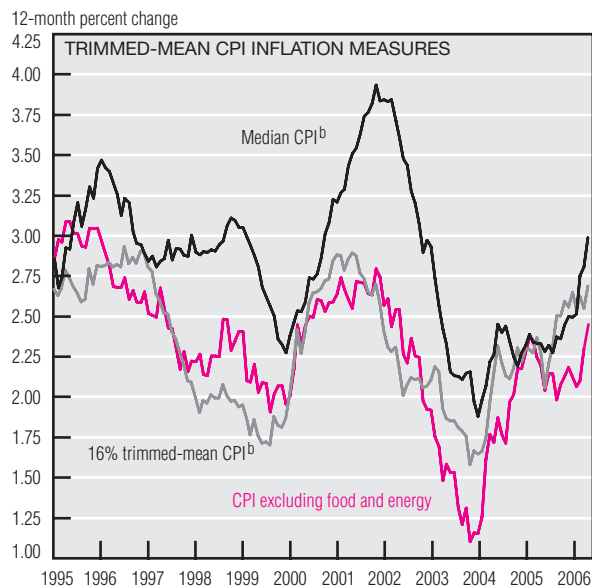
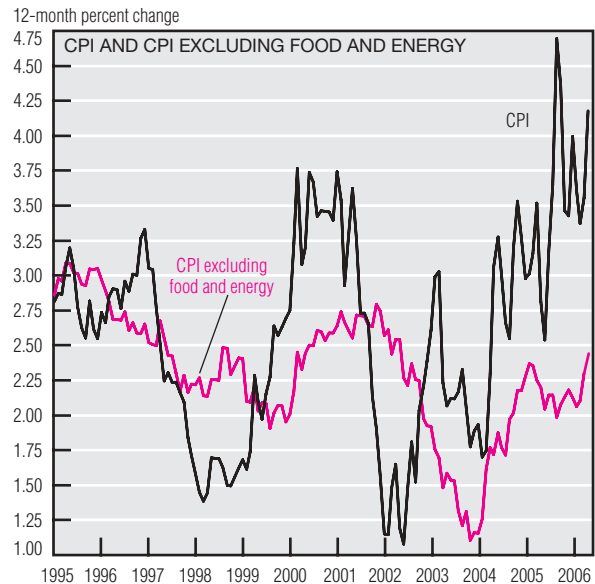


Inflation and Prices

	Percent change, last:				2005 avg.
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	
Consumer prices					
All items	5.5	5.7	4.2	2.6	3.6
Less food and energy	3.6	3.8	2.4	2.1	2.2
Median ^b	4.3	4.2	3.0	2.7	2.5
Producer prices					
Finished goods	2.3	6.7	4.5	2.5	5.8
Less food and energy	3.1	2.0	1.5	1.2	1.7



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 Commerce, Bureau of Economic Analysis; Federal Reserve Bank of Dallas; and Federal Reserve Bank of Cleveland.

Inflation pressures intensified further in May. The Consumer Price Index (CPI) continued to accelerate, rising at an annualized rate of 5.5%. Brisk monthly growth in the core retail price measures outpaced longer-term trends: The CPI excluding food and energy rose at a 3.6% annualized rate, while the median CPI surged at a 4.3% annualized rate.

Longer-term growth trends in the core retail price measures reveal increased pressure since at least last fall. The 12-month growth rate in the

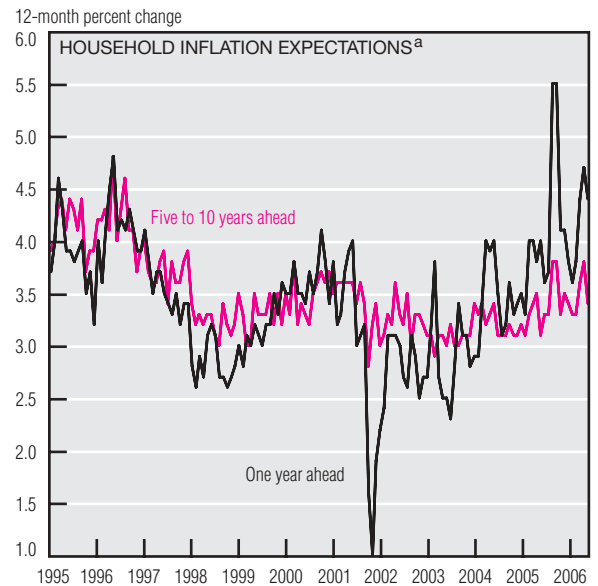
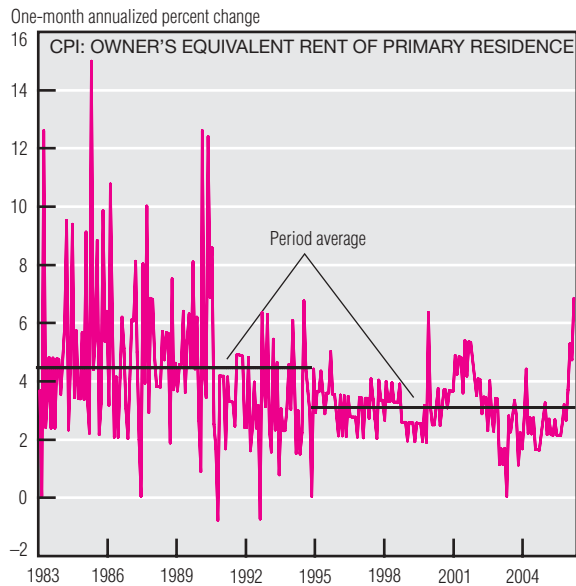
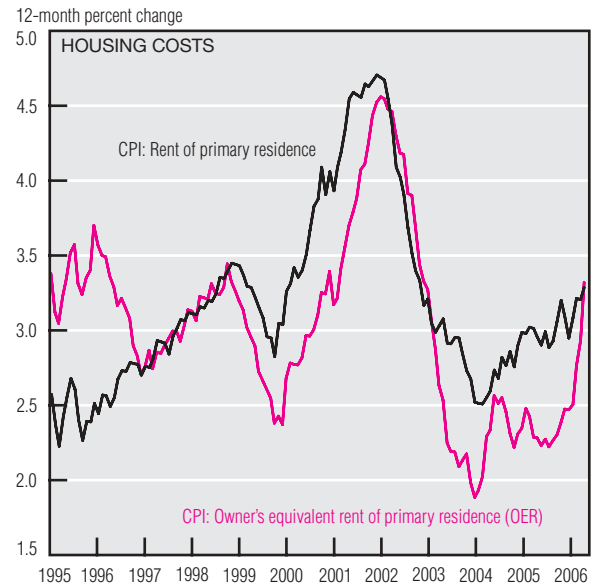
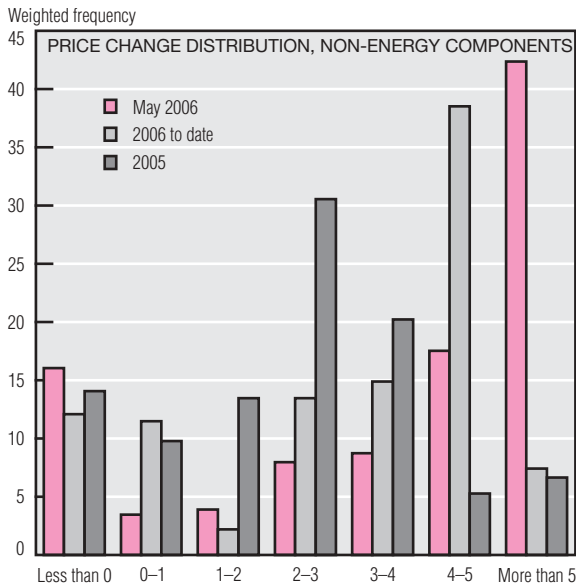
CPI excluding food and energy ratcheted up to 2.4%, a bit above the 2%–2 $\frac{1}{4}$ % range in which it has fluctuated for about a year. The 12-month growth rates of the 16% trimmed-mean CPI and the median CPI ticked up to 2.7% and 3.0%, respectively. The growth rate of both these measures has risen roughly $\frac{1}{4}$ to $\frac{1}{2}$ percentage point since last fall. Meanwhile, the Personal Consumption Expenditure (PCE) Price Index excluding food and energy, an alternative measure of underlying retail

price pressure, rose 2.6% on a year-to-date basis in May, also up about $\frac{1}{2}$ percentage point from its 12-month trend.

Intense retail price increases are widespread. In 2005, about one-third of non-energy CPI components posted average monthly increases of 2%–3%, and prices of another third of these components rose more than 3%. Since the beginning of this year, a majority of the non-energy components have risen at average monthly rates exceeding 3%, while nearly 70%

(continued on next page)

Inflation and Prices (cont.)



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; and University of Michigan.

of such components rose 3% or more in May. Indeed, almost 45% of non-energy CPI components rose 5% or more in May, including the single largest component, owner's equivalent rent of primary residence (OER).

OER—the costs that homeowners would assume if they rented their homes instead of owning them—accounts for nearly one-quarter of the CPI market basket. Monthly growth in OER has accelerated since the beginning of the year. OER

jumped 6.8% in May, well above its 3.1 average monthly percent change. Some of the recent rise can be tied to decelerating utilities costs, which are subtracted from this housing cost measure, but some part of the rise seems to come from a rental market that is growing stronger after several years of relative softness.

The recent pressure on the OER component of the CPI may be with us for the summer. Since 1995, the monthly OER index has been computed from six-month rent

changes, a procedure that reduces its monthly volatility but also causes the measure to exhibit some persistence. In other words, monthly changes in OER tend to influence the CPI's behavior over a period of several months.

One encouraging development is that household inflation expectations moderated a bit in June. Short-term inflation expectations fell from 4.7% to 4.4%, while longer-term expectations dropped from 3.8% to 3.4%.